Q1 2016 Earnings Call

Company Participants

- George Quinn
- Gianni Vitale
- Mario Greco

Other Participants

- Andrew J. Ritchie
- Andy Hughes
- Dhruv Gahlaut
- Farooq Hanif
- James A. Shuck
- Michael Igor Huttner
- Nadine van der Meulen
- Nick Holmes
- Paul De'Ath
- Ralph Hebgen
- René Locher
- Stefan Schürmann
- Thomas Seidl
- Vinit Malhotra

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, good morning or good afternoon. Welcome to the Conference Call on the Results for Three Months to March 31, 2016. I am Cher, the Chorus Call operator. I would like to remind you that all participants would be in listen-only mode and the conference is being recorded. After the presentation, there will be a Q&A session. The conference must not be recorded for publication or broadcast.

At this time, it's my pleasure to hand over to Mr. Gianni Vitale, Senior Investor Relations Officer. Please go ahead, sir.

Gianni Vitale {BIO 19816633 <GO>}

Good morning and good afternoon, and welcome to Zurich Insurance Group's Q1 results analyst call. On the call are our CEO, Mario Greco; and our Group CFO, George Quinn.

Mario will make a few comments and then we'll go – and then we'll take your questions. As usual, please keep to two questions.

With that, I will now hand over to Mario.

Mario Greco {BIO 1754408 <GO>}

Thank you, Gianni. Good afternoon, ladies and gentlemen. Thank you for joining us. And I'm here, as you expect, with George Quinn, our Group CFO. And before we start answering your questions, I'd like to have a few words about my priorities for the remainder of the year.

As you know, while I work with Zurich, in the past, I started as CEO in the March. My first priority has been to develop a deeper understanding of challenges and opportunities for the company and to identify the best way forward to help it achieve its full potential.

This is an ongoing process involving discussions with key business leaders, with employees, with brokers, with customers. What I can say today is that the group is fundamentally sound, reserves are adequate, capital is strong and the brand is very strong. That gives us a very strong foundation on which to build over the next months and years. My second priority has been to build confidence in Zurich. Confidence is vital to our success. It can only be achieved through transparency, through clear communication, and by delivering on the group's strategic objectives.

Today, (02:22) step in the right direction and they provide early evidence that the measures that we started last year are improving the performance of General Insurance and also the continued progress in Global Life and in Farmers is visible and is supporting the group results.

We expect to see further improvements during the year particularly in the second half. And our capital position, as I said, is very strong still today. My third priority is to position Zurich for the future. It begins with shaping a clear and simple group strategy for the next years and a strategy that would differentiate us among our competitors in the eyes of the customers.

As you know, we will present this strategy to you at our Investor Day on November 2017. Until then, we will continue to provide you with as much transparency as we can into the ongoing execution of our strategy and, of course, we will take measures between today and November.

Thank you very much for listening and now, over to you, and George and I will be glad to answer your questions.

Q&A

Operator

We will now begin the question-and-answer session. The first question is from Dhruv Gahlaut, HSBC. Please go ahead.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Good afternoon, guys. Thanks for taking my questions. Firstly, in terms of PYD, you've had a favorable result this quarter. Still, I think there was a negative movement in the international and the other business. Could you give us further details where this is coming from?

Secondly, in terms of real cost I saw (4:23) you're expecting $500 million odd this year. Any changes to the overall number of $1 billion or are we still shooting for that this year? Thanks.

A - George Quinn {BIO 15159240 <GO>}

Thanks, Dhruv. It's George. So, first of all, on the PYD. I mean, you're right. The overall and paying for the quarter is 1.5% positive. With the negative impact, I mean I think, because the way we've added together, appears to be an IM, but it's not. It's actually in the Group piece of the reserve development.

And actually, what's happened there is the original – the initial proposals from the units was actually for a stronger PYD outcome, and we decided to strengthen other reserves elsewhere for the Group recomponents (5:06) in the quarter. So I mean that's why you see that negative impact in the chart in the appendix.

On the reorganization, I mean, the guidance that we gave at the full year around cost for this year and next year, we haven't changed. The process continues. Under Mario's leadership, we're looking at gain, efficiency and expenses. I mean it's an increased focus area for us. We've made the comment several times today (5:29) being competitive, being more efficient and in fact, creating more room to invest for the future is absolutely crucial for us. So there's no change to the guidance that we gave on the amount for the claiming at this point (05:43)

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Sorry. Can I just follow up on the first point? So, are you guys saying that it's more of cautious approach in terms of the way you've added reserve this time and it could actually be that you – that this could get released in a few quarters?

A - George Quinn {BIO 15159240 <GO>}

I mean, it's a small number, I wouldn't (06:06)

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Yeah. Right.

A - George Quinn {BIO 15159240 <GO>}

I mean it's slightly more presence (6:10)

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Right. Perfect. Thank you.

A - George Quinn {BIO 15159240 <GO>}

Thank you.

Operator

The next question is from Nadine van der Meulen, Morgan Stanley. Please go ahead.

Q - Nadine van der Meulen {BIO 15200446 <GO>}

Yes. Hi. Good afternoon. Brief question. First of all, can you give a general comment on the reserve positions? Are you comfortable with the reserve levels in both the U.S. and Europe? And perhaps you can comment on that in a bit more detail?

And secondly, the Z-ECM quarter to-date, if you could provide update on that? And if not, I believe – sorry that was I think 110%, and on top line, so premiums and life sales were down, can you comment on top line pressure going forward? Thank you.

