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Acquisition of Guardian Financial Services by Swiss Re AG Call

Company Participants

- David Cole
- John Robert Dacey

Other Participants

- Anasuya Iyer
- Andrew J. Ritchie
- In-Yong Hwang
- Kamran Hossain
- Stefan Schürmann
- Thomas Fossard
- William Hawkins

MANAGEMENT DISCUSSION SECTION

Operator

Good morning or good afternoon, and welcome to Swiss Re's conference call on a recent transaction. Please note that today's conference call is being recorded. At this time, I would like to turn the conference over to Mr. David Cole, Group CFO. Please go ahead.

David Cole {BIO 7251632 <GO>}

Thank you. Good morning or good afternoon to everyone. Indeed, I'm David Cole, Swiss Re's Group CFO. I'd like to welcome you to this briefing call on the agreement to acquire Guardian Financial Services. I'm here today with John Dacey, our Group Chief Strategy Officer. Before we move to Q&A, let me start with just a very short summary of today's announcement.

As you will have seen in our press release and presentation, we announced today that Admin Re has agreed to buy Guardian Financial Services for £1.6 billion. The transaction is expected to generate multiple benefits and synergies for Swiss Re. First, it reinforces the position of Admin Re as a leading closed life book consolidator in the United Kingdom.

The transaction also allows us to deploy part of our excess capital into the business at above our group hurdle rate, as we talked about before, of 11% ROE. The transaction is ROE-accretive from the beginning and will support Admin Re to achieve its mid-term ROE

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target. It's also expected to significantly increase Admin Re's gross cash generation capacity.

As the acquisition is expected to close in early 2016, we do not expect any impact on the U.S. GAAP in 2015. However, under our internal EVM framework, a loss will be recorded in 2015 as EVM does not recognize expected future investment returns above the risk-free rate.

Over the life of the acquired business, however, the transaction is expected to contribute significantly to our economic net worth. We manage the group with a longer-term perspective, and therefore, we accept the short-term estimated economic loss upon inception given the medium-term positive contribution to economic net worth growth.

Following this transaction, we will continue to remain well-capitalized with an economic solvency ratio comfortably above our risk tolerance. This transaction is in line with our group capital management priorities and does not alter our view on the share buyback program authorized by our shareholders at the 2015 AGM.

So with that short summary, let's move to Q&A. As usual, I'll ask you to please restrict yourself to two questions. Operator, can we have the first question, please?

Q&A

Operator

The first question comes from Kamran Hossain, RBC. Please go ahead.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi. Good afternoon and congratulations on the deal. Two questions. The first one is on the 11% return that you expect from the acquisition, is that an immediate 11% ROE that we should see coming through from kind of when the acquisition in 2016 (03:06)?

And the second question is just on capital. There's an intention (03:14) from this point to manage the capital base closely towards the, I guess, 185% risk tolerance. Just some color on that would be really helpful. Thank you.

A - David Cole {BIO 7251632 <GO>}

Sure. I'll take both of those. So the transaction will, indeed, impact us first year 2016. And yes, both in year one as well as throughout the life of the transaction, we expect an ROE in excess of the 11%.

And in terms of the managing of our capital, we said our risk tolerance is around 185% on a group level under SST. We've been, over the last four years, five years, above that. There is some volatility associated with our number. Our intent is, basically, to either invest intelligently in the business allowing us to grow our earnings, and therefore, grow our regular dividend or if we can't find good ways to invest in the business at attractive rates, of course, we'll look for ways to return it. So I think over time, it would be a fair thing to state that we would be targeting to get closer to that 185% than we've been over the most recent past.

Q - Kamran Hossain {BIO 17666412 <GO>}

Perfect. Thanks very much. Cheers.

Operator

Next question comes from William Hawkins, KBW. Please go ahead.

