Q4 2017 Earnings Call

Company Participants

- Christian Mumenthaler, Group Chief Executive Officer
- David Cole, Group Chief Financial Officer
- Edouard Schmid, Group Chief Underwriting Officer
- Guido Fürer, Group Chief Investment Officer
- Philippe Brahin, Head-Investor Relations

Other Participants

- Andrew J. Ritchie, Analyst
- Daniel Bischof, Analyst
- Edward Morris, Analyst
- Frank Kopfinger, Analyst
- James R. Oram, Analyst
- Kamran Hossain, Analyst
- Sami Taipalus, Analyst
- Stefan Schürmann, Analyst
- Thomas Seidl, Analyst
- Vikram Gandhi, Analyst
- Vinit Malhotra, Analyst
- William Hawkins, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, good afternoon. Welcome to the Swiss Re's Annual Results 2017 Conference Call. I would like to remind you that all participants will initially be in listen-only mode and the conference is being recorded. At this time, it's my pleasure to hand over to Christian Mumenthaler, Group CEO. Please go ahead.

Christian Mumenthaler {BIO 6479864 <GO>}

Thank you much. Good morning and good afternoon, everybody, and welcome to our 2017 annual results conference call. I'm here with David Cole, our Group Chief Financial Officer; Eddie Schmid, our Group Chief Underwriting Officer, Guido Fürer, our Group Chief Investment Officer; and Philippe Brahin, our Head of Investor Relations.

Before we go to Q&A, there are several remarks I'd like to make, both on the results we reported today and on the recent developments. In early February, we informed that we're engaging in preliminary discussions with SoftBank, who approached Swiss Re regarding a potential partnership and minority investments.

We're carefully assessing the strategic and financial implications of such a partnership. There is nothing in our current discussions with SoftBank that would support the issuance of new capital. As discussions are still at an early stage with no certainty on the outcome, there are no further comments which we can make at this stage.

Turning to our annual results, 2017 was marked by a series of natural catastrophes around the globe and was, therefore, a year in which Swiss Re heavily supported its clients and their customers. In total, we expect to pay $4.7 billion in claims. Despite these events, the group reports a net income of US$331 million, reflecting the benefit of having diversified earning streams and supported by strong investment results.

The P&C Re business, segment result reflect the impact of bearing $3.7 billion of estimated large nat cat claims. The strength of our reserves remains intact and we benefit from favorable prior year development across all major lines of business. We're very pleased with the results of Life & Health Re business segment, which is continuing to show profitable growth and improved underwriting performance and strong investment results.

Corporate Solutions' result was also impacted by significant natural catastrophe losses in 2017. We'll continue to invest into the business unit, enabling the further rollout of the Primary Lead initiative, particularly as we have a positive outlook on the long-term opportunities in commercial insurance.

Life Capital generated strong gross cash of $998 million and paid a $1.1 billion dividend to the group. We're happy to have attracted MS&AD as a third-party equity investor in ReAssure, enabling us to pursue further closed book opportunities. Meanwhile, the open book business is continuing to grow dynamically. The group investment portfolio delivered a very strong ROI, supported by net realized gains from sales of equity securities. Our investment portfolio is also well-positioned to benefit from future returns.

Today, we also report the estimated outcome of the January renewals. Volumes were up 8% and were able to achieve price increases of 2%, as we remained focused on quality. I believe there's strong possibility that rates will continue to improve throughout the year. Overall, I would say, the outlook for P&C is stronger than it has been for the last four years.

Given our very strong capital position, we also announced this morning that the board will propose to the 2018 AGM a 3% increase in the regular dividend to CHF 5 per share, as well as a new share buyback program of up to CHF 1 billion. Unlike in previous years, there will be no other preconditions to the commencement of the proposed share buyback program beyond the board approval, considering our unchanged capital management priorities.

With that, I hand over to Philippe to introduce the Q&A session

Q&A

A - Philippe Brahin {BIO 19081619 <GO>}

Thank you, Christian, and good day to all of you also from my side. So as usual, before we start the Q&A, I would like to remind you to please restrict yourself to two questions each and register again if you have follow-up question. So with that, operator, could we please take the first question?

Operator

The first question is from Edward Morris from JPMorgan. Please go ahead.

Q - Edward Morris {BIO 16274236 <GO>}

Hi, everyone. Thanks for taking my questions; two please. The first is just for a bit more detail on the combined ratio guidance. I've been expecting most of the benefit from price increases to come through in 2019. So if you could just talk about how much benefit do you think is still to come in the 2019 year? And maybe if you could give us a little bit of help on reserve releases. I know you claim to reserve to best estimate, but some guidance on how much that might contribute would be helpful.

The second question relates to your over the cycle ROE targets, which, based on where U.S. rates are, is now 9.9%. Now, I understand your price quality metric is calibrated at the level to meet this target. So should we assume with your (05:24) 103% that you feel quite comfortable with that? And I notice from consensus that the ROE expectation is 8.8%. That seems like quite a large gap, so could you help, please?

A - Philippe Brahin {BIO 19081619 <GO>}

Okay. Thank you very much. Maybe, Eddie, you take the first question and maybe, David, the second one?

A - David Cole {BIO 7251632 <GO>}

Sure.

A - Philippe Brahin {BIO 19081619 <GO>}

Eddie?

A - Edouard Schmid {BIO 18942809 <GO>}

Okay. Thanks, Edward, for the question. On the combined ratio estimate for 2018, we should put at 99%. Obviously, that reflects the improvement in price quality you've seen at 101%. But as you pointed out, if you look at it on a GAAP basis, there's always a time delay to be considering. So if you, for example, look at the business we earn on the GAAP in 2018, about 50% of that is actually business we wrote in 2017. So that explains how we earn it over time and the business we wrote now, to a significant end, will be earned into 2019. So that explains the delay, and also the 99% estimate still includes business we renew later in the year. So it's hard to give a precise number, but clearly the improvements we have achieved now, they will not be fully earned this year, but they will significantly move into 2019. That's how I would summarize it.

