S1 2021 Earnings Call

Company Participants

- Frieder Knupling, Chief Risk Officer
- Ian Kelly, Chief Financial Officer
- Jean-Paul Conoscente, Chief Executive Officer of SCOR Global P&C
- Laurent J. Rousseau, Chief Executive Officer
- Laurent Rousseau, Chief Executive Officer
- Olivier Armengaud, Investor Relations Senior Manager
- Paolo De Martin, Chief Executive Officer of SCOR Global Life

Other Participants

- Andrew Ritchie, Analyst
- Ashik Musaddi, Analyst
- James Shuck, Analyst
- Kamran Hossain, Analyst
- Thomas Fossard, Analyst
- Vikram Gandhi, Analyst
- Vinit Malhotra, Analyst
- Will Hardcastle, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen, and welcome to the SCOR H1 2021 Results Call. Today's call is being recorded. There will be an opportunity to ask questions after the presentation. In order to give all participants a chance to ask questions, we kindly ask you to limit the number of your questions to two. In order to give all participants --

At this time, I would like to hand the call over to Mr. Olivier Armengaud. Please go ahead, sir.

Olivier Armengaud {BIO 20892984 <GO>}

Good afternoon, and welcome to SCOR H1 2021 results call. My name is Olivier Armengaud, Senior Manager in Investor Relations team; and I'm joined on the call today by Laurent Rousseau, CEO of SCOR; and the entire Executive Committee. And I please ask you to consider our disclaimer on page two of the presentation and statements in respect of COVID-19.

I would like now to hand over to Laurent Rousseau. Laurent, over to you.

Laurent Rousseau {BIO 19524847 <GO>}

Thank you, Olivier, and welcome everyone. Today is my first quarterly results as CEO of SCOR and I'm pleased to present strong headline numbers demonstrating our ability to create value as well as our resilience. Quite a few moving parts as quite of you have noted today. So, I'm going to shed light on three important drivers that we see. The first one is on the underlying performance of the business. The business engines remained solid despite sustained cat activity. First of all, both of our business engines generated good growth. This growth is profitable. If you look in P&C, our attritional loss ratio is significantly better than our Quantum Leap guidance. And on the Life side, we reiterate our Life technical margin guidance for the year. And on the asset side, we revised our return on invested asset guidance in the upper part of our initial range. And we have already started reinvesting our liquidities from the Covea transaction and we'll continue to do so proactively till the end of the year.

Now, the second driver is if you look at the COVID impacts and, of course, the pandemic is having quite an impact on both our Life and P&C businesses. On the P&C side, we received further data from clients that led us to increase the provision for COVID-related business and mostly these interruptions. On the Life business, it continues to be impacted by COVID claims, although this is in line what -- with what we've already communicated to you. Since March 2020, SCOR has reserved for around a EUR1 billion of COVID-related claims. This is meaningful and demonstrate our ability to absorb shocks. And we have been managing those exposures proactively.

The third driver is the conclusion of the settlement agreement with Covea. This settlement took place at the very end of the quarter on June 30th. It marks a very important milestone for the Group. It crystallizes the value of SCOR Life reinsurance portfolio, which is a very important point, we -- as it demonstrates the often underappreciated value of our Life business. It also enables SCOR to focus on its core business and reveal the working relationship with a leading insurer. Finally, it provides SCOR additional degrees of freedom to manage its capital and pursue its growth. Overall, I would say these results show our strengths in a volatile environment and they are on track with the strategic plan, Quantum Leap.

I will turn over to Ian. Once he walks you through the key financials of the quarter, I will then provide a perspective on what you can expect over the coming few months from me and from us, and we will conclude with a Q&A session. Thank you. Ian, over to you.

Ian Kelly {BIO 19976646 <GO>}

Thanks, Laurent, and good afternoon, everybody. As Laurent said, it's a busy quarter. There are quite a few moving parts. And I would like to highlight upfront that the underlying performance of the business is very strong.

Let's move to the settled agreement reached with Covea, and to reinforce Laurent's comment, the key thing to note about this transaction is that it demonstrates the value in the Life business and our ability to unlock that value. I think it's helpful if I walk through the mechanics of the transaction. The agreement provides for reinsurance of 30% of all of the in-force business carried by the SCOR Life Irish entities.

The impact on our financials is very positive. Firstly, it is beneficial for the solvency ratio. We receive a cash commission for the best estimate of the future cash flows. And the -- we receive a cash commission for the best estimate of the future cash flows, the benefit comes from the associated risk margin with the business that is released. This is positive for eligible own funds, and combined with the reduced solvency capital requirement on the business ceded, leads to a solvency impact of approximately plus 27 percentage points.

On the IFRS accounting side, against the commission received, we have movements in DAC and VOBA and the support of a strong net reserving position on the portfolio. The resulting impact on the P&L is a positive EUR311 million of income, net of tax. This includes EUR20 million pretax in respect of the indemnity settlement paid by Covea and EUR30 million pretax in recognition of the value as at June 30th of the call option granted to SCOR by Covea on the shares it holds.

Other impacts of the transaction are, of course, that the cash position is strengthened. The cash commission was received on July 1st. SCOR now benefits from strong flexibility to fuel profitable growth. So, those are the key features of the Covea transaction.

