Q2 2018 Earnings Call

Company Participants

- Paul Norton, Chief Financial Officer
- Philipp Gmür, Chief Executive Officer
- Ralph-Thomas Honegger, Chief Investment Officer

Other Participants

- Daniel Bischof, Analyst
- Peter D. Eliot, Analyst
- René Locher, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, good morning. Welcome to the Half-Year 2018 Results Conference Call and Live Webcast. I'm Sarah, the Chorus Call operator. I would like to remind you that all participants will be in listen-only mode, and the conference is being recorded. After the presentation, there will be a Q&A session. The conference must not be recorded for publication or broadcast.

At this time, it's my pleasure to hand over to Mr. Philipp Gmür, Group CEO. Please go ahead, sir.

Philipp Gmür

Thank you, madam. Ladies and gentlemen, welcome to our conference call and the results of the first half of 2018. Within the next 45 minutes, we would like to give you detailed information on our business development and the key financials of the reporting period. We proceed as every year. Following my introduction, our CFO, Paul Norton, will go through the financial figures. And after my summary at the end of the presentation, Paul and I, as well as our Chief Investment Officer, Ralph Honegger, will be pleased to answer your questions as always.

Let me turn to slide 4. On slide 4, I would like to share with you a brief overview of the main performance indicators. Paul will give you detailed information on the developments of these figures later on. In view of the challenging environment, we can look back on the resilient key performance indicators in the first half of 2018. We achieved a solid result despite headwinds from the capital markets and losses from bad weather. Growth, combined ratio in non-life and new business margin in life business are developing in line with our strategy.

In the first half of 2018, we achieved a business volume at group level of roughly CHF 5.8 billion compared to the first half of 2017 of CHF 5.5 billion. On a currency adjusted basis, this represents an increase of 2.9%. The main growth driver was non-life business, which achieved higher premiums of 5.5% year-on-year. The European units, which are back on growth track after the portfolio restructurings as well as Active Reinsurance, significantly contributed to the pleasing growth.

In life business, volume increased by 0.8% in original currency. This was mainly driven by higher volumes in investment-linked products in Switzerland and Germany. At CHF 224 million, the IFRS result after-tax was above the IFRS result of CHF 210 million for the same period in 2017, but below the respective underlying earnings of CHF 258 million. The main reason for this was the weaker performance of the stock markets in particular, which was reflected in both non-life and life business.

In non-life business, the quality of the portfolio remains good overall as reflected by the solid net combined ratio of 92.7%, yet a higher number of bad weather events in Germany and Switzerland had a negative impact. The factors just mentioned above naturally also weighed on the results of the segments, Switzerland and Europe, which therefore lagged behind the previous year. The development at Specialty Markets, however, has to be positively emphasized. Driven by strong technical results in France and in Active Reinsurance, we were able to increase earnings by 12.7%.

I am also pleased with the development of new business in life. The new business margin rose compared to the first half of 2017 and now stands at 1.4% compared to 1.2% in the previous year. One driver was the higher new business volume in capital-light, investment-linked insurance solutions. On the other hand, the product adjustments made in traditional saving products also had a positive effect.

Both in terms of combined ratio and new business margin, we continue to meet our targets for the current strategic period. Helvetia continues to have a solid capital base and a strong dividend capacity.

With that, I would like to turn over the presentation to our CFO, Paul Norton, who will now provide you with the most important information about the financial figures.

Paul Norton {BIO 16145125 <GO>}

Thank you, Philipp. Ladies and gentlemen, I'd also like to welcome you to this conference call. Within the next 25 minutes, I'll give you more detailed information on our financial performance in the first half of the 2018 financial year.

I'd like to start with slide 6. Before we look at the figures in detail, I would like to briefly explain that following the successful completion of integrations, we will no longer report underlying earnings. I would like to point out we are comparing with 2018 IFRS reported results with the 2017 half year underlying results. This is because the 2018 half year reported financial statements are comparable with the previous half year's underlying financial statements except for one item. The amortization of bonds, which we eliminated from the underlying results, will continue for several years as the bonds come to maturity, but the amounts will gradually reduce over the years. This accounting adjustment reduces the current half year reported results by CHF 8 million.

We achieved a solid IFRS result of CHF 224 million against underlying earnings of CHF 258 million in the first half of 2017. As I mentioned above, the IFRS result in the first half of 2018 was reduced by CHF 8 million due to the ongoing bond amortization, which is purely an accounting effect from the acquisitions.

Let's turn to slide 7 with more details on the business areas. In the non-life business, IFRS earnings amounted to CHF 147 million against CHF 177 million underlying earnings in the first half of 2017. The decrease was mainly driven by a significantly lower investment result because the weak and volatile development of the equity markets. We will have a closer look on the non-life profit by sources in a few minutes on slide 10. IFRS earnings of the life business stood at CHF 78 million, almost half the reduction compared to the previous year's figure is due to the bond amortization I mentioned above, included in the reporting period, which is purely an accounting effect.

