Q1 2018 Earnings Call

Company Participants

- George Quinn, Group Chief Financial Officer
- Richard Burden, Head Investor Relations & Rating Agency Management

Other Participants

- Andrew J. Ritchie, Analyst
- Arjan van Veen, Analyst
- Farooq Hanif, Analyst
- James A. Shuck, Analyst
- Johnny Vo, Analyst
- Michael Huttner, Analyst
- Nick Holmes, Analyst
- Oliver Troop, Analyst
- Peter D. Eliot, Analyst
- Vinit Malhotra, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, good afternoon. Welcome to the Zurich Insurance Group First Quarter Results 2018 Conference Call. I am Sarah, the Chorus Call operator. I would like to remind you that all participants will 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. Richard Burden, Head of Investor Relations and Rating Agency Management. Please go ahead, sir.

Richard Burden {BIO 1809244 <GO>}

Good morning, good afternoon, everybody, and welcome to Zurich Insurance Group's first quarter 2018 Q&A call. On the call today is our Group CFO, George Quinn. We have an hour time today, so can I remind you to keep your questions to two in the first go round, and if we have time at the end, we'll come back to you with additional questions once everybody has had an opportunity.

Before we start with the Q&A, George will just make a few introductory remarks to the quarter. George?

George Quinn {BIO 15159240 <GO>}

Thanks, Richard, and good morning and good afternoon to all of you. So a few initial remarks. The first just as a reminder that the – as you know from last year, the focus for the first and third quarter is on revenue trends with some qualitative commentary on the performance of the business, and of course, you'll see the customary and full earnings detail when we have the half year.

Over the first quarter, we made a good start to the year, and probably more importantly we've continued to make good progress towards the targets that you are all familiar with. We've also continued to strengthen the business through targeted transactions that builds on already solid foundation, particularly as you've seen in the first quarter in Latin America.

P&C pricing trends continued to improve in North America over the first quarter, but as we highlighted at the time of the full year results back in February, we continued to focus on improving underwriting profitability over volume. And rates in some areas of the portfolio is still not sufficient. The quarter has seen a number of knockout events around the world. However, I want to confirm that overall knockout levels for the first quarter are only very slightly above historical levels.

Life business continued to deliver on our strategy of focusing on capital light and protection business. And this is continuing to support good growth, which aims to return – to balance return on capital, cash generation, new business margins, which have all remained on attractive level. Farmers continued to deliver steady performance. But I think what stands out in the quarter is the improvements in underlying customer metrics and the performance of the Farmers Exchanges. And this shows up in both improved retention and growth in both new business and policy gains over the course of the quarter.

Combined with the further improvement in the underwriting performance of surplus of the Exchanges, these plans should be supportive of future growth in the business. The quarter also confirms the very strong cash positions that we have on our Z-ECM ratio. It's improved to 133% providing us with continued capital flexibility.

As you'd imagine, we continue to review the capital levels of our business in light of growth opportunities and the macro outlook. However, the near-term key focus remains on delivering on our dividend policy and on growing the dividend over the plan period.

I'll now be happy to turn to Q&A.

Q&A

Operator

We will now begin the question-and-answer session. The first question is from Peter Eliot from Kepler Cheuvreux. Please go ahead.

Q - Peter D. Eliot {BIO 7556214 <GO>}

Thank you very much. My first question is on the agreement you've reached with Uber. I guess you're one of a number of insurers that are talking about agreements with Uber in different regions. And I mean, just purely playing devil's advocate for a second, I mean, I guess, my starting assumption would be that Uber probably has the bargaining power in these agreements.

I'm just wondering, as the world moves from sort of smaller ticket business to larger ticket business, does that shift the value towards the customer rather than the insurer? Say just playing, devil's advocate, but I'd be interested in your thoughts on that sort of trend.

And then the second question, I was wondering if you could just run us through the operating assumption changes that you made in the Life business. Thank you very much.

A - George Quinn {BIO 15159240 <GO>}

Thanks Peter. So on the first one, important to say, first of all, that the Uber contract or contracts are with the Farmers Exchanges and not with the Zurich Group. Obviously the point is valid nonetheless. So I think the – I mean, as the world potentially shifts and we see more of ride share and eventually I guess shared or eventually fully autonomous vehicles, I think we all have an expectation that the insurance purchasing that goes with that will shift over time. We suggest that really change the fundamental dynamics between who has more influence over the outcomes.