Let's look at the other key metrics of the quarter on the next slide. In H1 2021, SCOR continued to successfully develop its franchise. Gross written premium stand at EUR8.4 billion. This is up 9.1% at constant exchange rates compared to H1 2020, driven by P&C up 14.3% benefiting from the excellent renewals during the year and steady Life growth up 5.2% with continued franchise expansion in Asia. Following the execution of the Life reinsurance treaties with Covea and the robust performance of the underlying business, SCOR delivers a net income of EUR380 million in H1 2021, translating into an ROE of 12.2%.

Let's have a look at the business performance, starting with P&C first. We've published combined ratio of 97.2% in H1. The underlying development of the attritional ratio is strong, but Q2 was impacted by a charge of EUR109 million before tax for expected COVID-19 claims as more information has been received from cedents regarding business interruption. The P&C business was also heavily impacted by cat events related to the Q1 Texas winter storm and Q2 European storms. On a normalized basis, for cat and COVID-19, the P&C combined ratio stands at 91.2%, better than the Quantum Leap assumption. In this context, we confirm our guidance for 2021 with a normalized combined ratio trending towards 95% and below.

On the Life side, we had two significant impacts in the quarter, the continuous development of COVID-19 in line with expectations as well as the benefit from the retrocession treaties concluded with Covea. First, the impact from COVID-19 on the mortality block is reducing and is tracking in line with our epidemiological model. Excluding the trend -- the Covea transaction, the Life technical margin stands at 3.1% for the first half and we should return to Quantum Leap assumptions in Q4 2021 with an underlying full year technical margin of 5%. If we now account for the one-off gains on the treaties ceded to Covea, the net technical result would increase by EUR346 million and translates into a Life technical margin of 13.1% for the half year.

On the investment side, the return on invested assets stands at 2.5% in H1, driven by realized gains on the fixed income portfolio in Q1, offset by the continuous low yield environment. The normalization of the asset allocation should be visible by the end of the year. The return on invested assets expectation for full year 2021 is revised to the upper part of the previously communicated range and stands between 2.0% and 2.3%.

Finally, in this context, the solvency of the Group is very strong at the end of H1, estimated at 245%. This is above the Group's optimal solvency range of 185% to 220%. The increase in solvency was mainly driven by 27 percentage points positive impact as of January 1, 2021 from the retrocession with Covea. The sensitivity of solvency ratio to interest rates is reduced due to the retrocession agreement. Finally, the positive impact from the operating capital generation and market movements is partially offset by model changes and COVID-19 impacts.

Briefly on a few other key financials. The shareholders' equity of the Group remains strong at EUR6.3 billion after taking into account the dividend payment. This is an increase on the year-end position and results in a book value of almost EUR34 per share. And finally, I would like to highlight the strong cash flow of the Group with net cash flow from operations exceeding EUR0.5 billion.

With that, I will hand back to Laurent. Thank you.

Laurent J. Rousseau {BIO 19524847 <GO>}

Thank you, Ian. Before getting into the Q&A, I would like to first of all layout what you, investors and analysts, can expect from me as CEO, and second, share with you how we have planned for the coming few months to prepare the ground for the next strategic plan and the future growth of the business.

So, first of all, what can you expect from me as CEO? The first thing is engagement. You are one of the key stakeholders of the Group and you're important to me. So, you can count on the fact that I would spend time with you, our investors, listen to what you have to say and hear your candid feedback. Personally, I started my career 20 years ago in the markets and I intend to stay closely in touch with you. Secondly, you can expect me to be transparent and candid. I will share my views on where the Group stands as well as the opportunities and the challenges that we face.

Now, what to expect from us in the coming few months? First of all, we have decided to extend Quantum Leap plan for one more year. The key reason is that I want to use the time to properly review the performance of our business, our operational discipline, our invested asset mix and the efficiency of our capital deployments.

So, what can you expect at our upcoming September Investor Day? We will make it shorter than usual and nonetheless provide important updates on the current business environments, life and health as well as P&C reinsurance markets are going through volatile times, yet we see clear and attractive opportunities to grow our franchise, in particular in P&C. On the asset side, there is also scope for normalization of our investment strategy. We will lay out the broad directions of our future strategic plan, where do we see opportunities to improve our returns, our capital deployment strategy and our strategic priorities as a management team. The results of today show clearly that we have some options to redeploy our capital and cash. I can tell you we will find the right balance between seizing growth opportunities in P&C, re-risking our assets and keep some flexibility in an environment marked by high natural catastrophes and COVID.

Finally, at the Investor Day, I will also communicate the timing and the discipline process through which we will produce our next strategic plan. I already know that this plan will include more of your inputs and objectives than it has been the case in the past. To achieve this, I will ask you for your time after the Investor Day to meet and discuss your individual inputs and objectives. I really want to be able to fully understand them and include them in our planning.

With that, I will hand over back to Olivier for the Q&A session. Thank you.

Olivier Armengaud {BIO 20892984 <GO>}

Thank you very much, Laurent. Page 14, you will find the forthcoming scheduled events. With that, we can move to the Q&A session. And can I remind you to please limit yourself to two questions each? Thank you.