A - George Quinn {BIO 15159240 <GO>}

First one. Just (7:03) comment on reserve position on Europe and EMEA – I mean, we have – sorry, Europe and the U.S. and we're comfortable with the reserving position on both. They both contribute relatively modest positives to the overall positive PYD you've seen for the quarter. I think most of the discussions we've had so far or we've had was probably focused on the U.S. position, and maybe just a couple of quick comments on that. I mean if you look at our U.S. book, I mean we have reasonably large proportion of liability which is not uncommon for a big market commercial player. But then we have workers' comp, auto liability, and general liability. If you look at the issues we've faced last year, we've been focused on the auto liability line. If you look at the other components of the book, but actually performed very strongly for us over a fairly long period now.

If you look at our workers' comp book in particular, which is about 25% of the book by written premium. I mean we believe if we do a peer comparison for, I mean, for example, IBNR as a percentage of the incurred or (8:13) 10-year to ultimate ratios, but generally more conservative than the peer group. And, in fact, if we move to peer group or even industry levels of reserving that would imply a reasonably significant release from (08:29) for the U.S. So overall, I mean, we feel comfortable with the reserve position that we have for the group and for our major units.

On Z-ECM, I don't have updates for the quarter. And again, we've given a figure for the quarter-end of midpoint range. That compared to the figure that we had at the end of the year of 121%. It's come down with a combination of the on-boarding of the completion of the RCIA acquisition and the impact of financial markets in Q1. And that's principally interest rates rather than equity markets, so spreads. If I look at interest rates, I mean the curve hasn't changed much since the end of the quarter. So I'd be surprised that had been a significant move. On top line, I think your comment was Life, is that right, or was it GI?

Q - Nadine van der Meulen {BIO 15200446 <GO>}

On both. Well, on GI, I suppose it's as expected that those premiums are coming down, but, yeah, on Life then particularly yeah.

A - George Quinn {BIO 15159240 <GO>}

Yeah. Okay. Just one comment on GI. I think as you pointed out, I think we're just about exactly where we guided people to expect this to be. I mean given the focus that we have on profitability for GI, is inevitable. But given the portfolio adjustments we're making that we would give up, some of the lower-performing parts of the portfolio. And we'd expect it to see a roughly mid-single-digit decline in premium volume. And that's what we have today.

On GL, I mean GL is a bit harder to judge. I mean EPE (10:02) is a relatively blunt measure of volume. We can easily be impacted by the timing of some of the (10:10) larger CLP's or the Corporate Life & Pension's transactions. From a new business value perspective, I mean, year started very well both from mix and from model change, and I mean we don't see an issue on the top line.

If you break up into the various parts and then we see strong performance in Latin America, the joint venture has grown it. Local currency 29% in the quarter. I mean that won't continue, but it's a very strong result. I mean and in general, we have small offsets elsewhere in the portfolio. But I mean the growth outlook for us, we expect to see growth from the Life business through the course of the year. Mario?

A - Mario Greco {BIO 1754408 <GO>}

Thank you. Can I add a comment – this is Mario speaking. Can I add the comment on growth especially in GI? I think one of the most important corrections that were taken at the end of last year then fully supportive that was abandoning the strategy called (11:11) which was a growth strategy. And go back to the older principle of underwriting discipline and underwriting focus.

And so you underwrite for profit, you don't underwrite for size, for premiums, this is what we're doing. And from that side, we will keep on doing that and the growth will just be a consequence of it and if it is negative beat (11:38) And there is no way in which we can solve an expense ratio issue by growing the size.

And if expense ratio worsens, we would take more actions on costs, but we will not derogated (11:54) to underwriting discipline.

Q - Nadine van der Meulen {BIO 15200446 <GO>}

Very clear. Thank you.

Operator

The next question is from Paul De'Ath, RBC. Please go ahead.

Q - Paul De'Ath

Yeah. Hi there. And just – first question is really a follow-up of I think Mario's comment. And on the expense ratio and the correlation to the, I guess, expense efficiency programs that you are running at the moment and previously you've guided to the fact that the expense ratio should kind of remain flat despite the cost coming down because of the top line also shrinking, is that still the best way to think about it going forward, effectively (12:42) going to keep that expense ratio the level is at the moment? And that's the first question.

And then, secondly was just a question on Farmers and Farmers Re. Can you just remind me the current state of play in terms of the Quota Share and position. I think, it's been coming down recently, is it – is there a scope for it to come down further or are you now at point where there isn't going to move around too much going forward? Thanks.

A - George Quinn {BIO 15159240 <GO>}

So, on the efficiency program. First of all, Paul. So the guidance that we gave was for this year. So the expectation was that given the combination of the cost cuts that we are making and allow the (13:29) impact on the top line, you see the expense ratio year-over-year be broadly flat. That shouldn't be taken as a sign of the ambition that the Group has for the cost ratio. I mean we'll have to come down further for us to be competitive, but the guidance was really for 2016.

On Farmers, so the Quota Share as you pointed has come down significantly in the course of last two years. The old one is Quota Share, I think has come down from something like 18% and 14% to 10% last year, to 8% this year, I think we've been relatively clear that from a longer term perspective we don't intend to be a reinsurer over time depending on the exchanges needs and the ways in which we can support them. I mean lately that number comes down further.

I mean one additional point. There was also an Auto Physical Damage treaty in place, also Quota Share. Now it's entirely terminated at the end of last year. I mean that's one of the things that obviously help us avoid some of the more negative impacts of the Texas hail storms on the exchanges in Q1.

Q - Paul De'Ath

Excellent. Thank you.

Operator

The next question is from James Shuck, UBS. Please go ahead.