I mean, it's not – I don't think it does. I think the biggest driver of, I think, what happens in terms of – I mean the entire contracting process is it's a normal economic demand and supply topic, isn't it. So where you have excess capacity, I guess the rates on offer and the types of conditions will be more conducive for the buyer and then vice versa.

So I'm not convinced that with the changes that we see or the changes that we potentially see in the way the market operates, the fundamental laws of economics are fundamentally altered by that process. I mean, the one benefit it clearly does create for the buyer is of course for a much larger entity in the same way that if you're a much larger insurance company, I mean, your tolerance for risk could be different and that will impact obviously the need for coverage in the first place.

On the operating assumption changes in the quarter, I mean there's a number of, I mean, relatively small things. I mean we've got – I think we have no numbers that are above the single-digit level. So we've got some minor changes to expenses and minor changes to lapse, but there's nothing in the quarter that particularly stands out what I would view as indicative of something you can expect to see in the remainder of the year. I viewed the changes in the operating assumptions is a better randomness in the first quarter.

Q - Peter D. Eliot {BIO 7556214 <GO>}

Yeah. Great. Thanks so much. And it is probably obvious by my first question but I guess what I was referring to was fewer customers controlling more of the market and possibly does alter the supply demand economics slightly, but I'm sure you've covered that. But thank you.

A - George Quinn {BIO 15159240 <GO>}

Thank you.

Operator

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

Q - Michael Huttner {BIO 1556863 <GO>}

Oh, thank you. And also on the Farmers, I wonder if you can – you talked about supportive of growth and also the policy count and new business and I just wanted if you could give a little bit more insight into these things.

And then the other thing, I was actually – I didn't see it at first and when I saw it I thought, oh no, this is not nice. And at Farmers you've got a $200-million reduction in gross written premiums and I understand this is the independent agent business, which you're de-emphasizing and there's still a lot more that you could de-emphasize. In other words, the fees at Farmers could really decline substantially if you give all this business away. And I just wanted to hear if the interest, the incentive for shareholders are fully aligned. It doesn't at first glance, I would say, the answer is no but maybe I'm completely wrong. Thank you.

A - George Quinn {BIO 15159240 <GO>}

Thank you, Michael. So on the first topic, so – I mean a bit more insight into the top line. I mean, if you look at the headline numbers, I mean, very strong growth in GWP. I mean both on an absolute and on a continuing operations perspective, continuing operations up 6%. Obviously, the Uber contracts that I was just discussing with Peter, they are very late in the quarter, so it won't have an immediate impact on hand (09:15). I mean an almost immaterial impact on fees for Q1.

But the other dynamic you see in the Farmers business over the course of the last couple of years is, I mean, there's a part of the business which have been in run-off for in 21st Century. That is obviously something that has reduced the reported headline growth number. We expect and the Exchanges expect through the course of this year that process of run-off will be complete. And therefore, by the end of the year, we should be away from this concept of continuing versus the headline number.

On the business insurance sold through independent agents, I mean you are absolutely right. The Exchange has taken the decision in the quarter to dispose of that via a renewal rates transaction with Hartford. I mean obviously that does reduce premium volume, it does have an impact on the fee that's paid. I mean, first of all, it's a decision that the Exchange makes rather than the one that we make. But to be honest, I think if any of us were looking at that portfolio of business, it'd be hard to reach the same conclusions that the Exchanges have reached. And, therefore, I think – I mean they are acting as you would expect them to act.

I think the most important issue – this issue that you raise around – I mean what the risks that we see more there. So two things, and I think if you look back or you've been on these calls over a longer period and you've listened to the conversations that we've had, I mean that particular portfolio has been a challenge for a relatively long period of time. So I think that we end up in this position is probably not a huge shock to people.

And then if you go back to the presentation that Jeff and the Farmers team gave at the Investor Day in December or November rather, and you look at what we're seeing elsewhere in terms of growth in the Exchange, I mean we have no significant concern that: one, we're not aligned: or two, that the Exchange has its right to dispose of lost parts of its business and portfolio. I mean the Exchange is looking for growth. And they are trying to find a way to make sure that they can find new folks at the market, whether it's the thing we just discussed around Uber; whether it's the eastern expansion that you saw in the press release today, they got significant growth there; or whether it's just using the distribution power that they currently have.