Questions And Answers

Operator

Thank you, sir. (Operator Instructions) And we do have our first question from Vikram Gandhi from Societe Generale.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Hello. Hi. It's Vik from SocGen. Hope all of you are doing fine. I've got two questions. Firstly, I wondered if you can share what is the right way of thinking about the attrition in the life and health operating result due to the agreement with Covea? I mean, looking at slide 34 probably annualizing the EUR621 million of premiums and applying a 7.3% margin is one way, but -- and then this should reduce over time as the portfolio runs off, but would be great to get your thoughts. And secondly, can you please share what kind of COVID-19 impact are you assuming in the Solvency II ratio going forward? And related to that, what's the level of IBNR claims for the COVID results on the P&C side? Thank you.

A - Ian Kelly {BIO 19976646 <GO>}

So -- yeah, hi. Hi, Vikram. I mean, firstly on the impact on the technical margin on the Life business unit, certainly on the Life side, we do see ceded premiums. And what we would do is certainly we confirmed that for 2021, the technical margin guidance excluding the one-off impacts of the retrocession agreement, the technical margin is confirmed at 5% for the full year. And then when it comes to Investor Day, we'll be confirming the impacts on the technical margin for 2022. But to be clear, as Laurent has laid out, I mean, what we have done here is we've crystallized the value that we would have done earlier than we would have done, and that's at the heart of this transaction. So, we've done that, we maintain conservative margins within the portfolio and we will come back at Investor Day to describe how we're going to use the additional capital benefits that we get from this to enhance the earning power of the business. So, that's the (Technical Difficulty)

A - Laurent Rousseau {BIO 19524847 <GO>}

I think we've lost Ian. Maybe we can move to the second question on the COVID expectations and solvency ratio. Frieder, do you want to take that?

A - Frieder Knupling {BIO 17247809 <GO>}

Yeah. I can take that. So, as far as incurred claims are concerned, the solvency treatment is completely in line with IFRS and we have obviously -- particularly reflected the strengthening of our P&C reserves for COVID-related claims. There is -- for Solvency II, there is also an allowance for future claims, and that's particularly irrelevant for the Life business, where as we demonstrated in previous quarters, we are holding additional reserves for expected claims in the coming quarters. This hasn't changed a lot since the last quarter. There are slight movements. We are updating the models on a regular basis and also taking into account actual claims emergence for the past quarters, but that -- the outlook is largely consistent with what we've presented in Q4 and Q1.

A - Laurent Rousseau {BIO 19524847 <GO>}

Jean-Paul, do you want to take the question on IBNR share in P&C?

A - Jean-Paul Conoscente {BIO 20770277 <GO>}

Yes. So, hello, everyone. On the P&C side, you have in the presentation deck on page nine the -- a chart of the ultimate reserves we have for COVID and the amount of paid claims. As you can see at the end of Q2, we paid only EUR58 million of claims for COVID.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Jean-Paul, if I can just come back on that, that's the paid claims to the ultimate, but that will not necessarily be reflective of the IBNR position. Right?

A - Jean-Paul Conoscente {BIO 20770277 <GO>}

Yeah. But the rest are our case reserves in IBNR. The majority of our claims after this quarter are property BI. And so, most of that would be case reserves.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Okay, thank you.

A - Ian Kelly {BIO 19976646 <GO>}

Hi. It's Ian here just reconnecting. I don't know whether I was still connected during my answer to the first question.

A - Olivier Armengaud {BIO 20892984 <GO>}

You were Ian.

A - Ian Kelly {BIO 19976646 <GO>}

Okay, thanks. Okay.

A - Olivier Armengaud {BIO 20892984 <GO>}

Thank you, Vikram. We'll take the next question, please.

Operator

Our next question comes from Kamran Hossain with RBC Capital Markets.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi. Good afternoon, everyone. Two questions. The first one is, I guess, on the redeployment of capital. It sounds like -- it's ahead of the IR Day and ahead of the kind of plan more fairly, you're planning to deploy more of the capital into P&C versus Life. Could you maybe talk about the relative returns that you see between those two businesses at the moment? I guess, it's a little bit difficult to really back it out without the segmental balance sheet. And the second question is, I guess, on COVID losses coming back to that, also the BI piece has obviously got a little bit worse in the quarter. Can you talk about the status of the credit and surety claims at the moment and whether these have crystallized at all? Thank you.

A - Ian Kelly {BIO 19976646 <GO>}

Yeah. Thanks, Kamran. And firstly on the capital deployment, right. Firstly, we're in a strong position on the capital side as a result of the transaction. That's clear. We really do benefit here. And this brings us more degrees of freedom in how we review the position, how we redeploy that capital. And as we said and as you point out, once we get to IR Day, we can talk about that a little bit more. And we'll talk about how we allocate the capital, where we see the opportunities in the market, how we view the capital return policy, and there are certainly key areas to highlight on, namely the P&C market where we see good growth opportunities and on the asset allocation which may -- remains extremely prudent at the moment, that could be normalized.

Now, we will talk about the relative returns in answer to the question. We will always seek to deploy the capital where we see the best value for the shareholders. It's a little early now at this point to talk to those relative returns and exactly how we're going to deploy this. We just concluded the transaction on the last day of the quarter, but it's on our radar. We're working on this and we'll speak more about it.

Q - Kamran Hossain {BIO 17666412 <GO>}

Thanks, Ian.