Q - William Hawkins {BIO 1822411 <GO>}

Hello. Thank you very much. First of all, forgive me, this is a really naïve question. But what do you classify as the E when you're talking about 11% ROE for this transaction? Not quite sure on that.

And then secondly, what's going to be the sensitivity of the return outlook if bond market yields change over time? So maybe if you could give us a sensitivity to whether 100-basis point increase in the risk free rates or 100-basis point increase in the credit spread. Generally, it seems to me there's a lot of credit that you're sort of picking up here. I'm not quite sure if you believe you're neutral to how markets change over time, or if you're deliberately taking more credit risk here? Thanks.

A - David Cole {BIO 7251632 <GO>}

Okay. So I'll just give short answers and if you need to follow up, I can come back. So the E is the U.S. GAAP shareholder equity deployed in the transaction, to be straightforward.

And the question about sensitivity, I won't give a specific number on the sensitivity, but it is fair to say that with this transaction, we are picking up some credit. There's no doubt about that and obviously, increasing spreads would grab a (05:35) higher capital component.

I don't think it will be fair, however, to say that we're targeting per se to have incremental financial risk or credit risk. We do have an ability to have more on our balance sheet, but it's not that we're making that a target in and of itself.

Q - William Hawkins {BIO 1822411 <GO>}

Thanks. And I'm sorry if this is again a really silly question, but when you're talking about U.S. GAAP shareholders' funds deployed, you're basically talking about the consideration you're paying, right?

A - David Cole {BIO 7251632 <GO>}

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Well, I think you need to take out the debt component, so we said about two-thirds equity and about one-third debt.

Q - William Hawkins {BIO 1822411 <GO>}

Okay. Thank you.

Operator

Next question comes from Anasuya Iyer from Jefferies. Please go ahead.

Q - Anasuya Iyer {BIO 18981555 <GO>}

Oh, hi. It's Anasuya Iyer from Jefferies. My first question was you've obviously given us the guidance for the higher cash generation for Admin Re now and I just wondered what would it take or how long would it be before that's reflected in your dividend remittance target?

And the second question was just in Q1 Admin Re had to take some actions for Solvency II as this is sort of changing the portfolio I think. And I just wondered if any risk you might incur some cost doing the same for Guardian? Thanks.

A - David Cole {BIO 7251632 <GO>}

Okay. So two quick questions, so it's quick answers. The first is that the expected increase in cash generation is fairly quick, so I would anticipate that that would translate into immediate expectations for I mean (07:15) higher dividend than perhaps what we were previously planning from the unit up to the group in 2016, certainly by 2017. So that's pretty straightforward.

The actions that you referred to with Admin Re in the first half are indeed about getting ourselves best positioned for the matching adjustment which basically meant we extend a little bit the maturity of some of our particular UK gilts. I don't anticipate any specific – certainly no material cost associated with aligning Guardian asset portfolio with our Solvency II expectations. So there's no expectation. There'll be certainly no material cost associated with that.

Q - Anasuya Iyer {BIO 18981555 <GO>}

Okay. Thank you.

A - John Robert Dacey {BIO 4437051 <GO>}

There probably will be some movements in the asset portfolio of Guardian over time, as it comes across to Swiss Re, but again, as David said, there shouldn't be any particular charges associated with that. We will, in fact, continue to manage and the UK under Solvency II and looking for matching adjustments for the positions we have, those assets linked to the liabilities, especially on the annuity portfolio.

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Q - Anasuya Iyer {BIO 18981555 <GO>}

Got it. Thank you.

A - David Cole {BIO 7251632 <GO>}

Thank you.

Operator

Next question comes from Andrew Ritchie from Autonomous. Please go ahead.

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

Hi there. Two quick questions. One is does the anticipated return include synergies? I mean are you actually going to identify specific cost saves number, because I'm guessing they will be reasonably material relative to the total return of cost saves, maybe just clarify what the trajectory of those cost saves might be?