Q - James A. Shuck {BIO 3680082 <GO>}

Good afternoon. Thank you for taking my questions. I had two questions for you, please. Firstly, on the General Insurance investment income in the quarter. It was about 8% quarter-on-quarter I think in the note you referred to the inflation linked bonds in Latin America, which is driving that. Can you shed a little bit more light on what's happening to the running yield and what your expectation is for investment income going forward? I'm surprised that LatAm inflation-linked bonds is a material contributor to total Group General Insurance investment income.

Secondly, Mario just interested to get your thoughts around the organizational structure of the Group. It strikes me that, at a Group level, you have the reporting, which is along the lines of Global Life and GI whereas at the country level the individual units are around very much at a country level. And there may be some disjointing features as a result of that. So just interested to get your views on that. And just very quickly, if you're able to shed any light on – if you have any exposure to the Canadian fires, please, that'd be helpful.

A - George Quinn {BIO 15159240 <GO>}

Okay. So, James, I'll start with the first one. So you're right, I mean, ordinarily you wouldn't see the Latin American business of a significant impact, given the size of interest rates there and the inflation moves, it does pick up a bit in Q1. Maybe to give you a sense of the overall, which I think is more meaningful. I mean, the overall accounting yield for GI is slightly over 2.6% in Q1. And that's slight up, I mean, very slightly up from the full year last year. And the turnover is roughly at 2.2%. So, again, we have about a 40-basis point gap between the book and the new money yield in GI currently. So, if things stay, we will see some further erosion on the GI (16:46).

A - Mario Greco {BIO 1754408 <GO>}

Yeah. On your question – this is Mario. On your question on organization, of course, I'm looking at that and Zurich is world famous for a complex organization for having the metrics triple or even four layers of metrics. So I'm concerned about that, I'm looking into it and I am also discussing with the board and with the colleagues ways to simplify and streamline the organization. But when we will have a decision taken, of course, we will communicate and you will know it. But I definitely have in mind that the organization is to be simple and has to promote accountability and the ownership of events.

A - George Quinn {BIO 15159240 <GO>}

On the wildfire topic, James, I mean, I don't have something for you today. Obviously, it's a too early stage here for us to have enough information from either reported claims or even, given the limited or, in fact, no access to the area for us to survey and reach a conclusion. Certainly at this point, I don't have something I can share with you on the Canadian wildfires.

Q - James A. Shuck {BIO 3680082 <GO>}

Could you just remind me what your market share is in Canada and I presume you have a $275 million retention, is that right?

A - George Quinn {BIO 15159240 <GO>}

Yeah. So the global cat program kicks in at $275 million. I mean obviously, we have more reinsurance beneath that, you know depending on the size of the individual per risk events can kick in and attach. I think for commercial, I mean our share, overall, is about 4% for Canada. So relatively modest.

Q - James A. Shuck {BIO 3680082 <GO>}

Thank you very much.

Operator

The next question is from Thomas Seidl, Bernstein. Please go ahead.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah. Thank you. First question on reserves again. I hear you are feeling confident on the U.S. reserve, particularly workers' comp and when you look at the U.S. reserve triangles, now half of your vintages are trending upward, so they show a negative development in other workers' comp in particular, the recent years show a much more negative development in the market. So I wonder what data you could or other evidence you could give us to join you in the comfort about the U.S. reserve side. That's the first question.

The second question, you had a rate increase of 2.5% across the portfolio in exchange for the 5% drop in top line. How does this compare to claims inflation? How is net benefit you see from this rate change? And the third question, expenses admin seems to be fairly stable, however, commissions trending. Is this something you expect to continue or are we stopping at the 14.7% we are right now?

A - George Quinn {BIO 15159240 <GO>}

So I'll start with the U.S. reserve topic. So I guess to begin with, everyone is very familiar with what we reported last year. And from a reserve perspective, I guess that's almost entirely a U.S. issue. If you look at the two key things, commercial auto and the construction that we talked about before, I mean, they're the two largest drivers. Secondary impact is a small – relatively small sub-line of workers' comp which is the Defense Base Act business that we exited in 2014.

I think if you look at workers' comp in particular, and even with DBA, the Defense Based Act business and we have positive run off on workers' comp. I'll repeat the comments, I think, I made in response to Nadine's question earlier. I mean, we have gone back to study how we compare the industry in general, particularly on workers' comp, with particular reference to the quality of the book, the mix of business that we have. So for example, the extent to which we're rating guaranteed cost versus high deductible, the extent to which paid claims would give (20:41) you anything about the quality of what we rate versus the peers and then looking at the actual reserving position, both from an IBNR standpoint and particular from, as I mentioned earlier, 10 years ultimate yield factor.

I mean, what that reveals to us would be the following. One is that the mix of business guaranteed cost versus high deductible is not significantly different to the peer group. Our pays are not significantly different to the peer group, but we are more highly reserved.

So if you use that measure of IBNR or you look at those deal (21:18) factors and, in fact, again, if we were to change the deal (21:22) factor or adjust the IBNR policy to one that was either in line with the peer group or in line with the industry overall that would imply a significant release in reserves for workers' comp. Now, obviously, we're not proposing that. We believe that the reserve position that we hold is appropriate given the risks that we run. But, I mean, I think fundamentally, Thomas, our view of this is different from yours.

On rate increase, I think, we try to give a bit more information in the quarter. I mean, more than just about the rate increase that we've benefited from, but also, a sense of how that rate increase impacts the different tiers of our business. And of course, that's a very important indicator from a forward-looking perspective.