A - Philippe Brahin {BIO 19081619 <GO>}

Right. And there was a point about reserve release, which really we don't give any estimate, as usual, nothing has changed there, when you consider combined ratio?

A - Edouard Schmid {BIO 18942809 <GO>}

No, we don't give an outlook on reserve releases. We stick to this best estimate. It's 3.3% prior year development on...

A - Philippe Brahin {BIO 19081619 <GO>}

2017?

A - Edouard Schmid {BIO 18942809 <GO>}

2017, yes.

A - Christian Mumenthaler {BIO 6479864 <GO>}

Our estimate looking forward is always on the (07:03) assumption of zero prior year developments.

Q - Edward Morris {BIO 16274236 <GO>}

Okay. Thank you.

A - David Cole {BIO 7251632 <GO>}

And now to your second question, so just referring to slide 15 of our results announcements, of course, you'll see the return on equity developments over the course of the last several years and also looking at the lower end of the page, you see the P&C Re segment that you're referring to. Over the last five or six years, we had a return on equity certainly benefiting from a number of years with relatively benign large cat losses, as well as some positive PYD of closer to 20% and even in some years above 20%, as you may recall.

Clearly, in 2017 we're significantly below that with net loss for the year. Our target of 10% to 15%, we think, still is absolutely appropriate. It's through the cycle target. We don't try to predict exactly when cycles will come or go. We don't, of course, try to predict exactly which year actual losses will be above our estimate versus below our estimate. But if you look at our results over the last several years, look at the quality of our portfolio, you look at the quality of what we have now written, and you think about it indeed on a through the cycle basis as opposed to in a moment in time basis, you're referring to a spot interest rate, then, yes, we remain comfortable that the business that we're writing will facilitate that we achieve our objectives, including the ROE target for this segment.

Q - Edward Morris {BIO 16274236 <GO>}

That's great. Thank you.

Operator

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

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

Hi, there. Two quick ones. Could you give us a sense as to what you think the average rate improvement might be in CorSo in 2018? I appreciate it's, obviously, skewed to the U.S. It's quite skewed to big ticket property. So, I guess, it would be fairly material, but just some sense as to what you think you might achieve in terms of average rate across the book as it stands?

Second question on ROI, how should I think about the outlook for the overall ROI? Clearly, it was very strong in 2017 helped by gains. Should I assume the running yield is kind of flat and, obviously, the gains I need to possibly adjust downwards, but also the changes to the U.S. GAAP could result in very substantial volatility through your P&L. Is there an intention to break out a kind of normalized ROI and/or adjust your ROE targets, given the implications of that? Thanks.

A - Philippe Brahin {BIO 19081619 <GO>}

Eddie, you took the first one, and Guido the second one.

A - Edouard Schmid {BIO 18942809 <GO>}

Yeah. Thanks, Andrew, for the question. It's really hard to give an average. As you understand, the portfolio is quite diversified. So we have clearly seen now a change in the tide for commercial pricing on the back of the large nat cats in 2017. So we clearly see significant great improvements in the U.S. and in the Caribbean, where the most of the losses has hit on property accounts, particularly on large accounts, and to a lesser extent on other lines of business. And the further away you move from U.S., the lower the impact will be. And again, there's a similar time delay also in the earnings on the Corporate Solutions side, a lot of that business will renew actually in the middle of the year. In general, it's only around 10% to 11%. So we still need to see, but clearly we will put a high focus on underwriting quality in our Corporate Solutions segment.

We will push for increases not just for property cat affected programs, particularly also on the casualty side, where we actually have pruned portfolio a bit over the last couple of years and this will continue. So we push for rate and, yeah, we're quite optimistic that we can achieve quite a bit, and this really backs up our long-term commitment into the commercial space. We have grown a lot in few years back. We now have moderated the growth the last two, three years. I think now, with the back of rate increases, we can again benefit a bit more also on the volume growth side.

A - Philippe Brahin {BIO 19081619 <GO>}

Thank you. Guido, on the outlook, ROI.

A - Guido Fürer

On the return on investment outlook, I think it's good if you quickly look from there the various sources are coming. As you've seen this year, we had just on the net investment income $3.1 billion, which corresponds to about 2.7% return on investment, and another $1.5 billion in realized gain. If you go back the last few years, there was always a good contribution from realized gain, different sources. Again, this year we had a particularly strong year on the equity side and on alternatives, which led to additional contribution. But overall, gain realization was always part of each Re's (11:38) yearly result. That's why (11:40) source differs depending what financial markets, of course, are doing. This year was particularly good on the equity side.

Running yield is the fixed income kind of forward guidance, 2.9%, we show now for two years very stable. If you look a bit what interest rates have done, they rather came up. And, of course, if the trend continues, this helps us on the new investment side. That's why running yield is clearly a good point as an input for fixed income. It's fair to say, gain realization was always a component. That's why we assumed they will still be an important piece going forward, because we manage the portfolio and if we see economic possibility to take some of the gains, of course, we do it.

Hard to predict what the year brings. But the other part of your question was the change in accounting, that means from now on all fair value change goes with the P&L. Then, of course, it impacts return on investment, and if we have a 10% correction in the market, this, of course, goes directly now into return of investment calculation.

Now, the traditional portion of the portfolio, which is basically newly affected by this accounting regime, is currently CHF 4.8 billion. That means, if you have a 10% drop, you would see an additional volatility of approximately CHF 500 million in the respective result. This gives you an idea. Important is that we look through the result, and again, such change in equity always impacted the economic position of the group. So far, many things have not flown directly to the return on investment this change in respect of equity, but from economic point of view, there's no change and just it's different presented.