In addition to a number of other effects, the weak stock markets also had an impact here. I will provide you with more details on the profit by sources on slide 12. The result from other activities, which includes the Corporate Center and the non-insurance activities of Market Unit Switzerland, such as MoneyPark and Defferrard & Lanz, however, increased compared with the first half of 2017. The rise can be attributed to consolidation effects from the funds included in this segment. The result also benefited from good and stable technical results in group internal reinsurance.

Let's turn to the segment results on slide 8. All segments delivered good results despite the impact of the poor equity markets. In the Switzerland segment, the IFRS result for the first half year was CHF 151 million. This includes a total of CHF 7.2 million of bond amortization, net of tax and policyholder effect, which impacted the life result in particular. The non-life and the life results were lower than the previous year, mainly due to poorer investment results in both areas following the weak performance of stock markets.

In the non-life business, the result was additionally burdened by a high number of weather-related events. In the life business, the operating result was lower due to declining yields and a lower death result, which could not be fully compensated by the improved stability result. The lower gains and losses from investments mentioned above were partly offset by lower expenses for policyholder participation and lower expenses for interest-related reserve strengthening.

The segment result for Europe, which comprises the market units of Germany, Italy, Spain and Austria, amounts to CHF 55 million against CHF 59 million underlying earnings in the first half of 2017. The non-life result improved compared to the previous year. The increase is attributable to a positive tax effect whereas technical results are weaker mainly due to higher weather-related claims predominately in Germany. The life result decreased compared to previous year because of lower gains and losses on investments and higher expenses for interest-related reserve strengthening, the regulatory mandated ZZR in Germany.

The segment result for Specialty Markets increased to CHF 16 million. The improvement was due to better technical results in France and following higher volumes and also better technical results, higher volumes in the Active Reinsurance. Specialty Lines Swiss and International reported stable technical results.

The Corporate segment includes the corporate functions and Group Reinsurance, in addition to the financing companies and the holding company. Its result of CHF 2 million rose against the previous figures of minus CHF 9 million. This was due to positive consolidation effects from the funds allocated to this segment. In addition, the result benefited from stable technical result of the group's internal reinsurance.

I will continue with our growth in business volume on slide 9. In the first half of the 2018 financial year, Helvetia Group achieved a business volume of CHF 5.8 billion. This equates to a currency-adjusted increase of 2.9% over the previous year.

In the non-life business, we achieved an increase in premium volume of 5.5% in original currency. The growth was driven by the European entities, which are back on track following the portfolio restructurings in the past as well as Active Reinsurance being in line with our strategy.

In the life business, business volume rose by 0.8% in original currency. The increase was mainly driven by a very good development of investment-linked products in Switzerland and Germany. Helvetia also recorded growth again in the Group life business.

Looking at the individual segments, business volume in Switzerland rose by 0.9%. In the non-life business, we recorded premiums of CHF 1,000,057,000 (00:11:53) in the first half of 2018 compared with CHF 1,000,053,000 (00:11:57) in the corresponding period in 2017. Underlying growth was 1.9% compared with the 0.4% reported growth. This was distorted due to a one-off accounting adjustment in 2018.

Business volume in life business increased by 1.1% with the biggest effect coming from the pleasing growth of investment-linked products of nearly 20% in individual life. Volumes of modern capital efficient products like Helvetia Garantieplan and Helvetia Auszahlungsplan increased. Furthermore, Helvetia successfully launched another tranche of the Helvetia Value Trend in the first half of 2018. In contrast, the business volume of traditional insurance solutions declined as planned.

In the Group life business, Helvetia increased premiums to CHF 2.1 billion. Regular premiums rose by nearly 4%. Growth drivers were positive changes within the portfolio of full-insurance solutions, i.e., lower transfers to other providers and a successful new business development with capital-efficient solutions provided by Swisscanto.

In the Europe segment, business volume increased by 4.6% in original currency. Except Austria, all country markets recorded higher volumes compared to the previous year. Spain and Germany posted the highest rates.

In non-life, all European entities were back to growth. After several years of declining volumes, predominately resulting from motor insurance in line with market conditions, the Italian non-life business also recorded growth again.

The European life business, however, slightly decreased by 0.8% in original currency. Volumes with investment-linked products decreased compared to last year, mainly because of lower volumes from large contracts with single premiums in Austria according to plan. Traditional products, by contrast, increased. Following the financial turbulence, the Italian market unit saw an increasing demand for traditional savings products. However, our Italian subsidiary focuses on the sale of products with low guarantees or on so-called hybrid products.