And you see in there that – you see a combination of rate increase by different tiers and you see a retention rate. I mean, I guess, in common with the market, our best clients are achieving small discounts, which simply reflects a relatively soft market environment and the broad, very competitive market conditions. I mean, that would imply for me that, I mean, not only it's rate in some areas, slightly negative but allowing for loss cost inflation and margins are definitely softening overall for the businesses that we're in.

But, if you focus on where we're tackling the issues, so I guess we talked before at the year-end around the lower performing tiers being the key areas of focus. And there you can see that we're achieving significant multiples of the overall stated entries for GI albeit at a cost of lower retention. So, again, I think, that combination is to be entirely expected.

But on the connection side, I mean, we have a very small impact from the impact from some of the mass consumer stuff we've done in Latin America. We have a true-up on commissions and our crop (23:19) business in the U.S. has a slightly negative impact in the quarter. But at this stage, I'm not aware of anything that would drive the acquisition element of the expense ratio, either up or down. I'm assuming the business mix stays relatively consistent throughout the remainder of the year.

Q - Thomas Seidl {BIO 17755912 <GO>}

And the rate, 2.5%, how does it compare to underlying claims inflation? Will you say, 1%, 1.5% claims inflation right now?

A - George Quinn {BIO 15159240 <GO>}

Sorry, I don't have a precise number. I mean, for me, the net sum for the market overall is clearly slightly negative. I mean, obviously we're achieving more than the market because of what we're doing on the portfolio and risk selection. I mean, I wouldn't disagree with the number you gave, but I don't have a precise figure (24:03).

Q - Thomas Seidl {BIO 17755912 <GO>}

Okay. Thanks, George.

Operator

The next question is from Andrew Ritchie, Autonomous. Please go ahead.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Hi there. I guess I wanted to really understand a bit more about the benefits from change reinsurance as they might accrue over the year. I think Q1, this year; have still included quite high large losses, at least one point higher than last year. And maybe just remind us what you've put in place for large losses in terms of aggregate reinsurance protection. I'm not talking natural catastrophe, I'm taking underlying kind of large losses. And just a reminder of the fact that we started Q1 last year quite strongly, and then, we know what happened in the rest of the year. So just remind us what arrangements there?

Also, are there any other reinsurance benefits in terms of the attritional level? If you've ceded and done quota shares and some quite high loss ratio business, for example, are there some earn throughs to occur there?

Second quick question, your friends at the road produced a comprehensive walk through from SST to Solvency II. I see you've saved money by not doing the same thing. But can you just give us directionally, would you kind of – I'm sure you looked at it. Is there any sort of directional sense for you in terms of SST to Solvency II and any measure of quantum you have in the past at about 70 percentage points to some of the subsidiaries is not roughly still the right number? Thanks.

A - George Quinn {BIO 15159240 <GO>}

Thanks, Andrew. Excuse me. So first of all on the reinsurance side, just a reminder of the aggregate cover we have in place. So as of January 1, we have an accident year cover payer risk. Franchise is $15 million, deductible is $300,000, cover is $300,000 (25:45). I won't give you a precise update on where that stands after one quarter, but we have used a bit more than one quarter of the cover in terms of how much has been ceded to the deductible.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

So you've used a bit more than one quarter of the deductible, you haven't use the cover yet?

A - George Quinn {BIO 15159240 <GO>}

No. (26:05).

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

All right.

A - George Quinn {BIO 15159240 <GO>}

On top of that, maybe just to give a touch more color. I mean, we've obviously added a number of new reinsurance programs beneath that cover. So we have quota share on a number places that was designed to bring the line size down more rapidly than we could do otherwise. I mean, I hesitate to take one example and trying to enter some like a giant projection of the future. But just to give you a sense not only the – I think the potential benefit of what we done on reinsurance but also the benefit of what Kristof and the team have done around underwriting.

So we have one of our larger losses and one of the components of our General Insurance is a net $35 million loss. If that had happened on the last day of last year, it would be a $50 million loss. If it had happened on a contract that we had written starting this year, it would be a $15 million loss.

So, we won't get all the execution absolutely perfect first time at the gate across of this. I mean, we will be impacted by the seasonality of – I mean, the different risks that we run. I mean, we're doing everything we can to avoid the pattern (27:24) that you saw last year. And there's no reason for me to believe that that's a likely pattern for us to repeat this year.

And, in fact, I mean, if you look at the aggregate cover in particular, I mean, to the extent that we continue to see significant large loss activity. We have one point more than Q1 last year, one point less than the year overall. So we some improvements certainly versus the second half of last year but we still expect some more to come. But if we do have the same experience, we'll see significant benefits from the aggregate in the second half. I hope not.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

And is there any benefit the attritional level from the quota shares? I mean, I don't know if your quota share some casualty business or something like that does come through.

A - George Quinn {BIO 15159240 <GO>}

I mean, they're maybe a very, very small fractional benefit on the ceding commission. I mean, if it would be material, I would isolate to...

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Okay.

A - George Quinn {BIO 15159240 <GO>}

(28:17)

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Okay.

A - George Quinn {BIO 15159240 <GO>}

On the topic of my friends on the road, I mean, you're right. So we haven't done the same thing. The figure that you referred to was – so, the 70-point was our estimate of what we were seeing from an SST perspective versus what was typically standard model for most of the local businesses that we have in Europe. So from an overall internal model perspective, I think it'd be a bit less but there's certainly a significant difference in SST, Solvency ratio and a Solvency tier 1 (28:53) and SST is considerately more conceptive. But I mean, I couldn't give you more than we gave you last year at this stage.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Okay. Thank you.