Of course, we will always make the distinction, what has been related to moves, mark-to-market moves in the market and basically what has happened based on portfolio action. That information can be provided for sure. To give a guidance, as you know, you need basically a crystal ball what the equity markets are doing.

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

Just to follow-up on, it's fair to say that for Corporate Solutions at least, the average rate will be more than for the reinsurance book. Is that a fair statement?

A - Edouard Schmid {BIO 18942809 <GO>}

That's hard to differentiate. On reinsurance, you have the non-proportional side, which goes up quite significantly. Proportionally is a bit lower.

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

I mean weighted average.

A - Edouard Schmid {BIO 18942809 <GO>}

Weighted average?

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

On the weighted average, you told it is 2%.

A - Edouard Schmid {BIO 18942809 <GO>}

It's hard to say. I would need to think about it more carefully.

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

Okay.

A - Philippe Brahin {BIO 19081619 <GO>}

Thanks, Eddie. Thanks, Andrew. Next question.

Operator

The next question is from William Hawkins from KBW. Please go ahead.

Q - William Hawkins {BIO 1822411 <GO>}

Hello. Thank you very much. I'm slightly picking up on Andrew's two questions. On Corporate Solutions, given that you did have a very tough 2017, I would think it might be reasonable to expect a bit more clarity on how optimistic you are shorter term for that business. So I know you've dropped the combined ratio guidance for this year and that's sort of understandable, but sort of not.

So could you just try and be a bit clearer? You just put another $1 billion in. You've still got the 10% to 15% medium-term ROE target, but maybe we should even – on the one hand, I'd hope for payback that would be generating a greater ROE on that. On the other hand, you still think the restructuring, so maybe the environment is going to be tougher. So I'm really not clear about the earnings momentum for Corporate Solutions, so some clarity there will be helpful.

And then secondly, when we look at the great return you've done in Life Re, the 15% ROE, that's clearly smashed through your 10% to 12% targets. But again, I'm finding it kind of hard to see whether that's telling me that you are sustainably doing better returns in that business or if it's all just market noise. So, I mean, should I just assume that the 15%, say, versus 12% is just capital gains and strip that out or can we be any clearer in terms of why you've done well last year? Thank you.

A - Philippe Brahin {BIO 19081619 <GO>}

David, you want to...?

A - David Cole {BIO 7251632 <GO>}

Yes. I'll try to pick up both, and then, Eddie, if you want to complement what I say on Corporate Solutions, please do so. So, yeah, we had a tough 2017 and it was tough for two reasons. I think both of them are very visible, not really specific to Corporate Solutions, if you don't mind, I'll say it that way. Obviously, the pricing environment going into 2017 and throughout most of 2017 continue to be very strained, and that reflected in the fact that we were moderating our growth, we were pruning our portfolios, as well as, of course, the large losses that emerged, particularly in markets that we are disproportionately represented, so the North America market historically very, very large part of the overall Corporate Solutions business mix.

Now, we've been investing in this business and we've been managing this business (16:46) for many, many years. It's been spread out now, separated out as an operating model since 2012, but we have very good view of historic performance in this business. There are couple of things that we think people should bear in mind if they think about the short-term performance, and we certainly are looking at the short-term performance, but not losing sight of the long-term objective that we have.

We, obviously, continue to invest in the footprint expansion, as well as the Primary Lead capabilities. We've said to you in the past that we think that's probably in the neighborhood of between 3% and 4% of the combined ratio manifesting itself on the expense side, incremental to what we would have once, I think, we get to a little bit of a steadier state and a different scale. We've also in the past referred to this total financial contribution, which basically reflects only the development of reserves, which gets, for the moment, (17:39) investment income on those reserves, but the development of the reserves that were as part of the carve-out left behind, and we said that's also been somewhere in the neighborhood of 4% or so of PYD on the Corporate Solutions related book.

Now the reported number, as you see, over the last handful of years is 3.1%, clearly below the 10% to 15% guidance. I think if you look at it and you factor in just a few of the things I just talked about, you actually would find yourself nicely above the 10%. As we go forward, we've put the $1 billion into Corporate Solutions not to cover the losses. We're very clear about that. Corporate Solutions was adequately capitalized for all of its claims in 2017. We put the capital in because we believe that there will be interesting opportunities to ride attractive business and to show further growth going forward in Corporate Solutions.

We do expect the pricing situation not only in the loss impacted areas, but also, more broadly, if you think about some of things other significant players are now communicating regarding their views of pricing, adequacy and the need to move pricing to a more sustainable level. We do anticipate that pricing levels will continue to show a inflection point from what we have seen over the last several years. We've been down now fairly steadily since just about 2012. The degree of that decline started to moderate already a year half, two years ago. At this point – and you'll see that in the back of our presentation – our own estimate is for positive pricing moves throughout the course of 2018. As Eddie said, we'll be working very hard to achieve that. Eddie, do you want to add something?

A - Edouard Schmid {BIO 18942809 <GO>}

No, I think you have pretty much given the story. I'll just share one data point. If you look at the portfolio in core, so that was written in fourth quarter 2016 versus fourth quarter in 2017. So the fourth quarter was already benefiting from the losses, and for that portfolio we have about a 4% improving price quality, and the prices will not move in one go, but they will now gradually over the next probably 18 months gradually improve, most affected, of course, in U.S. property cat. It's the significant part of the portfolio, and then gradually also in other parts. Again, it's difficult to give an overall number, but the movement is clearly there.

A - David Cole {BIO 7251632 <GO>}

And we also saw, of course, in Australia after Debbie some very clear pricing movements there as well. Let me pick up your second question, William. So, yeah, 15% plus ROE in 2017, significantly above our 10% to 12% target. We had good underlying performance. If you look at the overall biometric side of things, you look at the actual versus our expected, actually more or less in line, maybe if you look at it in entirety a little bit better than what we would have expected, and that was then supplemented by the realized gains.