In the Specialty Markets segment, we also achieved a 12.1% increase in volume in original currency. Growth was mainly driven by Active Reinsurance, resulting from targeted diversification by region and business lines, selected expansion of existing business relationships, as well as rate increases due to Ogden. Specialty Lines Swiss International (00:14:33) also recorded strong growth, about half of which is due to a one-off accounting effect.

Now, I would like to look at the profit by sources in the non-life business on slide 10. In the first half of 2018, the technical result was down 7.2% on the previous year, mainly due to a higher number of weather-related events in Germany and Switzerland.

The investment result, net, decreased by nearly 40% compared to the first half of 2017 and was therefore the major driver for the decrease in net income. The capital markets and, in particular, equity markets showed a volatile and weak performance, which led to much lower capital gains on investments.

I would now like to move to the net combined ratio on slide 11. Despite higher weather-related losses in the reporting year, the net combined ratio is on a good level at 92.7%. The increase compared to the first half of 2017 year is mainly due to a higher claims ratio following the winter storms Burglind and Friederike, as well as a higher number of thunderstorms with heavy rain and hail, mainly in Germany and Switzerland. Due to the warm spring, thunderstorms season already started at the end of May, earlier than in previous years.

The claims ratio excluding NatCats also slightly rose in a year-on-year comparison because of a lower run-off result. However, the three-year trend in the loss ratio still reflects the successful portfolio restructurings over the last three years.

Looking at the cost ratio, we were able to improve the cost ratio due to economies of scale resulting from growth. All segments reduced cost ratio with the biggest impact coming from Europe and Specialty Markets.

Looking at the segments, Switzerland showed a net combined ratio of 86.3%, still on a good level. The increase compared to last year was due to the above-mentioned bad weather events. With 95.7% Europe also recorded a higher net combined ratio compared to the first half of 2017, mainly as a consequence of the higher claims burden from weather-related events. All European markets achieved combined ratios below 100%.

In the Specialty Markets segment, the net combined ratio improved to 96.2%, driven by the lower cost ratio.

If we turn now to slide 12, we can see that in the life business, net income in the first half of 2018 was CHF 5 million below the previous year's figures due to different effects. Looking at the profit by sources, the operating result was down mainly due to a lower savings result and a decreasing risk result. The savings result was driven predominately by Swiss group life business, as the mandatory interest rate for retirement assets remained unchanged. If you remember, the federal government left the minimum interest rate at 1% while market yields declined.

The lower risk result also mainly resulted from Swiss group life business, as the lower death result, mortality result was not fully compensated by a better disability result. In addition, we had a positive one-off effect in individual life in Switzerland in the previous year arising from the Nationale Suisse integration.

Gains and losses from investments decreased. Given our strong reserve position, we did not have to reserve as much this year and expenses for reserve strengthening were consequently lower than in the previous year. All these effects, both positive and negative, were offset to a large extent by the policyholder participation mechanism, which resulted in a net decrease of only CHF 5 million.

I would now like to switch to new business, which has developed very positively, as you can see from slide 13. New business is developing well. The new business margin rose compared to the first half of 2017 and was 1.4% against 1.2% in 2017. One driver was the higher new business volume in capital-light, investment-linked insurance solutions. On the other hand that the product adjustments made to traditional savings products and the consistent improvement of the new business mix in individual and in Group life business had a major impact as well.

I would now like to move to the direct yield and guarantees in life business on slide 14. Direct yield in Switzerland and EU countries declined compared to last year because of lower interest rates. In Switzerland, the interest margin went down when comparing the first half of 2018 to the first half of 2017.

This was attributable to the following reasons. Direct yield decreased on the one hand due to special effects such as an aperiodic dividend payment; on the other hand, in the first half of 2018, U.S. dollar bonds with higher coupons, but also higher hedging costs, were switched into Eurobonds with lower coupons, but also lower hedging costs. As hedging costs are not included in current income and are therefore not considered when calculating direct yield, the shift had a negative effect here in the diagram. The average technical rate also declined.

The main drivers here were the successful revision of our traditional product portfolio and the focused sales of modern, capital-light products; maturing insurance contracts with high guaranteed rates, which were being replaced by modern, capital-light products; and finally, additional reserve strengthening. However, as the direct yield declined at a faster rate than the average technical rate, the interest margin went down.

In Europe, the interest margin shows an increase from 0.35% in the first half of 2017 to 0.47% in the reporting period. Here we see a sharp drop in the average interest rate Helvetia has to generate in order to meet its obligations due to additional reserve strengthening and new contracts with lower guarantees replacing old contracts with higher guarantees.

On the following slides, I want to provide you some more details on our investments and move to slide 15. The current investment income of CHF 506 million did not quite reach the previous year's level of CHF 521 million, partly because of the ongoing low-interest environment and partly because of these aperiodic dividend effects, which will be offset in the second half of the year.