Operator

The next question is from Farooq Hanif Citigroup. Please go ahead.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi, guys. Thanks very much. Just on your 5% reduction in local currency, the GI top line, is there anything that could accelerate that? I mean, in terms seasonality and renewals or further actions that you're taking on pricing later in the year. That's question one.

And secondly, in the Life business, I mean, you already alluded to LatAm being exceptionally strong in the quarter and not to repeated. Could you explain that? But also, I mean Asia Pac and LatAm both looked particularly strong. So I just want to get a sense of what the current non-recurring elements are there and what's driving it? Thank you.

A - George Quinn {BIO 15159240 <GO>}

On the 5-point reduction and I mean the risks, I mean, I'd refer you both to what Mario said and his response earlier and some that Kristof had said at the year end. I mean, profitability is what matters most here, what drive the allocation of capital based on the profitability of the risks that are presented to us. We tried to make a reasonable estimate, what we think the impact of that would be on the portfolio overall. And at this stage, we see no reason to vary that estimate. Profitability comes first. So, if we have to drive it out, we would. But at this stage, we don't expect to see that.

On LatAm, I mean, I wasn't trying to talk LatAm down or to give you the impression it was one-off. I mean, it's just the strength of the business in Latin America given the local economy and the challenges that some of the countries have there. I think it's a surprising positive. I think we've said for some time though that we think that the growth rate that the joint venture has been achieving, at some point, will not continue at the same very high level. And that's really – I'm really trying to reiterate the same point.

So there's more element that's non-recurring. But just given the challenging environment, it's very hard for me to imagine that we can sustain this kind of growth rate. We can still grow, just not at 29% every single quarter.

Q - Farooq Hanif {BIO 4780978 <GO>}

And sorry, just I know I've used up my two questions, but just on LatAm and non-life, I mean that just looks materially better than a lot of other companies reporting. Your mix is different. Your product is different. Your speech (31:24) different. But still, I mean, are you sort of happy now in the kind of in the 90s and combined ratio that this will be repeated?

A - George Quinn {BIO 15159240 <GO>}

So I think on the...

Q - Farooq Hanif {BIO 4780978 <GO>}

I won't hold you to it. Don't worry about it.

A - George Quinn {BIO 15159240 <GO>}

I think on the LatAm side of it, I mean, I think the team that we've had in position – as you know, we changed most of the management and they're over the course of the last 12 months to 18 months. We've got a stable team now down there for about 12. I think the steps that they're taking have had an appreciable impact on the result. I'm not sure it will immediately continue at the levels you've seen. I think it will probably edge up again as we go through the year. But I mean, if you look at – you pick our largest business there, I think it produced a loss in excess of $200 million last year. We're expecting to see something more like breakeven this year, but not a low to mid 90 combined ratio, so we have almost certainly some non-recurring elements in the results that you've seen here.

Q - Farooq Hanif {BIO 4780978 <GO>}

Okay. Thanks very much. Thank you.

Operator

The next question is from Michael Huttner, JPMorgan. Please go ahead.

Q - Michael Igor Huttner {BIO 1556863 <GO>}

Fantastic. Thank you. My peers are very good – or you're very good. Most of my questions have been answered. But maybe in a bit of detail. On the tiering, can you explain a little bit the benefit, which is yet to come from the actions that you detailed on the last slide. I'm thinking that, obviously, not all the price would have been earned through and maybe not all the cancellations. So, maybe you can give some insight in that. I think maybe we could do it, but I'm sure we can – we'd need the combined ratios for each tier.

And then on a separate topic, and here I'm just – it's a stab in the dark, really. I had in mind, but I may be completely wrong, but you had a plan or an idea to improve cash flow by reallocating capital and that might have involved some disposals. I can't remember what disposal you did make year-to-date. But if you did, can you maybe give an indication of how much they add to cash flow or something and maybe if you're considering more? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Yeah. Thank you, Michael. Soon the tiering topic and the impact to come, so I mean, the figure that we'd be discussing from a volume perspective is GWP. So the cancellations are in the GWP already. Obviously, the bulk number – what we're talking about is the end number. So the largest part of the benefit from a rate perspective is not in the bulk at this point.

I mean apart from the obvious P&L benefit of the rate increase in excess of the loss cost inflation, if you look at the Tier 4 element, I mean, that's really only partly above rate. I mean, it's really probably more about risk selection and picking the risks that we feel we want the rate (34:28) and offers, I mean, not just the rate/risk reward but we have the right understanding, the right information and the confidence in the loss control.

So I think there's a mathematical element. I mean, I think I haven't tried to do it here. I mean, obviously I can see it in our internal forecasts. I think there probably is enough information to make a reasonable stab at it. The thing that you probably can do, and it's very hard for me to give you on is the benefit of that risk selection and of course, that's really important when it comes to the large loss topic that I covered in the earlier discussion or the earlier question from Andrew. So cancellations and most of the benefit from tiering from a P&L perspective here to come.

On the cash flow and the disposal, let me start from beginning. So, I mean, you've had it so often you're probably bored by it. I mean, we're focusing the...

Q - Michael Igor Huttner {BIO 1556863 <GO>}

Never. Never. Never. It's worth a lot of money.

A - George Quinn {BIO 15159240 <GO>}

So, we're focusing the retail footprint and the aim there is to simplify the network and really focus our capital (35:35) what we believe we can achieve the scale that retail really needs. Other than that, if you are in a niche position, we don't have that many niche positions. It was actually nothing do with cash flow. I mean, it was a capital reallocation play, but it's not really to do a cash flow. The things you've seen so far, I mean, since the – I think you've had most of them already.