A - Jean-Paul Conoscente {BIO 20770277 <GO>}

And this is Jean-Paul, on the COVID P&C losses specific to credit and surety. So, our view is based on the information received from our cedents. The results are coming in, the estimates are coming in much better than we had anticipated. And this is mainly due to the government actions taken to shore up the trade credit environment in the different economies worldwide, as well as the underwriting actions taken by the credit and surety and underwriters in pretty much every country, not only price increases, but the shrinking of limits, repositioning of the portfolio and focusing on less risky sectors relative to the economic environment. So -- and what we see actually is the results for the -- some of the large trade credit insurers are actually better than the results pre-COVID. So, we remain very bullish on the trade -- on the credit and surety market overall and believe that that portfolio even if the environment deteriorates in 2022, 2023 is in a very good position to withstand that deterioration if it happens.

Q - Kamran Hossain {BIO 17666412 <GO>}

Thanks for the color.

A - Olivier Armengaud {BIO 20892984 <GO>}

Thanks, Kamran. Can we take the next question, please?

A - Laurent Rousseau {BIO 19524847 <GO>}

Maybe one thing that we can say on the returns on the P&C side. What we're seeing at the moment is that couple of points of improvement in the underwriting ratio. So, if you look back in time over the cycles, for sure in terms of return on allocated capital, we've been quite steadily improving, getting to fairly good levels over the cycle.

Q - Kamran Hossain {BIO 17666412 <GO>}

Thanks so much.

A - Olivier Armengaud {BIO 20892984 <GO>}

Thanks, Kamran. Next question, please.

Operator

Our next question comes from Andrew Ritchie of Autonomous.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Hi, there. I'm sorry to go back to this topic. This is addressed particularly for Laurent. I think investors need more reassurance that the deal you conducted with Covea is in the end ROE accretive and over a fairly short timeframe because from the information we have today, we will be taking down earnings expectations for the Life business by 20% or something like that for the session. There is no clarity on whether any capital is going to be deployed. You haven't referred to the fact that -- I would hope the hurdle rate for deployment is at least the ROI on your own shares, which looks very attractive and also the fact that you possibly need to address your cost of equity inflated by the fact you are one of the few financials to have not caught up on the unpaid dividend from 2019. So, I just want a clear message that you're seeking to enhance earnings power net rapidly and the transaction with Covea will be ROE additive in the end in a short timeframe. I'm not sure we've really got that message clearly yet so far, sorry to be so blunt.

Secondly, can I just have some clarity as to what belief you have in that normalized combined ratio? It's very low, it's very impressive, but obviously the cat loading looked quite high for a benign quarter. So, maybe just give us a sense as to your sense, is there any other normalization we should do for the underlying combined ratio and/or your latest thoughts are on the right cat budget?

A - Laurent Rousseau {BIO 19524847 <GO>}

Thank you, Andrew. So, let me take your first -- I don't know if it's a question or a comment, but I'll answer. And I'll let Jean-Paul talk about the normalized combined ratio.

On the ROE accretive, so the answer is yes. Your message is loud and clear. It is indeed what I meant when I talked of capital deployment earlier on. And it is as well what I was alluding to on my -- on the P&C returns comments that we're seeing today rate of returns, including on capital on equity that are very strong. So, clearly, the earnings are going to be gone in this -- in the Covea transaction will be replaced and we strongly believe that they will be accretive to the ROE.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Do you think that can be --

A - Laurent Rousseau {BIO 19524847 <GO>}

Yeah, Andrew.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Sorry. I mean, are we talking replacement over many years or what's the kind of trajectory we should think about?

A - Laurent Rousseau {BIO 19524847 <GO>}

So, this is what we will be taking you through on the IR Day, Andrew.

A - Jean-Paul Conoscente {BIO 20770277 <GO>}

The -- on the normalized net combined ratio, I think your question is -- has two questions in it. One relates to the cat ratio, the other one relates to the normalized combined ratio. If we look at the normalized net combined ratio, the cat ratio of 7% is comparable to what we used in last year. And if you add the commissions and the attritional loss ratio, excluding COVID, you see a 5 point improvement overall compared to last year. The -- that improvement comes from two parts, one is roughly 1 to 1.5 points of improvement because of the lower man made losses in H1 2021 compared to 2020, that could be partially related to lower economic activity because of COVID. The second part is simply pricing improvement. And we need to validate whether this continues for the rest of the year, but there is no normalization needed there.

On your question on the cat ratio, it's something that we're looking at very closely and we'll come back to you at the IR Day. But the fact that we've only reached our cat ratio budget in one year over the last five years is something that, of course, we've noted and are studying and we'll come back to you with more information at the IR Day on this.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Okay, thanks.

A - Olivier Armengaud {BIO 20892984 <GO>}

Thank you. We'll take the next question.

Operator

Our next question comes from Will Hardcastle of UBS.

Q - Will Hardcastle {BIO 16346311 <GO>}

Hey. Good afternoon, everyone. I'll try one more way on the capital allocation. I know we're going to get more color on the Capital Markets Day. I guess, very strong Q&A session, it feels like we're talking here about your opportunity of P&C, the return on capital is improving and that's where we'll get most of the replacement on earnings. I guess to the point that we were currently -- you were currently operating above the top end of the target range before the settlement. So, what was constraining you before to grow P&C more at these return on capital levels? Or am I missing something here?