So I think from a shareholder perspective and I think the most important factors from today's release are – I mean, the customer metrics are obviously extremely important. Policy count is a very strong indicator of where the business is headed. And all of that combined with, I mean, Farmers continuing to drive rates, I think is actually a very positive sign for the future. And on this particular topic, they are acting, I think, as almost any of us would.

Q - Michael Huttner {BIO 1556863 <GO>}

Noted. Thank you.

Operator

The next question is from James Shuck from Citi. Please go ahead.

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

Thank you. Good morning, George. I'd like two questions. Firstly, on Farmers and the Uber deal again. I guess this is the first time really we're seeing Farmers grow outside of tied agents and then start to come around maybe direct. My question is really kind of how that affects the FMS business model over time?

I think you mentioned that the margin will come down because the level of services is being reduced. So if you could just explain the dynamics a little bit about all the services that you provide kind of to the tied agent and how that will evolve through a partnership type model, particularly given that's where a lot of growth might be expected to come from over the medium term.

Secondly, on the Zurich Americas statements, just kind of first time to ask you questions on this, but I was just looking at the reserve releases by line of business. And we've seen big releases on workers' compensation, particularly in the kind of 2014 to 2016 years and relatively good conditions on commercial multi-peril and other liability lines. If could you just comment on those that would be helpful, please?

A - George Quinn {BIO 15159240 <GO>}

Great. So thank you, James. So on the first one – so the Uber deal is – I mean it's quite different from what happens with the tied agents, or the Exchanges, or Farmers. If you buy a policy through an agent – a tied agent at Farmers, you buy also a home, it's like the type of product that you and I would recognize. So you pay a premium, you cover for all the risks that the policy provides protection for. And if you have a claim, the claim gets paid.

I mean on the Uber transaction, I mean, it's a commercial rideshare contract that covers particular part of the risk and, I mean, it has characteristics of the claims handling agreements in the end. So it's really quite different from I think what you see within the normal Farmers distribution channel. So I don't think it has a direct impact on the tied agent, I mean, we could debate. I mean, if you have a much longer time horizon, so if you're thinking 10, 20 years from now, I mean, what impact can this have. We're back to that strategic question around impact of gig economy, impact of shared or fully autonomous vehicles.

But for the time being, I mean, the way that we are inclined to view this and the way I think the Farmers tend to view this is that this is then taking advantage of a core competence that they have, a scale that they have to support, I mean, what is an interesting customer segment that is not currently covered by Farmers through the tied agents channel.

On the Zurich America, instead of saying – I guess we talked at length at various times at worker's comp on this call and I guess point more often in the sense of some of the concerns that people have had, I mean we've given group disclosure and you have access to the Yellow Books in the U.S., which you've obviously used. I mean we've been pretty positive on workers comp over the course of the last few years.

We've seen good performance from the book and that's reflected in the reserve releases that you've seen recorded in the financial statements and in fact that also flows through, as you can imagine, into the reserve development group and is published, and as a sign of a couple of things. One is that the – I mean for the recent years have been a period of, I mean, relatively strong profitability in workers comp, combine that with I mean relatively modest inflation, all of those things tend to drive these outcomes.

I mean, if you look across the Zurich American book, I mean we've seen relatively strong reserve release across the entire portfolio. And then you mentioned two of the more obvious lines, I mean there are some areas we've added because Zurich America has been one of the most significant contributors to the group's reported PYD of 1% to 2% regularly over the course of the last couple of years. And in fact, I mean given what we see coming, I expect that to continue. So, we are very happy with what we're seeing, but it really looks like a combination of a relatively positive period in pricing and a relatively benign period for claims.

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

I guess if I can just quickly follow up on the workers comp releases. So, I mean, is it something that's coming through from the market as a whole, because it seems like rate increases are stalling a bit on workers comp. And I guess I'm just wondering there's such a high level of releases coming on that line. I think you're reporting combined ratios in the region of 60%, is that in common with the market, do you think rate is going to stick in that line of business?