So, we thought with the Middle East run off topic, I mean, we are active on a number of fronts currently. I'm not going to expect more to say on this on due course. I think just to continue expectations about here. I mean we have a proven out disposal that would tackle the (36:16) and 10% of the underperforming capital. So, I mean, it will certainly take a significant step in the right direction, but there's much more to do to drive a much more attractive return on the bulk of that allocated capital. I mean, you will hear more from us on this in due course.

Q - Michael Igor Huttner {BIO 1556863 <GO>}

Congrats. That's very helpful. Thank you.

Operator

The next question is from Andy Hughes, Macquarie. Please go ahead.

Q - Andy Hughes {BIO 15036395 <GO>}

Hi. It's Andy Hughes from Macquarie. A couple of questions if I could. The first one was on slide seven where I look at the different tiers. It kind of looked from both the charts and look at the total, the Tier 4 is quite small. Otherwise, you couldn't give the average of 81% and obviously the 2.5% is that a fair comment?

And I guess the second question was about the OOB stuff. So I'm struggling a bit because obviously the OOB result was quite low in this quarter and I know you're guiding towards increased marketing spend in further quarters, but also you're saying that you've retired a lot of expenses debt that would go through that line as well. So I'm struggling to see how you're going to get to $800 million for the full year, is there anything I'm missing there? Thank you.

A - George Quinn {BIO 15159240 <GO>}

On Tier 4, I mean, we haven't quantified Tier 4. I mean, Tier 4 is not that small. And in fact, if we look at Tier 4 from a contribution to loans perspective the last year is not small at all. It's actually very significant. I mean that's the key driver of that change that you're seeing here. I mean, again, maybe just to emphasize again something I said earlier, it's only partly about rates. (37:57) is far more about risk selection. So I wouldn't necessarily draw conclusions about the absolute volume, the absolute rate and that's been the key driver here. I'm not sure if we're trying to select things that we believe we have a good handle on.

On OOB, also we have a relatively low number. For the quarter, we have a FX benefit in there that tends to – that will be one-off in nature. And therefore, it creates a lower than expected run rate. I mean, we'll have a modest entries on the marketing side before we get to the very end of the year. I mean, if you ask me today, I mean, I think we're more likely to beat the $800 million than to wind at $800 million, but we got more work to do to make sure that we can do that. But I certainly don't expect we're going to miss that number.

Q - Andy Hughes {BIO 15036395 <GO>}

So, a follow-up on this Tier 4 side. Sorry, I was just curious how big it was in terms of proportion of the – as a book. Because if you just look at the charts you can see that the two of them are only – it's easier to scale, the Tier 1 and Tier 2 only slightly above the 81%. And the Tier 4 has got a much lower retention. So, I mean, it's not like a quarter of the premium income or anything.

A - George Quinn {BIO 15159240 <GO>}

I understood the question. And I deliberately avoided answering it.

Q - Andy Hughes {BIO 15036395 <GO>}

Okay. All right.

A - George Quinn {BIO 15159240 <GO>}

I mean, I think it would be more helpful. I mean, it's obviously not quarter, but it's not 10% either. This is a significant part of the overall portfolio.

Q - Andy Hughes {BIO 15036395 <GO>}

Okay. All right.

A - George Quinn {BIO 15159240 <GO>}

And I don't think the absolute number because of the comments I made earlier around the risk relation point, it's actually that important.

Q - Andy Hughes {BIO 15036395 <GO>}

Okay. All right. Thanks.

Operator

The next question is from Nick Holmes, Société Générale. Please go ahead.

Q - Nick Holmes {BIO 21515144 <GO>}

Oh. Hi, there. Thank you very much. First question is for Mario. I know it's early days but I wondered, are you thinking or can you share with us any initial thoughts about business mix changes like, for example, moving more into personal lines, getting away perhaps from the commercial line focus.

Second question, more for George, is you've obviously got quite big premium reductions in Global Corporate and NAC. And I just wondered, do you expect this to continue? And how concerned are you that this is going to eat into the expense ratio this year? I mean, I know you said that the expense ratio should be flat but if this continues, that's going to be quite a difficult thing to manage. Thank you.

A - Mario Greco {BIO 1754408 <GO>}

Nick, hi. This is Mario here. Of course, you understand that it's very early days to talk about business mix. And this will be a big part of the thoughts on the new strategy and the new targets for November. But you asked me what are my early thoughts on it. So, I do think that having a bigger share of retail SME business will be helpful. The question is more how to do it and how to achieve it. And it goes back to also the way we're organized and the way we pursue our targets. And so I'm keen to find ways to grow more the SMEs and the retail components in our books, but I'm not yet there where have planned programs and I can discuss them with any of you.

Q - Nick Holmes {BIO 21515144 <GO>}

Okay. Very fair. Thank you.

A - George Quinn {BIO 15159240 <GO>}

Nick, on the second point of the premium reduction, so I mean, so far, we've seen a reduction in the top line which is in line with our expectation and what we'd indicated to you previously. It won't stop immediately at Q2 nor do we expect that to continue indefinitely either. I mean, once we get the portfolio to the position that we are seeking to achieve, you should see the normal influence on top line that you'd expect to see in the business.

From an expense ratio perspective, again, the clear guidance to the business and the clear ambition of the business is around profitability. So the extent to which some of the volume reduction creates a challenge for expenses as Mario said earlier and as Kristof has also said before, I mean, if that becomes an issue, we'll go back and tackle it when it arises, but the immediate focus is on profitability.