And then perhaps just on the COVID claims in P&C, is there any chance we can get some more color on these? When were the specific court cases, for example, when will be the notifications coming in? I guess, what's the new information or the learning, is it specific numbers you've just being informed about? And then is it just these two cases that you worked for or is there an extrapolation within your increase? Sorry, there's a lot of very minor questions within that color, just some more color would be great.

A - Ian Kelly {BIO 19976646 <GO>}

Thanks. Well, it's Ian here. Firstly on the capital deployment, with the solvency now at extremely strong position, you questioned what was constraining prior -- the growth prior to the Covea transaction. We operate under a variety of constraints, we lead the Group by the Group internal model under the solvency metric, but we have other constraints including rating capital constraints. We do maintain an excess over AAA to have our AA minus credit rating with S&P, for example, but these -- that's a constraint under which we operate. Now, the transaction that we have concluded at the end of the quarter is very positive from a rating capital context, so that's good. And that gives us more degrees of freedom and flexibility when it comes to the growth opportunities that we have.

A - Jean-Paul Conoscente {BIO 20770277 <GO>}

This is Jean-Paul, I'll tackle the second question on the P&C business interruption claims. So, again, this relates to affirmative coverage for business interruption. The main drivers as we noted in the presentation have been an increase of the gross losses estimated by our clients, primarily coming out of the UK and France. There has been -- France doesn't have any centralized data I can refer you to, but the UK does. The FCA has published information showing both the number of claims accepted and paid by insurers as well as the amount paid. And what we see is the number of claims as well as the amount paid by insurers in the UK between the middle of March and the middle of July has more or less doubled in that timeframe. So, this has led our clients to review and revise upwards their own estimates. And then we apply those growth estimates with our own assumptions to the reinsurance treaties. And so, this is the driver between our -- behind our increase of COVID reserves.

Q - Will Hardcastle {BIO 16346311 <GO>}

Okay. So, just to follow-up, and very specific to those specific cedents and it's not something that we should consider like in the risk of extrapolation beyond those. Is that fair?

A - Jean-Paul Conoscente {BIO 20770277 <GO>}

Well, we -- that's fair. I think the markets we see were the biggest amount of litigations and I'd say the most negative development against insurers have been the UK and France. And so, other countries, I think, the development is going in line with expectation.

Q - Will Hardcastle {BIO 16346311 <GO>}

Okay, thanks.

A - Olivier Armengaud {BIO 20892984 <GO>}

Thank you. Well, we'll take the next question, please.

Operator

Our next question comes from Vinit Malhotra of Mediobanca.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes. Good afternoon, sir. Thank you. Some of my questions have been addressed. Maybe if I could just ask again about the solvency. So, from Frieder's comment, I could understand that the future claims has not changed a lot since the last quarter as I noted from previous comment, but I'm still struggling to see, was there any major model changes high single-digits that you would like to flag in some way or, I guess, versus the 1Q 232% and then the Covea settlement? I mean, I'm still struggling to see why we got only to 245% with all that put in there. So, that's my first question on Solvency II.

The second question is more about the COVID, which you have kindly addressed just now. But just on the P&C side, I mean, is the EUR58 million rather a low number as per what you would have expected? And does it suggest to you that there is actually some more buffers built in or should we interpret that the fact that you had to strengthen reserves in 2Q, means that last year the strength on the reserves wasn't very conservative. So, just any comments additionally on this paid claim ratio being so low and the general reserving [ph] confidence level for COVID will be very helpful. Thank you.

A - Frieder Knupling {BIO 17247809 <GO>}

Okay. Hi, Vinit. On your question on the solvency movements in Q2 and what brought us to the estimated level of 245%, there are a couple of one-offs, which lead to the fact that the closing estimate is below just the simple sum of the Q1 estimate and the Covea impact. First one is model changes, as we indicated in the pack. We had a couple of model changes as we always do, we constantly improve the model and this leads to sometimes positive, sometimes negative solvency impact. As it happened in Q2, the aggregate impact of the model changes was negative and a little more significant than in -- what we would have seen in previous periods, still a single-digit number in terms of solvency ratio impact, but towards the higher end of what you would have seen in the past. There was not a massive single model change, which caused this, but it's really more a combination of different changes which have more coincidentally led to this impact this quarter.

Secondly, the Covea deal has been assessed as of January 1st, which is the effective date of the treaty. And that then leads to the solvency ratio impact estimate of plus 27 percentage points, which we mentioned. The retrocession does cede a significant portion of our most interest rate sensitive business to Covea, and that includes interest rate sensitive risk capital, which we've hold for this business and also risk margin. So, as a consequence of that session, our interest rate sensitivity -- or the interest rate sensitivity of our solvency ratio has reduced due to the deal. And that means that the impact of the interest rate increases which we've seen in Q1 is then correspondingly lower. So, the impact of interest rate movements over the first six months is less -- somewhat less than what you would get if you used the sensitivities which we originally published in February and then apply the interest rate movements which we've experienced in the first six months.