As expected, the direct yield fell slightly to an annualized 2.1%. Realized gains and losses balanced each other out, resulting in an overall zero effect. Unrealized gains and losses in equity decreased by CHF 549 million, mainly due to slightly higher interest rates. As of June 30, however, unrealized gains and losses were still respectable CHF 1.5 billion. Overall performance was slightly negative at minus 0.1%, this was mainly due to the weak performance of the equity markets and the result from investments with market risk to the policyholders as a result were at minus CHF 42 million.

By the way on slide 19 (00:22:13), you can see the investment result broken down by asset class if you wish to go further.

On the slide 16, about two thirds of the current income of CHF 506 million came from bonds and mortgages, which contributed CHF 273 million (00:22:32), respectively, CHF 43 million in absolute terms. Dividends accounted for CHF 50 million and investment property for CHF 121 million. Gains and losses on investments balanced each other out resulting in a zero result.

As already mentioned, unrealized gains and losses decreased by CHF 549 million. The lower half of the slide shows the return on new and reinvestments. CHF 3 billion in total reinvested or newly invested in the first half of 2018. Just over 85% of the funds were invested in Euro and Swiss franc fixed-income securities, the remainder in mortgages, equities and real estate. Due to increased hedging costs for the U.S. dollar as a result of higher interest rates, the portfolio was partially reallocated to reduce the weight of the American currency. The average return on new investments totaled 1.3%.

And on that note, I will now hand over back to Philipp Gmür again.

Philipp Gmür

Thank you, Paul, for the details of our financial performance in the first half of the 2018 financial year.

In the last part of the presentation, I would briefly like to share my conclusions with you.

Let's move on to slide 18. Let me summarize, we have reported a good set of key figures for the first half of the year. We achieved a solid result despite headwinds from the capital markets and various storm events. The quality of the non-life portfolio is and remains good. Storm and hail events are part of the business of an insurance company, after all our clients want to be financially protected precisely in the case of such extraordinary events.

In life business, the improved new business margin demonstrated once again that our efforts to revise traditional insurance products and to focus on the sale of capital-efficient insurance solutions are bearing fruit.

Both, in terms of combined ratio and new business margin, we continue to meet our targets for the current strategy period. Helvetia continues to have a solid capital base and a strong dividend capacity.

I am also very pleased with the good non-life growth overall. However, I am convinced that the Swiss market has even more potential. Thus, we want to unlock the growth possibilities in Switzerland and have therefore launched corresponding initiatives.

We see growth opportunities in the SME business on the one hand. The SME segment is particularly interesting for us because insurance is rather a low-interest product for these customer groups and therefore trust and quality of advice are much more important than price. The SME segment works in a similar way as the retail business does. Important success factors are simple and standardized processes and products.

We are an all-line insurance provider with a strong position in property, liability and specialties and have a good profitability in the SME business, which is a good basis for future growth. Thanks to our close and comprehensive sales network and our strong Swiss brand, Swissness. We are well positioned for the SME segment. What makes SMEs successful are also values that we embody, such as quality, reliability, trust, proximity to the customer and appreciation.

We already have an attractive product range for SMEs. Convenience and so called all-in-one solutions are important purchase arguments, and therefore, we have revised the product range for SMEs accordingly and now offer eight products in one policy. In order to meet the needs of customers, whose needs cannot be covered by the standardized product range, individualized product solutions are available.

Technological change creates new insurable risks for Swiss SMEs, such as cyber, sharing, drones, etc. To all those demands, we can react quickly. Thanks to our size and flexibility. This year, for example, we launched a simple cyber product for SMEs.

Another trend is the increased internationalization of the value chain. Here, we have started to offer a new innovative and simple Freedom of Service solution via Liechtenstein to support SME customers with international insurance needs.

On the other hand, we are opening up growth opportunities by expanding our distribution channels. In the Swiss market, we are already well positioned. We rely on a strong sales force and established partnerships with brokers and bank partners.

I have already mentioned at our Full-Year-Results presentation that we also distribute insurance products via our network of specialist retailers, through which customers can conclude tailor-made digital insurance solutions. We call that the B2B2C channel. In the first half of the year, we further expanded our activities in this area.

Our focus is primarily on Switzerland, but we are also active in Europe. In Switzerland, for instance, we have started a cooperation with a major retailer for consumer electronics. In Europe, we have initiated a very promising partnership with a broker operating throughout Europe in the automotive sector. In both cooperations, customers can take out an extension of the warranty provided by Helvetia with their local dealer.

We use the digital technology of INZMO. INZMO is the operator of a fully automated insurance solution, which makes it possible via a web platform, be it B2B2C or B2C or an app B2C, to process all processes in the life cycle of an insurance company within seconds. Helvetia has invested in INZMO via the Venture Fund in December 2017.