A - George Quinn {BIO 15159240 <GO>}

I think when you look around the rest of the market, the – I mean you see a variety of different positions. I think – and both from a perspective of the initial loss pick which can differ significantly from company to company and from the actual experience therefore on PYD. I mean, it's hard for me to comment on, I mean, how the peers see the market, but I mean we've been very pleased with the performance.

I think you're right on the current price trend. So, I mean as we look back, I think you would be a bit complacent if you were to extrapolate this into the future. So, on the pricing thing I mean we looked at it carefully, we've talked at length either on these calls or the Investor Day on mix and the importance of that to us. And in fact some of the commentary around premium volume in the press release this morning. So, you saw this remark that maybe we have growth in APAC, and Latin America, generally we've seen a reduction across North America, especially around commercial. Part of that is driven by us trying to move the workers comp book away from the more inflation exposed product and into the less inflation exposed product as we try and position the book to some of the risks that will almost certainly emerge in the future. But, happy with what we've seen in the past, but we should be cautious about how this line develops in the future.

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

That's great. Thank you.

Operator

The next question is from Arjan Van Veen from UBS. Please go ahead.

Q - Arjan van Veen {BIO 5197778 <GO>}

Thanks. George, can you just comment briefly on the minus 2% reduction in EMEA, which we also saw in 2017 just where some of the pressure points are coming from or is it like in the U.S. a bit more mix shift?

And the second question was on the margin in the Life portfolio. Last year you had very strong growth in new business values, it's minus 1% in the first quarter. So, I was just wondering whether there's a bit of seasonality there and what we can look for in the full year.

A - George Quinn {BIO 15159240 <GO>}

Great. So, on the EMEA topic, so if you look around the European business, we have growth in Switzerland, particularly in commercial, and maybe (19:34) weakness than in the UK and in Germany. I think nothing particularly stands out for me, I mean there are – there is a need for example in the same way that we're tackling commercial auto and the weakness to that tends to produce in the U.S. We have some of those issues in Europe too on commercial auto and you can extend some of the action we're taking in the U.S. on a smaller scale and to some of the things see happening in Europe. But in general, UK and Germany are the drivers of the reduction. Switzerland is slightly up.

On the Life portfolio, it's not really seasonality, so what you see in this quarter and you see pretty healthy growth on APE, but as you mentioned, I mean our new business value, if you adjust for foreign exchange and the impact of last year's disposal of the corporate savings business in the UK. I mean, we're in this 25.1% margin level.

I mean, the reason you see the slight drop in Q1 is really a mix of business, that's actually deliberate rather than accidental and it's driven by two areas. So one in the UK, we've grown in that, particularly because of corporate protection, which certainly drives volumes but has a relatively low margin, I mean that can come or go depending on client demand in a particular quarter.

And the other thing we've done this quarter, which is something we have done before, and we've grown the planes de ahorro business in Spain with Banco Sabadell, our joint venture partner there. That's a savings product. It's spread supported. So it typically has – I mean very little, sometimes negative new business values. The reason for doing that kind of business is that there is an ROE optimization that we can achieve through rating some of it. So I mean we have set an appetite for that business with a certain capacity to do it in Q1 and we certainly had a partner, who could sell it. So that's what you've seen, it's not a seasonal issue, it's really – at least partly opportunistic.

Q - Arjan van Veen {BIO 5197778 <GO>}

Okay. I understood. Thanks, George.

Operator

The next question is from Farooq Hanif from Credit Suisse. Please go ahead.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi there. Firstly, going back to – shifting away from kind of inflation exposure in the U.S., but when you look at the price increases that you're getting, does that mean the risk of that will be offset in the future when inflation has gone down materially, could you comment on that?

And secondly, going back to the Life margin, I just want to understand this point about optimizing between margin, ROE and earnings. Does that mean – I mean you are basing – your answer just gave it to Arjan. So that means that actually the earnings on this business that you're writing are going to be better than the margin suggests? Thanks.

A - George Quinn {BIO 15159240 <GO>}

Great, Farooq. So on the first one, it'd be (22:49) to claim that on the basis of what's happened in Q1 that we've really shifted the inflation profile materially. I think as you know from prior conversations and generally from the Investor Day that we had back in November, we're looking at a number – or we have looked at a number of different levers to move the portfolio mix and those levers available to us include reinsurance.