And then finally, there is some impact of the COVID losses. We've, of course, taken, as I said, the P&C losses. There have been small movements on the Life side, which have also reduced solvency a little bit. And these three factors explain the big unusual movements and everything else is really pretty much in line with what you would have seen in earlier periods.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Sure, thanks.

A - Jean-Paul Conoscente {BIO 20770277 <GO>}

This is Jean-Paul. I'll try to address your second question on P&C COVID claims. I think the EUR58 million paid at the end of Q2 really reflects the complexity of the claims settlement around COVID. The -- I think when there is a clear presentation from our clients and no questions asked about how the -- these claims are aggregated, we pay them very quickly. But as you see, it's a very small number. The large number of claims remaining are first complex for the cedents to get an assessment of their own exposures. And secondly, there is more complexity about how those claims are ceded to the reinsurance treaties. So, we see these -- this ratio probably lasting until the end of the year and probably into 2022. So, the majority of our ultimate claims estimates are based on our own estimates based on information we receive from our cedents basically, it's a combination.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Sure. Thank you. Thanks.

A - Olivier Armengaud {BIO 20892984 <GO>}

Thanks, Vinit. We'll take the next question.

Operator

Next question comes from Ashik Musaddi of JP Morgan.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Yeah. Thank you, and good afternoon, everyone. Just a couple of questions I have. First of all going back to the topic around the normalized combined ratio. I mean, clearly, what you are saying at the moment is 91.2% and actually it is even better based on one comment if I understood it correctly, and that compares with 95% what you've been guiding for Quantum Leap. So -- I mean, there is a material difference between the two. And clearly, one of your comments suggested that we need to see what the pricing is going to do. But if I look at some of your statement, pricing was still strong in July, you are expecting pricing to be in the hard market next year as well. So, what is the reason you are not improving this Quantum Leap 95% to say 93%, 92%, something like that? Some color on that would be good.

And secondly just going back to the Covea thing. I mean, how should we think about annual impact on earnings at the moment? Shall we just do -- like EUR300 million is the profit you have booked, so say EUR30 million lower earnings until you redeploy the capital or would you say that that math is not right? So -- because, I mean, there will be some lead time on the capital deployment. I agree that you will give more color at the Investor Day, but still there will be some delay. So, what should be the earnings impact going forward in the short-term? Thank you.

A - Jean-Paul Conoscente {BIO 20770277 <GO>}

Thanks. This is Jean-Paul. I'll start with the question on the net combined ratio. What we -- looking at different actions we've taken over the past 18 months, we took significant underwriting actions in 2020 to reposition the portfolio to be more profitable. And in 2021, we really accelerated the growth because of what we saw as improving market conditions. As Laurent mentioned in our own pricing, we see year-on-year pricing improvement between 2020-2021 more or less resulting in at least 2 points of improvement of the loss ratio. We expected this to be earned over time. What we're seeing in the first two quarters of 2021 is both the benefits of the underwriting actions taken in 2020 as well as some of the earning of the better business in 2021. So, again, for the time being, we haven't revised our guidance. We'll come back to you on this at the IR Day, both for the rest of the year 2021 and in 2022.

A - Ian Kelly {BIO 19976646 <GO>}

And just on the second question, and the -- I'll come back to what I said earlier actually, in that the way to look at this is not about earnings dilution. The -- what we've been able to do is crystallize value now, get cash now first, cash flows that we would have had in the future. And that's the key element here, that's at the heart of this transaction. Now, we do get the capital benefit. The way I would look at this is not to start then to model downwards. We are confident that we can deploy the capital and this is not going to be dilutive. We can deploy this to enhance the earnings of the Group and we will come back with our plans there. And so, yeah, that's how we're looking at this is -- we've received this benefit of crystallizing and we shall deploy that.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Okay, that's very clear. Thank you.

A - Olivier Armengaud {BIO 20892984 <GO>}

Thank you, Ashik. We'll take the next question, please.

Operator

(Operator Instructions) Our next question comes from Thomas Fossard from HSBC.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes, good afternoon. Couple of questions on my side. The first one would be on the P&C. If I'm looking at slide 32 of the pack, when I'm looking at net earned premium, I can still see net earned premium falling by 4%, 5% compared to last year, while we are now 18 or 24 months into much better markets. So -- I mean, can you comment on why is it still the case? And actually when we should expect net earned premium to turn to a more positive or stronger number at some point?

The second question will be related again to the Covea deal and maybe to the origin of this short duration of this deal. I mean, why 30%? Why 20% of the mortality book -- of the US mortality book? Were there any more appetite from Covea and you refrained? Or -- I mean, just to better understand how the transaction has been sized up between both parties and what have been the driver to decide which was the right amount.

And maybe connected to this. I mean, to be fair with you, I'm still struggling to understand why we've got kind of a loss of 14 points of solvency if we are starting from the end of Q1, and I think the 27 points from the Covea agreement. So, let me put the question differently. If you would have potentially strengthened your balance sheet without showing too much of the number of the impact of the Covea operation, would have been this -- been possible by model changes? And at the end of the day, you're not showing too much, but ultimately the balance sheet has significantly improved and this is also where you're getting more confidence regarding your freedom for the future. Thank you.