The second question, I appreciate under EVM, you take $900 million hit and that, obviously, flow through to your (09:18) capital and SST. But given that you've purchased the business below MCEV, does that mean on an S&P model, it would be – that it wouldn't be anything like $900 million hit, in fact? Furthermore, you can be accretive on an S&P basis, maybe just clarify the different sort of view S&P versus – or rating agency versus SST EVM?

A - David Cole {BIO 7251632 <GO>}

Okay. Thanks, Andrew. So I won't give specific figures. I'll give you the three broad areas where we would expect synergies. And those synergies would come forward fairly significantly first three years, particularly after we would be able to execute a VII transfer, which we anticipate during the course of 2017.

So the synergies will come from administrative costs that we would expect to be able to take out come from capital, benefiting from the diversification across the two portfolios and come from enhancement on the asset side where we would expect also some lower costs associating with managing those assets.

We'll be combining the two operations in the UK. And I suppose it would be normal expectations. There will be some synergies coming out of that aspect as well. In terms of...

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

The Part VII transfer, you think, is 2017, is that right?

A - David Cole {BIO 7251632 <GO>}

The second half of 2017 is our (10:40).

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

Okay. And I guess that means that the cash projection is sort of – is back-end loaded. Well, I guess you wouldn't really get (10:47) any cash-out until 2017 in that case?

A - David Cole {BIO 7251632 <GO>}

No. I wouldn't say that. I think we'll start seeing already some cash coming out in 2016, but then that would be accelerating enhance to (10:57) 2017.

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

Okay. Sure. (11:01)

A - David Cole {BIO 7251632 <GO>}

But to your second question, I guess we could have a whole workshop on this. It's just between MCEV and EVM and S&P and SST and Solvency II. I propose not to do that. Here's I'll say just quickly today. We'll come back to it, maybe when we get together for our Investor Day later in December, talk a bit more depth about this. It's obviously under EVM I should say, obviously, I think as we communicated in the past, we basically are discounting at risk free rates, so we don't use markups (11:33) swap curves.

And we also don't recognize any form of liquidity premium. In terms of the difference between S&P and SST, under SST credit, it does have a fairly heavy charge whereas under S&P, it doesn't. So I think the capital impact on a SST basis is a little bit more than what you would expect to see under S&P.

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

The S&P would use the MCEV as the available capital as well, wouldn't it?

A - David Cole {BIO 7251632 <GO>}

I'm going to hesitate to answer, because I'm not sure I can give you an accurate answer. We can follow up on it later.

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

Okay. Okay.

A - David Cole {BIO 7251632 <GO>}

But what I would say is S&P doesn't reflect the same level of credit charge.

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

Yeah.

A - David Cole {BIO 7251632 <GO>}

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And so, I think, to be honest, the S&P impact is not going to be that significantly different than what we do see under U.S. GAAP type of capital (12:32) significantly less than SST.

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

Yeah. Okay. Understood. All right. Thank you.

Operator

Next question comes from Stefan Schürmann from Bank Vontobel. Please go ahead.

Q - Stefan Schürmann

Yes. Good afternoon. I have two questions. The first one is basically on the platform. I understand the portfolios you buy. There's a couple of sub-portfolios to former Aegon Guardian...

A - David Cole {BIO 7251632 <GO>}

Stefan, may I interject just to ask if you can speak up a little bit?

Q - Stefan Schürmann

Yes, of course. Can you hear me now?

A - David Cole {BIO 7251632 <GO>}

Yes, that's better.

Q - Stefan Schürmann

Yes. So the first question is on, basically, integration of the portfolios, I mean basically that's a former Aegon Guardian portfolio, that's the Phoenix, National Provident, Pearl and so on portfolio, and there's a separate Ark Life portfolio. I mean will that all be integrated into your UK platform? And I believe the Irish one will remain as a separately (13:22) going forward? Is there basically a reason there to have that or to build that up?

And the second question, just very simply, should we expect any integration costs in 2016?