Finally, we are also making great progress in implementing our strategy. The aim of the Helvetia 20.20 (00:29:35) strategy is to strengthen the core business, tap into new sources of revenues and promote targeted innovation. One example of the successful strengthening the core business is the implementation of a new software solution for the Specialty Lines.

This allows our employees, supported by artificial intelligence, to process all information from internal and external sources about a contractual partner in a structured manner. This not only saves a considerable amount of time, but also enables a better premium calculation for the risk to be insured.

Furthermore, we are opening new sources of revenues, for example, with the home ecosystem. Here, we made further progress in the first half of the year. For example, we invested in the Zurich based start-up flatfox via our Helvetia Venture Fund. flatfox uses its platform to enable private individuals and professional property managers to digitize their rental process for residential properties.

The flatfox offering is integrated into home ecosystem. MoneyPark, the largest Swiss mortgage broker, is a strong anchor within this ecosystem. In addition to the mortgage comparison, MoneyPark also launched MEx in the first half of the year, Switzerland's first mortgage exchange for owner used properties. MoneyPark is thus creating completely new offers for mortgage borrowers and also for institutional investors.

MEx enables investors such as family offices and pension funds to invest in mortgages as an asset class, which was previously often not attractive due to the costs for risk management, the reporting, the settlement and portfolio management. The technological basis for MEx is provided by finovo (00:31:52), a start-up that MoneyPark itself acquired at the beginning of the year.

An example of the innovation portfolio is the chatbot for contract renewal and the chatbot for regulating bicycle theft, both of which Helvetia tested as part of a prototyping project. Due to the high acceptance of such chatbots, Helvetia is now planning to introduce a chatbot for permanent operation.

Helvetia is also driving automation in the European markets by means of targeted innovations. In Italy and Spain, for example, the use of a digital signature was introduced, which makes it possible to conclude an insurance contract without any paper.

In Germany, the focus was on automating the claims process. For example, the process of claims settlement for glass damage has been fully automated. In addition, claims are digitally checked for insurance fraud. If a claim is reported online, an automated coverage check is carried out when the claim dossier is opened.

The successful implementation of our strategy will make us more agile, innovative and customer-focused. We will continue along the path we have chosen without neglecting our core business.

And this brings us, ladies and gentlemen, to the end of the presentation. My colleagues and I would now be pleased to answer your questions. Thank you for your attention.

Q&A

Operator

The first question is from Peter Eliot, Kepler Cheuvreux. Please go ahead.

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

Thank you very much. I have three questions, please. The first one was, I guess, we've seen a nice convergence of underlying profit and IFRS profit with these results as you'd indicated would be the case. I was just wondering if you can sort of help us identify where – well, help us identify the synergies that have come through from the Nationale Suisse deal a few years ago now. I mean, if I look at maybe the administration ratio in non-life, for example, that's come down by 40 basis points, but you have seem to be sort of attributing that to a volume effect from this recent growth in that rather than anything that's sort of acquisition related. And I guess, in life, we're not really seeing the cost ratio come down, so that is clearly there, but I was just wondering if you could sort of help us identify where we can actually see these in the results?

Second question was on, I guess, a little bit more specifically on the life earnings. I was just wondering if you could sort of take us through how those results compared to what you consider a normal run rate. And I guess especially (00:35:18) the risk results given your comments on the impact of the debt result investment (00:35:25) and maybe the other as well.

And then finally, last question. Thank you very much for the capital management disclosure on slide 59. It's very helpful. I guess the one sort of or two remaining parts of that is sort of actually quantifying the free distributable reserves and also exactly how you think of those? I mean, perhaps, you can correct me, but I think we're looking at about sort of CHF 700 million there. And I'm just wondering what the next – what your decision process is around how much of that you would consider to be excess? How – at what point would you think about distributing that? And if you did so, could you do that quickly? Is this sort of cash available or do you need to sort of think about upstreaming anything to do that? Thank you very much.

A - Philipp Gmür

Okay. Thank you, Peter, for those three questions. I'm happy to turn over to Paul.

A - Paul Norton {BIO 16145125 <GO>}

Okay. The synergies, it's actually difficult to see the (00:36:47) synergies. They are coming through. There's no doubt about that. Yes, we have attributed mainly to volume increase. It is a factor of life that costs do increase, particularly in Europe. Part of the problem we have is that in all European insurance industries that I know of, there are collective bargaining agreements with the employees, unions, or associations, and you have a regular increase of costs coming through, which you can't avoid. So, there are definitely cost increase if you start (00:37:26) offsetting those synergies.

In other areas, of course, we mentioned at the end of last year in a press conference in March, we do have projects and some of the costs are being absorbed by those new projects. But it's – we do see – on the run rate, we do see synergies coming through which are then offset by some other costs. The net effect is generally positive, but in this case, the predominant effect has been the volume.