A - Laurent Rousseau {BIO 19524847 <GO>}

So, Thomas, I'll start on the question on the net earned premium for P&C. So, the difference you see between the numbers we showed for the gross written premium and the net earned premium really relates to the earning of premium. So, if we look at 2020 earned premium, the earned premium at the first half 2020 was driven by the very strong growth in 2019, and in some effect but very little of the repositioning of the portfolio and the underwriting actions taken during the renewals in 2020. So, the -- I'd say the normal earning patterns we saw in 2020 were stronger than I'd say usual.

In 2021, what we have is a flattish renewal of the portfolio in underwriting year 2020 plus the effect of COVID where there was some premium take-downs on some lines of business, like political risk, construction, which is earned through now in 2021 and we haven't fully benefited of the underwriting increases we've achieved in underwriting year 2021. So, that explains the drop in net earned premium. We expect this to continue in 2000 -- in Q3 because the same effect will continue and we won't really start earning significant amount of premium in Q3 from underwriting year 2021. But I think from Q4 and then into the first quarter of 2022, you should really start seeing in the earned premium the effect of the premium increase that we've achieved on a written basis in underwriting year 2021.

A - Frieder Knupling {BIO 17247809 <GO>}

Okay. On your second question, Thomas, Frieder speaking. The model changes, which we've made in Q2, have nothing to do with the Covea transaction, if that was part of your question. So, they were done completely independently part of our regular maintenance of the model and now it's -- this is complete coincidence that they happened in Q2. As I said, they are more significant than what you would have seen in previous periods. And this explains a significant part of the difference between the simple sum of the Q1 ratio and the Covea impact. And then the other somewhat minor but so not insignificant movements are caused by the fact that the impact of interest rate movements and the increase in interest rates post Covea is smaller. So, we've reduced interest rate sensitivity of the solvency ratio by the session and that has led to a correspondingly lower impact on the solvency ratio of the interest rate movements in Q1, plus there were the -- there was the COVID deterioration mostly from P&C and these are the main one-offs which explain the difference between the simple sum and the ratio which we are publishing.

Is that answering your question or --?

Q - Thomas Fossard {BIO 1941215 <GO>}

Yeah, yeah. No, I fully understood. Thanks for that. If you can say a word on, Laurent, the calibration of the deal, on the appetite and why 30, and not 20 or not 40 or -- what was the appetite, what was the constraints, what was -- anything on the calibration of this transaction?

A - Paolo De Martin {BIO 15930577 <GO>}

I'll take this, this is Paolo. Hi, everybody. First of all, there was a strong willingness between the two parties to resume meaningful commercial relationships, and that was identified as one area that was beneficial to both parties. Negotiations per se are confidential. And so, going too much into the details I don't think is appropriate in this (Technical Difficulty) From our side perspective, we felt that that level of session would bring a strong rebalancing to the -- to our Life portfolio as we cede about 20% of our US mortality business. That gives us a much more balanced portfolio between the US and the remaining global franchise.

Just to note a few comments made before. I just want to underline this, this crystallizes EUR1 billion of economic value of the franchise effectively. So, I find surprising some of the comments on the dilution reinforcing what Ian said because effectively this crystallizes future cash flows into today. We know risk margin effectively. So, we thought the deal on our side was again very beneficial economically and also very strong rebalancing, and we're going to show more data on the rebalancing as we get to the Investor Day in September.

I don't know if that answers your question, Thomas?

Q - Thomas Fossard {BIO 1941215 <GO>}

Partly Paolo. Thank you.

A - Olivier Armengaud {BIO 20892984 <GO>}

Thank you, Thomas. We'll take the next question, please.

Operator

Our next question comes from James Shuck of Citi.

Q - James Shuck {BIO 3680082 <GO>}

Hi, there. Good morning, good afternoon. More questions on the capital side of things, I'm afraid. Thank you for the commitment to greater transparency, Laurent. It would be helpful to get an update on where you stand in terms of rating agency capital over that AAA level pro forma for the Covea deal, please. Because when I look at your Solvency II ratio kind of rolling it forward and think about how you manage that, it seems to me that you're going to have to periodically securitize the Life in-force book from time-to-time, so that you can increase the rating agency surplus. So, if you could just clarify your thinking around that.

And again, when I think about the exposure growth that we've seen in the first half of this year, really all of it is rate-driven rather than exposure, and yet you are alluding to the fact that you think you can grow quite strongly in P&C re. So, keen also to understand where that growth is going to come from. Whether you are actually specifically referring to exposure growth and whether that growth is going to be more than the retained earnings after the ordinary dividend? Because the -- I would have thought that it would be self-funding and therefore the stock of capital, again, just thinking about how you manage that down with the leaders you've got. And appreciate the Capital Markets Day is coming up fairly soon in September, but it's an important point to dwell on I think.

The second kind of question or area, I think, is a much shorter one. And Laurent, you alluded to flexibility when you talked about the optimal capital position. Could you just update us with your thoughts around potential M&A? And I don't think I heard the answer to Andrew's question earlier on, but how do you think about the ROI when it comes to M&A versus, say, share buybacks? Thank you.