The challenge on the reinsurance side is that's a relatively effective way to address inflation exposure on the prospective liability risks. Doesn't do so much for the in-force and there's also a very limited appetite in the regions market for the workers comp exposure. So some of the things we've done will certainly have moved it in the right direction, whether that's the use of reinsurance or whether it's some of the product shift that we try to execute within Q1.

But as I mentioned earlier, we still need to tackle some of the issues around the products that carry the most significant inflation exposure, and that's workers comp. And we try to shift clients away from the products that carry the most would certainly help. I mean ultimately though I think given the way that inflation expectations develop, I mean lately over time that portfolio for us will be a bit smaller in the long run than it is today. And that shows the most effective way and the most cost-effective way to address inflation exposure.

On the life margin, that question, and earnings that – I mean just to be very transparent about when the product works. If you look at it on a – I mean if we sell our spread-supported product, which is not so common in our portfolio, I mean if we do that because the economic system that we apply has no liquidity premium within it, I mean that type of business will typically produce either very low or potentially negative new business values or issuance.

On the assumption that over the life of the product, and the products are typically pretty short-term, let's say the spread adjustment that you would make from a risk perspective is not required because you don't see the levels of defaults that might be anticipated. That will produce a higher ROE than you would see otherwise. Now, the ROE is clearly now risk adjusted. I mean we try and look at all of the different metrics to try and optimize earnings. In the end though, from a group perspective, this impact is really small. So, I mean, I wouldn't spend too much time worrying about it.

Q - Farooq Hanif {BIO 4780978 <GO>}

Okay. Thank you very much.

Operator

The next question is from Johnny Vo from Goldman Sachs. Please go ahead.

Q - Johnny Vo {BIO 5509843 <GO>}

Yeah. Thank you, guys. Look, there's obviously been a focus on profitability of certain business lines in your North American business for a number of years now, but I guess how many more years are we likely to see this restructuring taking place? I know that there're issues with workers comp and trying to move the portfolio, but obviously you've been doing this for a number of years now. So when are we going to see that restructuring sort of ease?

And the second question is just bit more of a cheeky question. I guess one of your peers described the possibilities of a merger of equals, how would you view these within the context of possibilities at Zurich? Thanks.

A - George Quinn {BIO 15159240 <GO>}

Thank you. Where am I going to start now? Let's do the profitability question first, while my brain thinks about the answer to the second one. This might seem a bit odd, but I don't think we're in an abnormal period in what's happening in the U.S. business. So I mean obviously it's our aim in all of our businesses to grow them over time. I think if you look at the entire commercial market in the U.S., I mean it clearly faces some challenges, certainly if you look at a more granular level, say, line of business.

So I mean the need to tackle that is not a surprise, I think, actually to many people. I mean as the market turns and as we see more momentum on pricing, I'd expect that business to grow again. But I mean we wanted the business to maintain a focus on profitability at all times. This is the most important driver of success for the firm. I mean hopefully it's not always necessary to make such adjustments as you've seen in Q1, but I mean there's nothing going on that feels like a major turnaround situation. I think what we see the business do is make, I mean, reasonable choices with capital allocation, which is what we want them to do.

So I can't tell you when the business will grow, but it will grow when the opportunity to grow more profitable is there; and hopefully that's not far away. I mean on the pricing, the rate topic, just to maybe broaden the issue a second. I mean you've seen the commentary already today in the press release around rate for Q1, sequentially that's stronger than Q4 last year. Initial indications are that Q2 will be sequentially stronger again. And, in fact, in discussion with the U.S. team, I mean they have some – and it's not just optimism, the foundation for their expectation which is that trend will continue certainly through the middle of the year. Some of the most loss affected accounts actually have yet to renew. So we are expecting to see some of that – I know you're pretending that will accelerate and become exponential, but we certainly expect to see an improving trend certainly through the middle part of the year.

M&A; so I think the most important I can say on M&A is that, I mean, we don't exist to do M&A. I mean we exist to serve our customers well and generate a good return for our investors by doing that. And that means that the operational plans that we put forward at both the Investor Day in 2016 and again at the Investor Day last year are the most important priorities for us. And I think you can see through the course of last year and the results that we published in February, I mean we're making progress, and that's had positive benefits for shareholders. We think that's the highest value priority that we can pursue.