Now, the realized gains, as Guido has referred to, are really economic. They're not about managing a short-term P&L, either looking at the valuations or the various instruments particularly on the equity side or here and there where we had to, I think, reposition our portfolio as a result of statutory update to liabilities in one or two markets. We maintain the 10% to 12%. We maintain our growth outlook for that business. I think we're very comfortable that the quality of the book that we have, increasing diversified earnings streams that we have, support that outlook of 10% to 12%.

A - Philippe Brahin {BIO 19081619 <GO>}

Thanks, David. Thanks, William. Can we get the next question?

Operator

The next question is from Frank Kopfinger from Deutsche Bank. Please go ahead.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Yes, good afternoon. I have two questions. So my first question is on the buyback. So you adjusted the conditionality on the buyback, but you haven't been precise when you really want to start. Can we assume that you start right after the AGM, given that the board will decide to do so? And then secondly on the topic of Life Capital, obviously, there is some news flow today with the Phoenix deal. Do you see that this has any impact on your business and strategy going forward?

A - David Cole {BIO 7251632 <GO>}

Thanks, Frank. So the buyback, yeah, so number one, I think the announcements today around capital twofold, both the increase in the dividend, as well as the intention to request authorization for new share buyback, really underline our statement regarding the capital position of the firm, which remains comfortably above our target. The change in approach, change in communication, I think, is reflective of couple of things. Number one, this is not the first year we do; we now have three years under the belt. We see how the market has responded. We also have, of course, seen in years what's relatively low nat cat losses, as well as in 2017 clearly more significant, well above expectation in terms of losses.

I think we've tried to listen to feedback (20:44) and we came to the conclusion that we could be a little clear with the market at this point in time that the capital position of the firm is strong. We would do away with that conditionality regarding waiting to see what happens with third quarter windstorm in North America. The actual timing of the launch is really at the discretion of the board. It could happen at any time subsequent to the authorization to be given at the AGM with the intent of, of course, having it concluded in advance of the next AGM in April 2019.

But the board would want to look at the specific circumstances and determine exactly what the right moment may be and how to go about the implementation. But it's quite clear we've stepped away from that precondition, and I think we're signaling to the market that the capital position of the firm is comfortably above our targets and therefore, we think it's appropriate to get authorization and change the communication. I think on the second question, I will ask Christian if he want to respond.

A - Christian Mumenthaler {BIO 6479864 <GO>}

Happy to respond. So we're not surprised, because we see a very active market right now in the UK. Obviously, you have to pick your battles, because every one of these deals is a significant work in consolidating on our platform. So this year, we focused on the L&G transaction, which was also ideal in terms of size compared to the investment that MS&AD was prepared to deliver, plus L&G is an excellent client of ours. So I think the only thing it shows is there's a lot of activity going on in the UK market right now, that the solution itself is well-recognized, and it's probably where things will go. And so I take it as a positive.

A - Philippe Brahin {BIO 19081619 <GO>}

Thank you, Christian. Thank you, Frank. Can we get the next question please?

Operator

The next question is from Kamran Hossain from RBC. Please go ahead.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi. Afternoon, everyone. Three questions. The first one, just coming back to Corporate Solutions, I guess, following the losses in 2017, could you talk us through how your protections for Corporate Solutions for the reinsurance cover there, et cetera, has changed going into 2018? So that was the first question.

And the second question is, I'm kind of with you on the pricing. I think I'm a believer in the fact that pricing will improve throughout the remainder of the year. I guess, well, the best thing is there's this massive pool of capital out there waiting to deploy. We heard from one of your peers yesterday that in some cat bond funds, they had kind of soft closes, that still 25% in cash not fully invested. What's the argument back to that, prices versus too much capital still in the industry? Any color or thoughts would be really helpful. Thank you.

A - Philippe Brahin {BIO 19081619 <GO>}

All right. Thank you, Kamran. Maybe I hand over to Eddie and then Christian (25:41).

A - Edouard Schmid {BIO 18942809 <GO>}

The first one, yes – thanks – on the CorSo reinsurance protection, so it's fair to say that CorSo loss is a bit higher than with peers, because, again, there is a significant part of the business in the U.S. So it is also more problem to cat exposure, and we intentionally only bought really severity-driven protection in the past. We consciously accepted the higher volatility, because we can really carry at on the overall balance sheet. But we review, of course, the region's protection on an annual basis and into 2018 we actually decided to lower detection point, so the protection attach is a little bit quicker and also we added a so-called added cover, so also second and third events will be covered in a year similar to what we've seen in 2017 with a series of, let's say, medium sized cat events. So CorSo into 2018 is better protected, so the volatility is dampened (26:41) should something similar happen again.

A - Philippe Brahin {BIO 19081619 <GO>}

Thank you, Eddie. On pricing and (26:46) capital moving.

A - Christian Mumenthaler {BIO 6479864 <GO>}

I'm happy to take that question, right, even though that probably would take a long time to go through all the different aspects here. In our view, long term we think some of that capital will stay in the natural catastrophe field, because that's a natural place to be, and reinsurance has been scarce there for decades. And there's still a huge protection gap, so over time you think capital market has to play a big role here. So I certainly think that alternative capacity will stay, either in form of cap ons (27:21), which is a bit more limited and hard to do, or in form of actually reinsurance, collateralized reinsurance.

I have to say that these price levels, when we calculate it, I'm afraid there's a little aspect of what we saw in the financial crisis, a decoupling of people who understand the risk and people who take the risk. There has been a period where not much has happened, and so some of the returns look good. But I'm not sure that everybody in the capital market value chain is completely aware of where prices are, because in contrast to us, they don't have diversified capital and they have to completely collateralize it. So I have a little doubt here whether we're not in non-sustainable territory right now. But I leave it at that.