Within the different units, you picked a Global Corporate and NAC, I mean, obviously, Global Corporate in particular, especially in North America, it was a large part of the challenge last year. Therefore, I think you would naturally expect that that would be one of the areas where you would see a larger proportional decline than you would for the Group overall.

Q - Nick Holmes {BIO 21515144 <GO>}

Okay. Thank you very much.

Operator

The next question is from Stefan Schürmann, Bank Vontobel. Please go ahead.

Q - Stefan Schürmann

Yes. Hello. Just two small questions. The first one again on the reserving side. Can you maybe specify gain on the reserving process? If you do all the external reviews you have done – you said all done or are there more reviews to come later on from an external point of view or today, if you just go to the normal end of year process on reserving? The second one is on duration gap between change year or is that probably unchanged from end of the year?

A - George Quinn {BIO 15159240 <GO>}

Hi, Stefan. So, on reserving and process, process is normal, it would be the best description of it. I mean, we're doing the same thing that we always do on the quarter end. I mean, I guess in common with most companies, we have a continuous process rather than a particular focus on any given quarter.

I mean, from an external review perspective, we've commented in the past that – certainly through the course of 2014 and the early part of 2015, we had a number of areas where we had mandated reviews by regulators. Again, that's a completely normal process in today's regulated insurance world.

For us, from an internal policy perspective, the only thing that we have come out that would be external in nature that we were traditionally have an external review of employers' liability or APH exposures, I mean typically every two to three years. At some point over the next 12 months to 24 months, we'll conduct another review of those reserves to the extent that we still have those risks in the portfolio.

On the duration gap, I mean it's largely unchanged from the end of last year. I mean, we're very slightly a long on the asset side.

Q - Stefan Schürmann

Okay. Thanks.

Operator

The next question is from Vinit Malhotra, Mediobanca. Please go ahead.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Hi. Good afternoon. Just very quickly two things. First, again back on slide seven just to understand. I understand the achieved price, technical price and tiering focus was also there in the past. Have you seen any reason to change some of the underlying models that define this tiering or define these technical prices? Or maybe it's too early but I just thought it'll be helpful to understand and show us what kind of changes are going on in the group?

Second question is just a little bit more on the cash flow. Obviously, given this slight bit of volume and also management actions that we had earlier heard about, like, for example, U.S. extraordinary dividends. Is there any update on these management actions you can provide, please?

And I need to follow up quick one, just on the last comment you made. George, did you say that the top line was continued in 2Q but not after or – if you'd just verify that please, that would be great. Thank you.

A - George Quinn {BIO 15159240 <GO>}

Taking the last one first. Just – I mean to repeat again, the guidance for this year for is actually earned premium was that we expect to see a reduction in premium volume in the mid-single-digit range. So I mean while we continue the actions that we have underway with MGI (46:39) and the market continues to be very competitive, I mean that will have an impact on volume.

I didn't limit any period, but again, I don't expect it to continue quarter-after-quarter. But today, we certainly have instructed – have not instructed GI that they need to stop this (46:47) What GI has to do is to deliver the planned profit for the year.

On the tiering, I mean I guess, it's – I mean it's probably pretty obvious that the execution of tiering has poor, otherwise we could not have ended up and the position that we ended up in last year. And a lot of what we did at the end of the last year was to reinforce discipline around that topic, Kristof and his team I mean have reinforced that process significantly. We talked already about some of the changes that we made to promote that. So I won't repeat it here. I mean we have an altogether different focus on tiering. It's absolutely crucial for the delivery of (47:42) plan and everyone completely understands that.

On the cash flow, I mean also the volume side of things, that will have no impact on cash flow because the cash flows will be driven by the profitability at the end and the improved profitability will have a much bigger impact than the volume cuts that we're seeing. So that topic, no issue.

One of the management actions that we're taking to make sure that we maximized cash flows in a year, we suffered a bit of a hangover from the GI performance of last year. I mean I've got no precise update for you today. I mean we've talked in the past about the things that are possible. We're working on those. We still remain very confident we will deliver cumulative cash flows over the three-year period of more than $10 billion. That's the end for the year.

Q - Vinit Malhotra {BIO 16184491 <GO>}

All right. Thank you, George. Thanks.

Operator

The next question is from Ralph Hebgen, KBW. Please go ahead.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Yes. Hi. Ralph Hebgen from KBW. Just two things. One is would you be able to talk about the large loss experience which you had in the quarter and put this into sort of back to (48:55) framework of where your large losses will obviously in third quarter and fourth quarter, but also where you see them going over the remainder of the year. That was number one.

And second one is on the reserve releases. Well, obviously, it was actually quite heartening to see that Global Corporate and North America Commercial were material contributors to the reserve releases. Could you give us some more color on that? What were the lines of business that drove those reserve releases and also which accident years were behind actually? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Okay. Thanks, Ralph. So on large loss experience, if you compare it to the same quarter last year, we are one point heavier. If you compare to the year overall, we're 1 point better, and obviously it's a significant improvement over Q3 and Q4 last year. I mean I think we hadn't necessarily expected to see a significant shift in the large loss experience in Q1 other than because of the random incidents of events, because of the – because the impact to things that we started, of course, wouldn't have had a major impact in Q1.

And you see that more as the year goes on. I mean I think the things that I can't point to in Q1. I mentioned earlier that obviously we have in some parts of the portfolio more reinsurance protection quite apart from the aggregate cover. I mean we have a loss that I mentioned is $35 million in the quarter. It would've been $50 million, that have happened before the year end. And if I given the new underwriting requirements that we have in place. If it was on a new contract that we ran this year, it would be $15 million.