A - Ian Kelly {BIO 19976646 <GO>}

Yeah. Hi, James. Just firstly then on the S&P impact, I mean, we maintain, as I said, an excess over AAA. We don't disclose our margins over AAA. Certainly, the transaction, as I said earlier, it was very positive on a direct S&P capital model basis. Just need to remember that the transaction took place on the last day of the quarter. So, how we now think about balancing the capital that we've received under the various measures and what impact it has as we deploy this on IFRS earnings, on our solvency, on the S&P capital, on the cash profile of the Group as we deploy that, that just takes a little bit of time. It was -- it's a complex transaction, it's very beneficial across these metrics. We just need to think through how that's going to be applied to ensure that it is accretive and that we are managing to the targets of the Group, yet within the constraints that we have. I think we -- as I said, we will come back at IR Day with more color around the approach there.

A - Laurent Rousseau {BIO 19524847 <GO>}

Jean-Paul, do you want to take on next quarter growth in P&C?

A - Jean-Paul Conoscente {BIO 20770277 <GO>}

Sure. So, I think your comments must relate to the June-July renewals, where indeed the growth is more or less in line with the price increases we've seen. And the June-July renewals are dominated by the US. In the US, the question is not so much the price increases, but more the claim inflation. And our view is that both across property and casualty, the price increases are barely keeping up with loss trend on both segments. Therefore, there's a lot of underwriting actions behind those numbers that took place in June-July, where the end result is more or less a growth in line with price increases.

If we look across the year, we are growing our reinsurance book almost 11% and 11%-plus throughout the year and we definitely did not achieve 11% rate increases. So, there is exposure growth there as well. On the specialty insurance, we've had significant growth this quarter in the finances. Our specialty insurance grows on a gross written premium basis almost 30%. And again, the average rate increases we see across different lines of business is about 15%. So, I think there is both price movement as well as exposure movement in that growth. And as we look at 2022 and review the market conditions that we expect there, I think you'll see similar projections that we anticipate in 2022.

A - Laurent Rousseau {BIO 19524847 <GO>}

On your question James on -- actually I think that's two questions, one is on the M&A environment and the other one is how do we decide to allocate capital and how do we identify opportunities inorganic ones versus organic ones. So, first of all on M&A, look, our approach here is very much the same in the sense that we do not plan on M&A in our plans and we take an opportunistic approach as and when. If you look back in history, I mean, the market is hard at the moment, and particularly on the P&C side. So, we do see a number of very attractive opportunities. We have the capital to grow. So, the addition of a franchise in such a market will actually -- would be potentially more disruptive to our ability to really focus on underwriting the business. So, we don't change our approach to M&A.

On the second point on the flexibility, how do we compare the various rates of returns? I mean, clearly, we will keep all options in mind when we look at the flexibility of deploying our capital, whether it is to invest it, I think we've already alluded to the asset risk. I think this is something as well that Francois and his teams are looking at quite closely. There is a pretty interesting number of organic opportunities, I would say. And in the way we look at capital return, this is something that we will be exploring at the other end going forward.

Q - James Shuck {BIO 3680082 <GO>}

Okay, thank you very much.

A - Olivier Armengaud {BIO 20892984 <GO>}

Thank you, James. We'll take the next question, please.

Operator

And our next question comes from Will Hardcastle of UBS.

Q - Will Hardcastle {BIO 16346311 <GO>}

Hi, there. Thanks for taking the follow-up question. Just thinking any early thoughts on European flood loss really, any comments whether it'd be industry loss expectation, your comments on that, anything we should maybe extrapolate from the Q2 European storm loss for Q3 flood loss, any high level commentary would be helpful. And secondly, I think on the solvency ratio, we know the ratio, I'm just checking if I -- is there anywhere where you published the numerator or denominator in that ratio? I guess, there's a lot of moving parts on the model change, et cetera. Any guidance to what we can have as the denominator at this point? Thanks.

A - Jean-Paul Conoscente {BIO 20770277 <GO>}

So, I'll start with the European flood question. So, yeah, as you noted, the Q2 events that we booked are the European connected storms that took place in the Czech Republic and the adjacent countries. The market loss estimates for those events, they happened at the end of June, so the estimates are very rough -- or between EUR3 billion to EUR5 billion. The European floods that took place in July will be part of the Q3 results. And there, we saw recently an estimate from the German Insurance Association of a range of 4 -- EUR5 billion to EUR6 billion just for Germany to which probably we have to add Belgium and other places. So, I'd say what you can see in Q2 is probably indicative of what we can expect for Q3 and probably the events that we have in Q3 are worse than the ones in Q2.

A - Laurent Rousseau {BIO 19524847 <GO>}

On the second question, we'll publish this in all detail at the IR Day. So, you will see the breakdown and also the full movement analysis in the assured [ph] level of detail, including the breakdown of the operating capital generation. So, you should all get this in early September.

Q - Will Hardcastle {BIO 16346311 <GO>}

Okay, thanks. This was worth a try. Cheers.

A - Olivier Armengaud {BIO 20892984 <GO>}

Thank you.

Operator

Ladies and gentlemen, this concludes today's question-and-answer session. At this time, I would like to hand the call back to speakers for any additional or closing remarks. Thank you.

A - Olivier Armengaud {BIO 20892984 <GO>}

Thank you very much for attending this conference call. The Investor Relations team remains available to pick up any further question you have, so please don't hesitate to give us a call. I wish you a good afternoon. Thank you.

Operator

This concludes today's call. Thank you for your participation. Ladies and gentlemen, you may now disconnect.