I think the implication is that, certainly, overall in the nat cat field, which historically has been a big driver of profits, you would see some capping of how far prices can go up. All the other lines I think through that will get under pressure, because reinsurers still need to make profits. They still need to earn cost of equity, and they need to be active in all these other lines, which cannot be taken by this capital.

So there's overall from the reinsurance side, but also on the primary side, a push for higher rates, which doesn't uniquely come from this capital that is just there for the cut at the end. So you can clearly see that, for example, the big CorSo-type players in the U.S., they all push for higher prices, and that's independent of alternative capacity, because they know their value chain, their piece of the value chain needs higher rates.

So, in other words, I don't think, no matter how long this goes (28:58), that completely unsustainable rates for the whole value chain will be borne. So I think prices have to go up. But it's clear that on medium to long term, there is a dampening effect on this sub-line of business coming from this alternative capacity.

A - Edouard Schmid {BIO 18942809 <GO>}

Let me just add. If you look at all the alternative capital, which is about $80 billion, that's still heavily focused only on U.S. cat, because that's really the outstanding peak parried on the global basis, and it's really hard to imagine how this capital can also be efficiently employed in other lines of business and the markets where diversification of global balance sheet is a major competitive advantage. But for the U.S., which is really a huge peak in the global risk landscape, there alternative capital actually has a role to play.

A - Philippe Brahin {BIO 19081619 <GO>}

All right. Thanks, Kamran, for your questions. Next question, please.

Operator

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

Q - Vinit Malhotra {BIO 16184491 <GO>}

Hello. Good afternoon. Sorry for following-up a bit on the CorSo. I was more curious on another number in the CorSo, which was quite tough in 2017, which is the PYD. Just in second half, it seems to be $144 million odd from what I understand from 2015 accident year. I know you guide for a 0% going forward, but because these numbers are quite material, David, would you mind just highlighting how we should think about CorSo PYD from these prior year casualty kind of losses going forward? So that's the first question.

And just the second question is more, how do we understand this renewals disclosure this time, because this obviously is second year you've excluded the large transaction. So the way I see it was last year up for renewal was $8.5 billion and you have renewed $8.1 million. Is that not the right way to do it and why not would you say that is the right way to think of this renewal? Thank you.

A - Philippe Brahin {BIO 19081619 <GO>}

Thanks. I'll turn to Eddie and possibly Christian as well.

A - Edouard Schmid {BIO 18942809 <GO>}

I will take the first question on the CorSo PYD development. Yeah, for 2017, it's 7.8% prior year development. Actually, with the overall reserve base, we feel very comfortable how this stands. The maturity of this can really be put down to two individual large losses. So there were couple of old nat cat losses that developed to some extent, one in New Zealand, another one from an older U.S. hurricane. But the most development actually we've seen from some larger U.S. liability losses goes back to accident year 2005, and these are really just in the nature of that business.

So until liability is really assigned to a party, it goes to several instances in the U.S court systems, where it took couple of years until the final liability was assigned, and then with CorSo playing mainly on an excess layer basis, it's just time delays. I would say this is really linked to these several large liability losses that explains the large part of the 7.8%. And it goes little bit back to what I explained earlier that CorSo has taken quite cautious approach on U.S. casualty business. So they started to prune a bit, particularly umbrella business.

We actually still maintain a fairly cautious view, particularly on large commercial risk exposed to liability that this underwriting actions start to take benefit. But, obviously, with the time lag, it took a bit of time to construe. So I really would describe this as a one-off based on the several losses and not as a more broader thing in the reserve base of Corporate Solutions.

A - Philippe Brahin {BIO 19081619 <GO>}

Thanks, Eddie. Christian, on the renewal...

A - Christian Mumenthaler {BIO 6479864 <GO>}

Yeah. On the renewal disclosure, that's always a bit of a pain point, because, as you can see, everybody does something different. And I would certainly welcome some standards that we could all make it more comparable with, but that's not the case today. So we tried to make something that makes sense from our perspective. And the way we report, and I think the same last year, is we try to determine all the pieces of business that will be replaced in the market, so that's the definition of up for renewal and then see, can we renew those or at new volume compared to that.

There's always piece of business that were renewed last year, that's not renewed this year. If it's a two-year deal, a three-year deal, if it's a one-off large transaction by somebody, is not placed again, this can drop. So it's hard to reconcile back to last year, but basically before the renewal, we make a bottom-up list of things that are up for renewal, and then we look and that's a definition. So if a large transaction is not renewed, then we know that it's not going to be part of that, and then we compared what we actually achieved compared to that.

I'm aware there's different ways you could do it, but that sort of makes sense from a managerial point of view, because why would you add things you know is not going to be renewed to that number, but you could. And it's not an exact science. I think the other thing that I think you all keenly aware is that, the correlation between top line and bottom line is extremely weak in reinsurance, which makes it really hard to compare notes. So you can have a piece of business with very little volume and is huge margin, you can have – in particularly the large quota shares typically are very, very thin margins. So the volume doesn't tell you much about the actual profitability business, if you don't combine it with combined ratio or something like that.

A - Philippe Brahin {BIO 19081619 <GO>}

All right, thanks. Vinit, thanks. Next question, please.

Operator

The next question is from Daniel Bischof, Baader Helvea. Please go ahead.

Q - Daniel Bischof {BIO 17407166 <GO>}

Thanks and good afternoon. The first question is on Life Capital, I would be interested to know how we think about the 6% to 8% ROE target longer term. And I appreciate there's still a significant amount of unrealized gains, but I guess after the L&G and Guardian deal, probably more than 40% of policies are now from these two transactions, whereas the old, less profitable business is running off, and then it is on top the growing open book business and presumably that's all priced (35:16) 11%.

Then the second one, on the U.S. tax reform, I may have missed it. Other than the 2017 impact, could you tell us how this will impact the structure of your reinsurance and CorSo business and which tax rate we should assume for 2018 and also for the mid to long-term?