The life results compared to the normal run rate, this is something we're looking at in more depth at the moment. We have a sort of range of results where we think the mortality rate should be. It is clearly – shall we say the top end of the – in terms of number of deaths and cost of deaths, it's probably even slightly outside it.

We also know that we've probably had too low tariffs for the last couple of years to some extent and so we plan to look at both the quality of the portfolio and the corrections to the tariffs. This is mainly in the Swiss second pillar (00:38:46) business.

Then on the capital management – oh, in other, you want to know that. That is very difficult one because we have this consolidation effect which comes in, which I also showed I think on a theoretical way of how it should works on 36 – 35. And I have to sit down and think about how we can maybe show the exact numbers here because that is really an accounting noise, which makes the other segment look a little odd. The one thing that is stable in there is clearly the Group Reinsurance results. They're roughly stable and that's the kind of thing we expect. They can vary plus or minus, acts as a buffer for the main non-life segments. So, as they (00:39:32) go up, they'll go down and then vice versa. So, that is a stable development (00:39:37).

The investment results in the other segment are also reasonably stable. We've moved a lot of the investments into the non-life segment last year. So, you'll get less volatility to that (00:39:48). So, the one big uncertainty is this fund consolidation effect, which we have to look at how we better disclose or even better book.

As for capital management, we took a bet that more disclosure is very helpful, but we took a bet that people would actually ask us for some detailed numbers on that. The free distributable shareholder reserves, we've done quite some extensive analysis on other companies and nobody gives that number, and we can go into detail but not on this call and – one to ones, but I can assure you nobody gives that number.

And we do have flexibility in producing that and turning into free cash. We don't need much liquidity. It is all located in the operating units. The holding company has no free distributable reserves which are liquid. Any free distributable reserves you see there are accounting reserves, which have no liquidity behind them, so – the holding company versus a pass-through company. That's all it is.

So, it's all in the operating companies, and as I said, there is some flexibility and we are continuously working on that to work out the best balance of short-term cash remittances out to shareholders and a longer-term sustainable dividend plan.

A - Philipp Gmür

Thank you, Paul.

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

Yeah. Thank you very much. It's a very detailed (00:41:27) so many. If you don't mind me, just coming back on one – that (00:41:30) the last point, and I guess the only other outstanding issue was just how you come to the decision of whether, out of that – I mean, I appreciate you can't speak (00:41:44) the number, but whatever that number x is, how you come to the decision about whether you should distribute that or did I understand that that is something you're also working on?

A - Paul Norton {BIO 16145125 <GO>}

That is part of this process of looking at what is a sustainable dividend plan and what is a short term. And we look at – I think we mentioned it clearly that the combination of pay-out ratio, dividend yield, and obviously what needs to remain (00:42:11) for growth. And, again, we want to balance off the short term with the long term. So, we don't want to be in a position where we're ramping up the dividend like some of our competitors are doing. They're not too far away from us here. And then you're in a situation where you're – you could be up against a ceiling where you can't payout anymore, and we would prefer a longer-term sustainability.

So, I say, we balance those elements off and come up with a figure. So, you won't see a huge great increase in dividends. We'll see the steady increase. The question is, how steep is that path? And that will depend each year we look at it looking for a medium-term sustainability.

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

Great. Thanks very much. Thanks a lot.

A - Philipp Gmür

More questions?

Operator

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

Q - Daniel Bischof {BIO 17407166 <GO>}

Yeah. Thanks, and good morning, everyone. And I also have three questions. The first one is on the growth – the strong growth you reported in non-life. It seems you're getting more bullish on motor. Could you explain some of the moving parts here in (00:43:32) Germany plus 18%, Spain plus 13%? And related to that, I mean, we are seeing a continued expansion on the engineering side, I was just wondering if you could get a bit more – provide us a little bit more details on where this growth is coming from, what's the underlying exposures are, how comfortable you are in terms of the quality of that business?

And then secondly, a follow-up on Peter's question, it's positive to see the improved productivity in non-life. I was wondering whether you think you have more room here for kind of productivity gains or you think that further growth is now kind of closer links to additional investments or additional costs.

And then, lastly a question for Ralph on the reinvestment rate sort of bond – on the bond side, it came down from 1.5 to 1.2, and presumably this is because of the switch from euro and U.S. dollar investments in the Swiss book, and obviously, it's gross of hedging costs. On a comparable basis, how would it look like so on the net basis and then also more generally, I mean, should we expect the lower reinvestment rate for 2018 compared to last year?

A - Philipp Gmür

I will answer the first two questions and then hand over to Ralph for your third question. Your first question dealt with the question about our growth rates in the European countries. Here, I would like to make the point that we see, first, a slightly lower growth rate than you'd just mentioned before in original currency, of course, that the growth rates are lower.