As far as how M&A fits with us, I mean you've seen us do M&A. So I mean over the course of – in the last 18 months, we've done a number of smaller acquisitions that in almost every case had two key characteristics. One is that they were a strategic enabler, so they were part of something that I hope you as analysts and our investors would recognize us pursuing goals that we previously communicated to you and financially they're attractive. So compared to the alternative use of capital, which would typically be to return them to investors, and these all represented actually a superior use for our investors.

You've also had to talk about the fact that we don't believe in this large scale, multi-market approach to M&A that creates a huge distraction for the business. It's pretty rare that two plus two in this world equals four or something more than four or one plus one is more than two sorry. So, I mean that's not our priority. Our priority is on the operational side and that's what it will continue to be.

Q - Johnny Vo {BIO 5509843 <GO>}

Okay. Thank you.

Operator

The next question is from Oliver Troop from Bernstein. Please go ahead.

Q - Oliver Troop {BIO 20035307 <GO>}

Thanks, and good afternoon. I've got two questions. My first question is on Farmers. You've obviously been reducing the quote share over time and it's now down to 1%. And I noticed also that the Farmers' certificates of deposit – sorry certificates of contribution held by the group are being reduced. It just seems like Zurich is becoming more and more decoupled from Farmers. So my question is, do you still see Farmers as a core part of the group in the long-term?

And then the second question, I wondered if you could just give an update on claims inflation. How does that compare to the 2% overall price increase you've got in P&C, maybe across your key markets?

A - George Quinn {BIO 15159240 <GO>}

So thank you Oliver. So on the first one, so is Farmers a core part, so Farmers Management Services is a core part for Zurich Group? Absolutely. I mean the things that we've done less of are the things – I mean Zurich doesn't necessarily do this for any of its clients. So the – I mean, I think probably as long ago as 2014 maybe 2015, we talked about the fact that I mean being a reinsurer to Farmers over a longer period. I mean, this makes no sense for Zurich or for Zurich shareholders, and therefore we've been reducing the participation over that period, the Exchanges of (31:53) resources of support.

I mean, Zurich is not a professional reinsurance organization, and I think Farmers is actually best served by finding that type of support. And certainly our shareholders are also well-served by us not exposing the capital base of the firm to those types of risks.

Q - Oliver Troop {BIO 20035307 <GO>}

Okay.

A - George Quinn {BIO 15159240 <GO>}

(32:14) I mean, we view that relationship as extremely important. I mean, we spent a lot of time looking at how we can help and how we can improve the relationship, it's a core part of what the Zurich Group offers, and I don't expect that to change in the foreseeable future.

On the claims inflation topic, I mean, as always it's going to vary a lot by different lines of business, and if you look at it in relatively short periods, it can be difficult to judge. I mean, given we've seen more significant rates within Q1, we expect claims inflation to come up gradually, but not at the same rates – same rate as pricing. So therefore we think we're seeing margin expansion currently.

We've talked in the past about the fact that claims inflation overall for our book is maybe running in that 1% level, it's maybe fractionally higher than that today. And of course if you look at some of the lines of business, I mean you see the opposite trend, but I mean for the overall portfolio, we're benefiting overall from the rate change.

Q - Oliver Troop {BIO 20035307 <GO>}

Okay. Thanks.

Operator

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

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

Hi, there. The first question P&C premium growth, growth versus net, I thought I understood part of the plan for 2018 was to continue re-underwriting gross which meant some shrinkage, but also re-underwriting or buying more reinsurance on certain lines. So is it fair to assume the underlying net written premium growth is below the gross still so far year-to-date? I presume the guidance still remains about flat NEP for the year as a whole, and is there any reason why that should have changed?

The second question looking at movements in yield curves and spreads year-to-date I would be assuming that your reinvestment yield had risen somewhat, are there any changes you've done to your asset allocation that would mean that I'll be wrong? Thanks.

A - George Quinn {BIO 15159240 <GO>}

Thank you. On gross versus net, so first of all on the reinsurance point, you are right, we have a bit more reinsurance, partly around portfolio mix and partly around some lines of business where we're looking to reduce the capital allocation. I mean within the quarter, I mean now that they're risk attaching contracts, so the impact to the reinsurance will blend in over time. Net and in the quarter I mean, it's not vastly different from the gross written picture, maybe a slightly more positive. I mean it's not materially different from the flattish picture that you see.