A - Philippe Brahin {BIO 19081619 <GO>}

All right. Thank you, Daniel. Turn to David.

A - David Cole {BIO 7251632 <GO>}

Thank you, Daniel. So, yeah, Life Capital, we have the 6% to 8% medium-term target and the business unit is really comprised of two different underlying activities, the closed life book, which I think is getting closer and closer to that 6% to 8% target as a result of some of the transactions that we have previously disclosed. You're well aware of those. That, obviously, is coming through as we fully integrate those activities and we will continue to average up the ROE of that business.

And to be very clear, why was that business stuck with such a low ROE? It wasn't because the performance of the policies was completely different than what we expected. It was because in previous years, there really was a harvesting of the income on the investment portfolio side, which was then difficult to replace. So we've decided that we're going to manage that business incredibly efficiently, bring it to a highly effective scalable platform, and then average that ROE up by writing attractive new transactions, which is exactly the path we've been following.

And the second activity within this unit, of course, is the open book business, and I think everyone is aware, that business is, on the one hand, small, but growing. Here, the more successful you are, the more impact it has on the negative contents in the first handful of years on the reported ROE. So we're writing what we believe are very attractive transactions, continuing to build volume on those platforms. But the reality is that in the short term, of course, that has a negative pull on the reported ROE. And then you yourself, I think, correctly pointed out, we still have these unrealized gains and on a shareholder equity base for about $7 billion, roughly a third of that, or $2 billion or so, is actually unrealized gains. And we're not to complaining about it. We just recognize it for what it is. As and when we write additional new transactions, acquire new portfolios on the closed side, as and when we get to a certain scale on the open side, and as and when interest rates will go up, it wouldn't surprise me to see this ROE move very quickly up into the – and perhaps at some point in the future, beyond up into the target range. It really is a medium-term target, just to be clear, and that was what it was when we originally articulated it some time ago.

To your second question, so the tax reform in the United States, as you've all seen, it had a net benefit of about $93 million for us, basically reflecting the fact that, although we were relatively balanced deferred tax asset, deferred tax liability, the net impact of the reduction in the corporate tax rate from 35% to 21% in the U.S., given the fact we had slightly larger deferred tax liabilities, was a net positive impact in 2017 of $93 million.

Going forward, it's quite clear that we, as well as others, will be looking at the new rules, first and foremost, to make sure we really understand how they're going to be interpreted and applied. There's also the possibility there may be some as yet technical corrections during the course of the, year so that's something that we, obviously, are following very closely. And as we always do with our business, we look to see how do we best optimize across the group, taking advantage of diversification, taking advantage of liquidity across the group to ensure that we get a good outcome.

Now, we've never been a firm that in the past has taken advantage of low tax locations. We certainly have used Switzerland as our home base, but with a statutory rate of 21%, I don't think it falls into the same bucket of some other places that have been the target with some of the attention in the United States. So we don't have to go in and address those types of situations, where we're bringing things into very low tax rate jurisdictions. But we want to look at our overall capital levels. We'll look at our internal group retrocession. We'll look at financial flows across the various entities.

Let me get to the heart of your question, because you asked for a forward-looking view of overall tax rate. And I'll just recall what I just said about the Swiss rate 21%, at this point in time the U.S. rate has gone down to 21% as of January 1 and going forward. I think for the Swiss Re Group as a whole, we would say something between 19% and 21% is probably about the right number in terms of forward-looking assumptions.

A - Philippe Brahin {BIO 19081619 <GO>}

Thanks, David. Thanks, Daniel. Next question, please.

Operator

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

Q - Stefan Schürmann

Yes, hello. Two questions. First one coming back to renewals, you had a nice 8% growth. Can you maybe give us some more color how much of large transaction were included there, and maybe also how much of large transactions renewing outside these renewals and maybe adding to growth going forward?

Then the second one on claims inflation, just generally your expectations in terms of claims inflation, maybe based on the on the major markets like U.S., UK, and then Europe.

A - Philippe Brahin {BIO 19081619 <GO>}

Eddie, I'm turning to you again for these two questions.

A - Edouard Schmid {BIO 18942809 <GO>}

Yeah. Thanks, Stefan. So you asked the 8% in terms of where this comes from. So I think it's broader base, so there's normal business that we deployed a bit more capital, but there is also a number of large transactions, cannot name the individual ones, but there were several ones, I would say quite a bit of them in Asia, but also in the U.S. If I reflect back on the P&C side, in 2017 about 28% of the bottom line actually comes from large transactions, so you see it's a significant contribution. But it's always a bit lumpy and when during the year they happen, it's hard to predict. So it contributes, again, to the growth, but I couldn't give you a clear breakdown. But they play a role again also in the renewal numbers 2018.

A - Philippe Brahin {BIO 19081619 <GO>}

And maybe, Eddie, on claims inflation, U.S., Europe, what we observe?

A - Edouard Schmid {BIO 18942809 <GO>}

So inflation is clearly a bit higher on our radar, but actually we always observe it very carefully, as obviously is a key underwriting consideration for our longer tail businesses. When we set our costing parameters, we always take the latest forecast, not just for CPI, but really the claims inflation on medical cost, on wage cost. So that's definitely reflected in the way we cost the business.

A - Philippe Brahin {BIO 19081619 <GO>}

All right. Thanks, Eddie. Thanks, Stefan. Next question, please.

Operator

The next question is from Sami Taipalus from Goldman Sachs. Please go ahead.

Q - Sami Taipalus {BIO 17452234 <GO>}

Hi. Afternoon, everyone. Just two. So on the Life Capital first, you, obviously, had quite strong cash generation there and you've reached a target on the cash generation. Are you going to provide an update on a new cash generation target there at any point or how should we think about the cash generation here going forward?