So I mean again beyond the commentary we've made before that we expect to see further improvement on the large loss side because of the underwriting action and the reinsurance program. I mean I can't give you very precise guidance because, there will be some randomness in the outcome. But I expect to see further improvement over what you've seen in Q1.

On reserve releases, I mean it's a quarter that's slap bang in the middle of the guidance that we've given. If I look at all of the areas that have been problematic in the past for us, we are all quiet. So commercial auto is stable, TBA (51:13) is stable, the contractor line of business is stable. The main positives are coming out of – I mean the majority that coming out of – I mean relatively recent years on property. So property is the main driver.

But in general, I mean, reserve picture and actually fairly globally, is pretty consistent. I mean the one place that stands out, is particularly strong still is Switzerland. But in general, we are in a reasonably good position in most places.

Operator

We have a follow-up question from Andrew Ritchie, Autonomous. Please go ahead.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Hello. Hi there. Sorry to come back. I just wanted to get a quick update on Farmers. You talked about putting through more rate actions. I think the implication is you expect that to start impacting top line because you have a fall off in retention.

I mean, there already has been some improvement quarter-on-quarter in auto. I mean what are the extensive rate actions and do you really think the trade-offs in volume and rate is going to result in sort of premium shrinkage there or is that too strong?

And the second question, just to – I wanted to clarify, George. I think you said you're still going through the footprint examination process. That is also happening. And actually, you have some pipeline of some modest things to come through. Is that what you meant? Thanks.

A - George Quinn {BIO 15159240 <GO>}

All right. So, as to the second one is, yes. That's a good summary. On the first one, on Farmers, I mean, we've seen a very – we've seen strong growth – the exchanges have seen strong growth in the first quarter. Obviously, the combined ratio also continues to be at a level that from a longer term perspective is not sustainable. I mean that's been a key area for the exchanges last year. And in fact, the rates that the exchange is filed for, the exchange is filed for, is the main driver of the premium volume. I mean given the plans that Jeff and the team have for the remainder of this year. I don't expect we'll see shrinkage, but I think you would expect the growth rate to slightly cool compared to where we are today. So it won't go into reverse, but I don't think you'll see a continuing 6% increase in the continuing business. It will be lower in the remainder of the year.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

And there's no impact on the fee level you think is the right fee level to charge yet because the underlying profitability is so weak. (54:14) thoughts of having these some kind of trade off there yet.

A - George Quinn {BIO 15159240 <GO>}

So, no, I mean, we've guided to everyone that 7% is the level that we expect, to continue at and you see that 7% in the quarter.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Okay. Thanks.

A - George Quinn {BIO 15159240 <GO>}

Thank you.

Operator

Last question is from René Locher, MainFirst. Please go ahead.

Q - René Locher

Yes. And good afternoon and good morning, everyone. Just a big picture question. So this one is on debt (54:45), have you changed anything with regard to your risk committees? I know the incidents happened at last year, but I was very much surprised to see what happened in Yanjing (54:45) And my question was then, is the risk committee within the Zurich Group really where it should be. So I was wondering any changes here.

And then just also in regard to Group's structure. Mario, you mentioned before that you would like to simplify the Group's structure and then I was wondering I've seen some press releases, what was going on in Germany, is this something we should expect also in other countries? And that perhaps, again or just a big picture while I was checking a little bit on the press releases is you were CEO of Generali and at the very end, I have seen that you are – I'd like to put that way, quite a big fan of insurance tax. I was wondering what are your plans for Zurich in regard FinTech or insurance tech? Thank you very much.

A - George Quinn {BIO 15159240 <GO>}

Thanks. As I would say, risk committee, so I think I mean again, René, I mean given the issues that we faced last year and the poor performance that we delivered. I mean there are challenges in a number of areas of the organization, I wouldn't pick out risk as the only part. And obviously, risk, underwriting finance, a number of areas have had (56:17) made significant changes to make sure that we can deliver on the commitments we've made for this year. I mean there've been a large number of changes up and down in the organization to try and make sure that we have no repeat of what we saw last year.

I mean, certainly, risks have seen changes as well as the other part of organization I mentioned earlier, but I wouldn't start to detail on media, but the changes have been significant across the organization.

Q - René Locher

Okay. Thanks.

A - Mario Greco {BIO 1754408 <GO>}

Yeah. This is Mario on the organization. So the decisions taken in Germany where taken before I joined, but I'm fully supportive of them. Fundamentally in Germany, Zurich used to have three different CEOs and this structure has been unified under one country's CEO and this allowed not just to simplify the business cards, but also to unify functions and priorities in the market and so that investments also better finalized where they have to go. This has also been started in Italy and would likely continue in other countries. And again, it's a trend that I support and makes sense. It is how the market. It's organized itself and it fits well with the customer organization and mindset.

On FinTech, Zurich has been investing heavily in data developments, data applications. Zurich has almost 600 people working on data analytics and data developments. So there is a lot here to build from and there are probably – there have been many more investments in the number of years.

My efforts in the space is to understand how to make the best use of this information and what else can be done with the information with this skills and with the capabilities that we have in the organization. But I'm impressed by the amount of investments made by the skills and by the data available.

A - Gianni Vitale {BIO 19816633 <GO>}

Okay. Thank you. That was last question. So, thank you very much dialing in. And, of course, if you have any further questions, don't hesitate to call IR. Thank you very much and good-bye.

Operator

Ladies and gentlemen, the conference is now over. Thank you for choosing Chorus Call, and thank you for participating in the conference. You may now disconnect your lines. Good-bye.