And our guidance for the full year hasn't changed, so flattish in the outcome. Albeit, we may see a switch as we talked about before between commercial and retail, and other businesses.

On the yield curve piece, I'm really glad you asked that question because I was hoping that someone would ask me that. On the SAA side I mean no significant change, but actually on the reinvestment rates and well – I mean again it's one quarter and it's a relatively small impact in the short term. What we've talked about this is the – as part of the year where for P&C sounded at least the impact of reinvestment would bottom out and in fact we've seen the inflection point already in the first quarter.

So, that we have a book yields in the P&C book of about 2.7%, reinvestment yield about 2.9%. So, that's actually beneficial for us as we go through the remainder of this year and next.

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

All right. Thank you.

Operator

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

Q - Nick Holmes {BIO 3387435 <GO>}

Hi, there. Just one question. I'm wanting to ask about your P&C expense ratio and can you update us on where you think this is heading? And in particular, are you concerned that by cutting premium in the U.S. you put more pressure on the expense ratio? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Thanks, Nick. So, obviously we haven't given an expense ratio number today, we'll update in more detail when we get to the half year. And just to remind everyone that we have a particular skew and seasonality around crop, which has some unusual expense ratio features that I know you're all aware of, but just a reminder as you think about the first half results.

I mean what's most important for us is reduction in absolute expenses, that's the thing that we obviously completely control. We have the target that you are aware of, you know how much progress that we've made through the end of last year, that progress has continued as we expected through Q1. We'll give a more fulsome update when we reach the mid-year but we expect to continue to communicate an achievement of our expense goals and the reduction in the expense base that would follow then.

I mean there will be a challenge at times if – I mean that was the reason why there is going to be a larger correction around premium volumes because of a profitability challenge in the market. I mean there is a risk to the expense ratio but that's the key reason why we haven't set an expense ratio target. Maybe more positively though – I mean as you heard me respond to Andrew a moment ago, in looking for a fairly flat outcome on the net end, which of course would be the driver of the expense ratio side. I don't expect at this stage to trade away the benefits of the expense cuts through a fall or a significant fall in top line.

Q - Nick Holmes {BIO 3387435 <GO>}

Okay. Thank you very much.

Operator

Our next question is from Vinit Malhotra from Mediobanca. Please go ahead.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes, good afternoon. Thank you very much. So George just to clarify this minus 5% in U.S., is this a shift in the recent few months that post your commentary in the full year you decided to get a bit more careful about underwriting or is it just something that was anyways likely to have happened by now as they are planned? just looking for whether it's incrementally more changed on underwriting.

And second question is you mentioned the bolt-on M&As and some of those have been in Latin America, where obviously the currency is quite in focus last week, as well in Q. Is there anything we should know about that, is a hedge in place or something to highlight? Thank you very much.

A - George Quinn {BIO 15159240 <GO>}

Vinit, thank you. So on the shift in business, first of all, so I don't remember precisely when we would first have talked about it in a public forum, maybe on the Q3 call, maybe on one-on-ones which took place in between, but this is something we've been planning since last August, September.

I think I've talked to some investors about the fact that – I mean, I think as you guys could see in the half-year results and again in the year, I mean within the commercial business, it was clear that we needed to do more to shift the mix. And part of that was going to be pruning some of the portfolios that have been a challenge. I mean, the obvious (39:55) I mentioned earlier on the call is commercial motor or commercial auto in the U.S. It's actually quite a hard business to reduce volumes and because it's the business that has by far the highest rate. But this is a planned activity and the plans go back already seven, eight months for the activity you're seeing there.

On the M&A topic, so I guess you are following – well, maybe not following, but you certainly are aware of what's happening clearly around the Argentinian peso. I mean, we have a traditional transaction, we have the customary protections, but of course, I mean we enter into this transaction with a longer term perspective on the market. And I mean, if you're really worried about Argentina environment, we have to have daily calls that give updates on what's taking place.

I mean we've had good experience in Argentina even through relatively difficult periods, but also I mean if you look at – I mean a good example is Brazil. So I mean go back to 2015, 2016 and look at the challenges that we saw on the macro side of Brazil. I mean, some of them are more recent in those two years has been a particularly strong period for Zurich in that market. So I mean what we see happening at the moment is something that I mean it can happen from time to time in markets, I mean, besides Argentina. But I mean this is a market we liked from a long-term perspective and that's why we made the investment.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay. Thank you very much.