And then the second question is on the renewals. Is it possible to just break out the movement in price quality between the rate, expenses, and interest rates? Thanks.

A - Philippe Brahin {BIO 19081619 <GO>}

Thanks, Sami. David, on Life Capital cash generation?

A - David Cole {BIO 7251632 <GO>}

Yeah. Indeed, we've had a wonderful, I think, delivery during both 2016, as well as 2017. So I think most of you picked up that at this point we say we're basically at $1.7 billion of gross cash generation over those two years, more or less in line with what we said the target would be for 2016 through 2018. Now, obviously, we're just at the beginning of 2018; two things. Yes, I do believe we'll come during the course of 2018 with an update to that figure looking forward. I think it would be also appropriate to say that we've been very pleased with the level of cash generation coming out of the closed life books, are pretty much in line with our expectations, and that's clearly something that we would expect to continue to see going forward. As also Christian indicated, we'll continue to be looking for opportunities to invest in that business. So short answer is that, I anticipate that during the course of 2018, we'll come back with some sort of communication regarding the periods going forward.

A - Philippe Brahin {BIO 19081619 <GO>}

Eddie, on renewals, again maybe also breakdown...

A - Edouard Schmid {BIO 18942809 <GO>}

Yeah, the question on the composition of the price increase, so overall we see a 2% improvement. I would say the majority is really quality improvements or really premium we get for the exposure we take on board. I can also split it down a bit more on the non-proportional side, which is cat business non-proportional business that we see more something like 6%, so that's real quality improvement, proportionally is a bit less than 1%.

Expenses I wouldn't say is a significant factor and you also point correctly to the interest rate. So our measure is an economic one, so the cash flows are discounted. But out of the two, I cannot give you a precise number, but it's a small part of that 2%, but it's contributing to the improvement, that's fair to say.

A - Philippe Brahin {BIO 19081619 <GO>}

Thanks, Eddie. Thanks, Sami. Next question, please.

Operator

The next question comes from Thomas Seidl from Bernstein. Please go ahead.

Q - Thomas Seidl {BIO 17755912 <GO>}

Good afternoon. First question on the casualty line of business in both reinsurance and in CorSo, we increased volume by some 30% in 2014, if I'm not mistaken, and quite similar in both segments, the combined ratio went up 20 percentage points to quite unsustainable level for different reasons, like reserve increase, asbestos, and what have you. My question is, could you share a little bit of postmortem, what went wrong during this period? And also going forward, what - what are you going to do other than quite marginal pruning you have done so far to correct the situation there? That's the first question.

And second on tax, you outlined the future tax rate. I also looked at the - in the risk section of your report you mention three items, changes to operating model, increased cost also related to different capital requirements, and thirdly, reduced access to liquidity. I wonder if you could comment on those three items, how that might impact Swiss Re going forward.

A - Philippe Brahin {BIO 19081619 <GO>}

All right. Thanks, Thomas. On casualty, Eddie.

A - Edouard Schmid {BIO 18942809 <GO>}

Yeah. First one on the casualty book, which you correctly reflect, few years ago we have grown the casualty business quite a bit, because actually we came out of a position where we were clearly underweight on casualty and we still saw opportunities, particularly on large transactions.

I think where we have really seen some adverse development is a particular case of U.S. motor business, which is not a Swiss Re specific issue. Actually, the whole market has suffered quite a bit, with more frequent driving again, un-experienced (46:36) driver, distracted driving. So the loss frequency and severity has increased a lot, and we were also affected by that. I think that explains a significant part of the performance we're not happy with, but it's fair to say that market overall in the U.S., but also what we did on the Reinsurance side, as well on the CorSo side, now see significant improvement. So rates are going up in this segment.

Also besides motor, on U.S. liability, we see now some movement. Also if I reflect on the 01/01 renewals, it's not just the cats affected business that has significantly improved in quality. It's particularly also the casualty lines, so U.S. motor, but also European motor, and U.S. liability has improved in price quality. So we are now at a much better level. But we also keep monitoring the cas (47:29) lines very carefully, because the loss trends we really need to be on top of and adjust accordingly.

A - David Cole {BIO 7251632 <GO>}

Thomas, I'll come back to your question on tax. I guess, the three things you listed right out of our report are not surprising enough in and of themselves. We operate in many different jurisdictions and, as you know, have done for 150-plus years. We're always confronted with changes in local rules and we look, of course, across organizations to say how do we best wish to respond.

And likewise, I think it's important to point out that we're not alone in this and looking at these changes now in the U.S., but many of our customers are also thinking about what it means for them. So we just wanted to point out that there are changes in the world. If we did nothing, it could potentially have a negative impact on our operations. It wouldn't surprise you to know that we're actively looking to see how best we can respond and make sure that we continue to optimize across the group.

I guess, little feeling for you. There's a possibility that we'll leave with a little bit more risk behind in the U.S. as opposed to moving it across through IGRs that may bring with it additional capital and liquidity requirements. But it's early days. We have a number of different initiatives that we're thinking at. We're going to wait to see exactly how the rules are finalized, guidance given around some of the technical aspects of the rules, and as and when we have clarity about that, we will, I think, make appropriate adjustments.

A - Philippe Brahin {BIO 19081619 <GO>}

Thanks, David. Thanks, Thomas, for your questions. Next question, please.

Operator

The next question is from James Oram from Citigroup. Please go ahead.

Q - James R. Oram {BIO 19736003 <GO>}

Hi good afternoon. I've just got one question left please, if I may. If I look at the Life & Health Re balance sheet, both sides seem to have increased quite significantly by about $7 billion since the first half, driven mainly by Reinsurance assets and liabilities. Is there a new retrocession agreement with Life Capital or something? Because the intergroup consolidation adjustments have also gone up as well. And if so, how is this likely to impact Life & Health Re's financials or is there something else going on there that I've missed completely?