The second point, we see a rebound in the growth rates, of course, in property and casualty throughout Europe because we come from a period where we have to very carefully look at the portfolios, especially at the portfolios we were taking over from Nationale Suisse, be it in Spain or be it in Germany.

The third point is that we are very carefully looking at growing Inter Motor (00:46:03) business. You mentioned before, we have, of course, realized some growth there, but we are pretty positive with regard to the quality of the portfolio.

And the fourth point, finally, is that in Specialty Lines, we not only see a certain rebalance because of the measures we took before, but we see a slight increase with regard to certain business lines in the rates, we can finally get on the market, be it, for instance, in Active Reinsurance, be it to a certain extent in marine.

So, after all, we think that this growth is, to a certain extent, is and remains sustainable because we come out of a period of downsizing our portfolio.

The second question, the productivity in non-life, I mean, the productivity is – depends on two success factors, I think. One is, are we able to launch new products, such as, for instance, the cyber product or are we able to produce new demand for our products, and here we are pretty much involved in looking for new opportunities to launch new products, new insurance coverage, new solutions.

The second point is, are we able to expand our distribution channels, and yes, we are. I mean, we – as I mentioned before, we expanded our distribution channels not only in Switzerland but also in Spain via a new broker cooperation, in Germany via new opportunities we are undertaking and we are leveraging now in the online business.

Paul? Sorry, Ralph, for the third question.

A - Ralph-Thomas Honegger {BIO 4932832 <GO>}

Okay. Well, as you said, you know the direct yield is coming down because we stopped investing in U.S. dollars because of the net basis after hedging. It just doesn't make sense. So, the euro and the Swiss franc is just more attractive.

This didn't only concern new investments. We also switched some of the portfolio from U.S. dollars to the other two currencies. So, on the net basis after hedges, this made a lot of sense, but I can't really tell you and we didn't do the simulation how it would have looked like if we wouldn't have done this approach.

And then looking to the year-end, I mean, I really can't tell at the moment that there are two points actually that we have to consider. On the one hand, the third and the fourth quarter in insurance business are not really very cash rich in the sense that there will be a whole lot of new investments. And what (00:49:39) a portfolio looking at (00:49:42), it just depends on the relative interest rate development. So, we manage that as we go ahead.

Q - Daniel Bischof {BIO 17407166 <GO>}

Okay. Thank you.

A - Philipp Gmür

Okay. Thank you, Ralph. More questions?

Operator

We have a question from René Locher, MainFirst. Please go ahead.

Q - René Locher

Yes. Good morning. It's René Locher from MainFirst. So, if we go to slide number 11, so I'm trying out to find – yeah, first of all, kind of underlying combined ratio, we have seen that NatCats ratio is a little bit up with 0.7% in 2016 and 0.7% in 2017, now we are at 2.1% and perhaps not sure if you have every given a guidance here. So, what will be a reasonable NatCats ratio for the full year? And perhaps you can also remind us what is the reasonable run rate for (00:50:58)? That will be my first question.

Then, it's just what Daniel asked before. I mean also on slide 38 on the investment income, here again, there's a minus of CHF 15 million in the current income year-over-year. So, I am wondering when we should see a bottoming off of that current investment income. Now, I do see the shifts you made in the bond portfolio make sense. What I'm really wondering, going forward, when should we see a bottoming out here? And perhaps a quick word on the rental income, which, yeah, is on also downslide (00:51:46), I mean, just now looks especially for the Swiss market.

And then I saw in the Appendix, on slide 62, the Italian credit spread sensitivities. So, I mean, what's the key message here? I guess, we shouldn't be that much worried about spread widening in the Italian market. And then I saw some interesting slide, that slide 35, the treatment of own funds in other activities, could you just quickly run us through this very interesting slide? Thank you.

A - Philipp Gmür

Thank you, René, for your three interesting questions. I would ask Paul to answer your first question with regard to the combined ratio and its developments referring to slide 11.

Then I would ask Ralph to answer the second question referring to slide 38 with regard to the current income statement. And then, finally, please, Paul, answer the third question.

A - Paul Norton {BIO 16145125 <GO>}

Okay. René, you're right. We don't give a run rate for the underlying combined ratio north of the – or claims ratio north of the further (00:53:16) NatCats. The NatCat ratio is clearly higher than prior year. We had something (00:53:24) more than CHF 20 million NatCats (00:53:28) large losses this year, weather-related claims this year in this period than in the previous period.

I'm not sure how much of that was due to the weather in May and June in Switzerland and Germany, which was clearly not typical, and certainly in the second half of the summer in July and August, it's been much milder. So, it could be just a shift. So, it's very difficult particularly on a half-year basis to give you an underlying rate.