Operator

The last question is a follow-up from Jim Shuck. Please go ahead.

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

Thanks for taking the follow-up. Just one question actually. I think George in the past you had referred to surplus capital in the U.S. and looking to upstream now after the holding company. It doesn't really seem to have happened. Just looking at the progression of the dividend over time and U.S. RBC ratio is now 378% for the full year. I guess what's the kind of target range on the RBC level and what's the outlook for that ratio given the potential tax factor changes or any potential changes to your (42:09)?

A - George Quinn {BIO 15159240 <GO>}

Yeah. Great questions. I mean you connect the two drivers here. So I mean you're absolutely right. I mean (42:14) in the past that we were looking to bring ourselves down to target levels of capitalization in the U.S. and that would have triggered, well, certainly an early expectation additional cash flow if we did that. We've never had those cash flows and the cash remittance guidance that was always going to be something that potentially was on top.

But the reality of the tax changes as we restructure avoids the potential issues the big components can create. That capital will be used locally to reduce to the extent to which we seed this and perhaps other parts of the Zurich Group. So at this stage, I have no expectation of other than the ordinary dividend flows from the U.S. and we'll use that surplus capital that was there to make sure that we get the benefit of the change in the federal rate in the U.S.

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

I'm presuming that doesn't change anything about the cash remittance target over the three years?

A - George Quinn {BIO 15159240 <GO>}

Absolutely nothing.

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

Wonderful. Thank you.

Operator

The next question is a follow-up from Farooq Hanif. Please go ahead.

Q - Farooq Hanif {BIO 4780978 <GO>}

Oh, hi there. On your Z-ECM capital ratio, you have made lots of little – I mean, obviously quite small acquisitions, but it seems that it's very difficult for you to sort of make a dent on that capital ratio to get it back down to 100% to 120% level. So I'm just kind of wondering do you think you could use that up with M&A or do you think you're going to have to do something else? Thank you.

A - George Quinn {BIO 15159240 <GO>}

The thing I'd point out here is that while probably people focus more on the acquisitions. We've also made disposals. And it's more than simply the – I mean, the things that we frequently talk about around the transactions in the Middle East, South Africa, Taiwan, Morocco. We've done (44:15) work. And in some of those transactions have had, I mean, really significant positive impacts on Z-ECM. So as you've seen us do things like couple more, I mean, some of those things are paid in their entirety by some of the restructuring done on the backend to remove some of the risk from the portfolio. So I think that's partly why you've seen the ratio be a bit more resilient than perhaps you might have anticipated given what's happened on the M&A side.

I don't think we can make a dent in it. I mean, I think we said frequently that we don't have a shadow target range that we haven't announced the target range is 100% to 120%. We're in the fortunate position that we run above that currently. Priorities are unchanged. So primarily that's something that should be a topic that gives investors a confidence that the dividend is very secure indeed. And beyond that we'd like to deploy a type

and beyond that we like to deploy it preferably an organic activity, if not an organic activity an inorganic activity that would be would help us not only get to targets, but either help us get there faster or help us exceed the targets. And if we can do that and we still have surpluses over given periods, we would do what you'd expect us to do. Nothing changed on our priorities on capital.

Q - Farooq Hanif {BIO 4780978 <GO>}

Okay. Thank you.

Operator

Last question is from Michael Huttner. Please go ahead.

Q - Michael Huttner {BIO 1556863 <GO>}

Thank you so much. And on the small rise in the Z-ECN from 132% to 133%, is there any anything to highlight in terms of moving parts as anything stands out?

A - George Quinn {BIO 15159240 <GO>}

Actually not much, it's one of the simplest course of movements on Z-ECM. And so it's actually 4 points, so I guess what we would call operating cash flow generation three points dividend accrual. No management adjustments or management actions or any other unusual things in the ratio. It's all the stuff you see or would see if we publish more details I guess.

Q - Michael Huttner {BIO 1556863 <GO>}

Thank you.

Operator

That was our last question. I would like now to hand over to Mr. Burden.

A - Richard Burden {BIO 1809244 <GO>}

Thank you very much everybody for dialing in today. In case if you have further questions obviously do not hesitate to contact the IR team. Thank you.

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.