A - Philippe Brahin {BIO 19081619 <GO>}

Thank you, James.

A - David Cole {BIO 7251632 <GO>}

James, if you'll give me just a second, I'll come back to it. We won't forget about it, I'll come back to it in just a second and make sure I get a good answer for you. Thanks.

A - Philippe Brahin {BIO 19081619 <GO>}

Well, we park this one for now, James. Next question, please.

Operator

The next question is from Vikram Gandhi from Société Générale. Please go ahead.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Hi. Good afternoon, everybody. Thank you for taking my questions. I'm afraid both my questions relate to CorSo. First of all, how do you see the pricing environment developing in primary versus excess markets? The group is actively focusing on being the Primary Lead, but that is what some others are also doing, Talanx, for example. So just wondered if that space is already getting crowded, and also the reasons why pricing should be better in one versus the other.

And secondly, I just wanted to ask what's the magic around the 0.9 percentage points improvement in CorSo admin expense ratio, when you have continuously invested in business expansion, while also maintaining that investment in growth represents 3% to 4% of your combined ratio. Thank you.

A - Philippe Brahin {BIO 19081619 <GO>}

Okay. Thanks, Vikram. Eddie, maybe on the primary business.

A - Edouard Schmid {BIO 18942809 <GO>}

I will take the first ones regarding, let's say, difference in pricing movement from excess layer business versus more Primary Lead business. If you look at the picture over a number of years, the segment where CorSo was most strong is the large corporate excess layer business and that's by the nature more volatile, not just from a loss perspective, also in terms of price changes. The mid-markets, the smaller risk, they are quite more stable. So that the price trends over the last two years were more moderate in this Primary Lead business. If it now comes to positive price momentum, it's fair to say that we would also expect more increases in the volatile high excess layer business that has also been hit by some losses and a bit slower in the primary business. So clearly, there's a difference, but it's hard to give a number how big that difference is.

A - Philippe Brahin {BIO 19081619 <GO>}

All right. Thank you. And on the admin expense ratio is due to higher premium earned, that's the background, Vikram.

A - David Cole {BIO 7251632 <GO>}

And if I may, James, I'll come back to your question. I just wanted to check and make sure I gave you a complete answer, because you were basically in the right direction here. So that really is related to a couple of different business shifts across the group. The two that I'll point out is the primary drivers of those changes, where the IGRing (52:16) of our group life business, elips, out of the Life & Health Re balance sheet, as well as we moved some of the non-Asian business out of this new Asian entity that we launched. We actually moved it from Switzerland to Singapore. It's a very complex story. I'll try to save you all the details, but basically there was a business shift of non-Asia business out of that entity that we have also executed during Q4 of 2017. So it really was driven by some internal shift across Life Capital and Life & Health Re.

A - Philippe Brahin {BIO 19081619 <GO>}

Thank. Thanks, David. So, James, that was the answer. Thanks also, Vikram. Next question, please.

Operator

The next question is a follow-up from Mr. Ritchie. Please go ahead.

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

Hi there. Just a very quick follow-up. First of all, you mentioned that CorSo has bought more reinsurance. Just to clarify, I'm assuming that's intergroup, not third-party reinsurance.

And then the other question just on Life Capital, can you give us what the losses are for the open books business? I'm assuming it's in that loss position, given new business strains what that number is. And also in relation to Life Capital, the cash generation has normally been a good forward indicator for dividend payments, which obviously you extract in the first quarter of the subsequent year.

I guess, I'm a bit confused as to how to think about dividends from Life Capital now, because you actually raised capital in Q1 in effect by MS&AD contributing a capital increase to fund the L&G deal. But at the same time the cash generation is very strong and presumably you still want to pay a substantial dividend. So maybe just clarify the guidance on dividend policy of Life Capital now. Thanks

A - Philippe Brahin {BIO 19081619 <GO>}

Right, Andrew, that was almost three questions, but it's all right.

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

Sorry.

A - Edouard Schmid {BIO 18942809 <GO>}

Thanks, Andrew. I'll take the first one on the CorSo reinsurance protection, and you're right, that still the majority is internal, so it's ceded to the reinsurance balance sheet. So with the margins healthy in that business, we definitely want to keep that margin within the group. So as in the past, there is some external, but the bulk is ceded from CorSo to reinsurance.

A - David Cole {BIO 7251632 <GO>}

And, Andrew, thanks for your questions about Life Capital. So you're right, the open book business is bringing some drain with it, earnings drain as we build it up. We haven't disclosed those numbers, but certainly at some point in the future we will. But at this point, I'll just confirm that indeed it is a negative drag on ROE for the unit as a whole. And to your comment about cash generation, absolutely, the cash generation here has been fantastic. One small correction, we typically get dividend out of Corporate Solutions in reinsurance in the course of Q1, but in Life Capital it's typically is during the course of Q2, because we have a little bit of additional regulatory discussion to go through.

So just not to be disappointed, if you don't see something in Q1, but certainly in Q2 of 2018, I would expect another healthy dividend coming out, amongst others, reflecting the transactions that you referred to, but also just a good ongoing cash generation coming off of that business. So, yeah, I believe that it's quite important that we maintain good discipline around expectations in that business and see a steady state of dividends coming up. We do continue to invest in the business, investing in from time-to-time large blocks, of course, as well as investing in the open book business. So, yeah, dividends, certainly I'm always happy to see the dividends from Life Capital and in terms of timing, more Q2 as opposed to Q1.

<<[0FV92N-E Philippe Brahin]??

Well, thank you, David. Thank you. So we have come to the end of our Q&A session. So thank you very much all of you for joining today. Don't hesitate to reach out to any member of the IR team if you have follow-up questions and we very much look forward to seeing many of you in Zurich on the 4th of April, where we will have our Investor Day. Thank you.

Operator

Thank you for your participation. Ladies and gentlemen, you may now disconnect.