And the claims ratio as well, we mentioned the slight one-off effect, that's a couple of still all (00:54:09) claims within the all (00:54:10) Nationale Suisse book coming through, but otherwise, it's reasonably stable. We don't specifically disclose standard run rates for either the main underlying sort of attritional (00:54:24) cost ratio – claims ratio nor for the large losses or the NatCat ratio.

Q - René Locher

Okay. Thanks.

A - Philipp Gmür

Ralph?

A - Ralph-Thomas Honegger {BIO 4932832 <GO>}

Okay. To the direct yield, well, it came down CHF 15 million as you mentioned. So, there's a couple of points I would like to give as an explanation. First, as Paul said, there is a aperiodic dividend effect in there. As you know, we are quite an important investor in (00:55:01) and the dividend payout (00:55:04) was not as the years before in April or May but only in July. So, this accounts for more than half of the difference you're seeing here. And the other things are, again, the investments that we stopped in the U.S. dollars, which brought the yield down since the hedging costs are not included on a net basis; basically, it looks the other way around. And the remaining small rest (00:55:41), basically, is the yield deals coming down generally.

A - Philipp Gmür

Thank you, Ralph.

Q - René Locher

Ralph, can I quickly – (00:55:53). I mean, just on the rental income, I see different articles, some of them are quite bullish, some of them are quite negative, around the Swiss

(00:56:04) real estate markets on the rental income. I mean, is that a reasonable run rate going forward, or yeah, do you see some pressure here on the rental income?

A - Ralph-Thomas Honegger {BIO 4932832 <GO>}

No, not for the moment (00:56:20). Things are quite stable. Moving ahead, I'd like to mention again we have basically a residential property, which is very stable. This property is in a very well (00:56:40) average looking at rental prices in Switzerland. So, we really have quite good and a lot of stability yield (00:56:49).

Q - René Locher

Thank you.

A - Philipp Gmür

Question number 3.

A - Paul Norton {BIO 16145125 <GO>}

3a actually and 3b (00:56:57), I guess, is the credit spread sensitivities on page 62. Yeah. I mean, from a group perspective, it's probably one of our biggest exposures, and when you look at it from the equity perspective, 200 basis points would lead to – Italian Treasury bonds would lead to CHF 45 million reduction in equity, which is not the end of the world. But it's clearly Italian bonds could increase more based on the crisis (00:57:27) before. And the biggest impact would be in the local Solvency. As you can see, you lose (00:57:32) 52 basis – 52 percentage points on the local Solvency II, which at the year-end was 150. So, it had (00:57:41) come down to around about 100%. So then, we have to talk to the regulators and so on as to what we need to do there.

Having said that, if you all remember back to 2008, 2009, this was already a problem then, and the Italian regulators effectively said (00:58:03) to stop this decline because you ended up with this sort of accelerating effect of the mark-to-market, and that stabilized the market for a couple of years until things could return. And I would strongly suspect that that's what they're (00:58:17) doing in the future because we certainly wouldn't be the only ones (00:58:21) affected here by that.

Q - René Locher

Yeah. Yeah. Okay. Thank you.

A - Paul Norton {BIO 16145125 <GO>}

And then going to the slide we put in on page 35, I think it was, was to help you understand that. This goes back to the volatility in other activities, and it's really to do with, unfortunately, technical accounting and reporting systems. The internal funds we hold are predominantly held by non-life Switzerland and life Switzerland. And we book them in the books for trading (00:58:58), so that you have the volatility going through the P&L.

And what that means is that the reason for that is it's almost impossible to split up the funds and book them as available for sale, which goes to the balance sheet. I mean, if you personally hold a fund or any institution that buys a fund would always certainly hold them as participations, as percentages of trading, just systems (00:59:22) wouldn't be able to cope otherwise.

On a group basis, we don't want the volatility. So, we book them at the group level as available sale with the volatility going through the profit and loss account – sorry, through the equity, through the valuation reserve and equity. So, to compensate that out, you need to book effectively an opposing entry through the profit and loss in the other activities side to offset that volatility in non-life Switzerland and life Switzerland. And that's why you get, in this case, a plus to offset the negatives in the two operating segments.

I've got (01:00:01), our Chief Accounting Officer, and I'm going to afterwards have a word with him and see what we can do to – if not do it otherwise and we have looked in the past, maybe to disclose it otherwise because I do appreciate it doesn't help you in understanding what's going on in the underlying activities of other activities.

Q - René Locher

Okay. No. That's helpful. Thank you.

A - Philipp Gmür

Are there more questions?

Operator

That was the last question.

A - Philipp Gmür

Okay. So, I thank you on behalf of my colleagues and on behalf of Helvetia in your interest in our company. I wish you a good day. And if you have any questions, please do not hesitate to contact us, be it Susanne Tengler or our Head of Communications, Claudia Sauter. We are happy to get back to you as soon as possible. Have a good day.

Operator

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