A - David Cole {BIO 7251632 <GO>}

Okay. I'll actually let John start off on this one.

A - John Robert Dacey {BIO 4437051 <GO>}

So with respect to the integration of the portfolios, we would expect the UK portfolios over time to be fully integrated. We've got our own proprietary IT systems and have systematically been able to migrate life businesses onto it, including the most recent transaction with HSBC where about 400,000 policies have come over onto our systems.

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The (14:05) model with the different portfolios is a mix of internal and external administration of the policies and we will find, I think, the opportunities as I said for the UK businesses to all come over to our systems. We'll sort through what the best answer will be for the Irish book of Ark Life.

Q - Stefan Schürmann

Okay.

A - David Cole {BIO 7251632 <GO>}

And as to the second question, yeah, there will be some integration costs in both 2016 and 2017, so we'll go through in two phases. But those have been factored into my comment about expectations for an ROE in excess of 11% from year one and throughout.

Q - Stefan Schürmann

Okay.

A - David Cole {BIO 7251632 <GO>}

That's embedded in that figure.

Q - Stefan Schürmann

Okay. Thank you.

Operator

Next question comes from Yong Hwang, Goldman Sachs. Please go ahead.

Q - In-Yong Hwang {BIO 18784369 <GO>}

Hello. This is In-Yong from Goldman Sachs. Two questions for me. Firstly on – you mentioned the capital synergies that's part of the gross cash generation of £1.7 billion. I was wondering whether you could quantify and whether this falls in the £1 billion portion that comes from Guardian rather than the £700 million from Admin Re?

And secondly, on the deal pipeline, is this kind of deal that the big part of the healthy pipeline that you were seeing at 2Q? And what do you see as the deal pipeline going to state (15:27) going forward? Thank you.

A - David Cole {BIO 7251632 <GO>}

Okay. Thank you. I'll take the first question and let John pick up on the second. So yes, there is capital synergy. Yes, it does show up under the Guardian £1 billion that you see on slide five of our presentation. I won't quantify it, specifically, other than to just let you know that in addition to capital synergies, we also see some cost synergies as well as I mentioned some synergies on the assets side as well. So yes, it's within the £1 billion that you see under the Guardian bar.

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A - John Robert Dacey {BIO 4437051 <GO>}

For the first three years?

A - David Cole {BIO 7251632 <GO>}

Yeah.

A - John Robert Dacey {BIO 4437051 <GO>}

Yeah. With respect to the pipeline, we continue to believe that there's going to be ample opportunity for Admin Re to evaluate other transactions in the space. The onset of Solvency II, in particular, and the continued challenges for the regulatory oversight of life businesses, I think make this a tough industry in the current macroeconomic environment. We've prepared ourselves to be able to assume additional portfolios after this one, and we will continue to evaluate those potential transactions to see what else we might be able to bring onboard at this kind of a return.

A - David Cole {BIO 7251632 <GO>}

If I may just add to that, we've talked about over the last several years the fact that we've been investing in our Admin Re platform to both make it efficient as well as scalable. And we've also talked about what we'd consider to be an attractive pipeline of potential transactions, clearly not simply one transaction, but a series of potential transactions, including some that are quite significant. So the UK closed life market remains a market that we think presents some very interesting opportunities for us and we remain open to look at those.

Q - In-Yong Hwang {BIO 18784369 <GO>}

Just to follow-up quickly, the pipeline and the opportunities that you see compared to from the start of the year, has that changed dramatically in the last eight months, nine months or so?

A - David Cole {BIO 7251632 <GO>}

It's not the size of the pipeline or the types of discussions that we would be having would have changed significantly. I think the timeline itself has gotten a little bit shorter. You may recall at some point we were talking about over the next two years and then we talked about over the next 18 months.

So I think amongst other things, given some of the changes in the regulatory environment that the timeline has gotten a little bit shorter over the past eight months to 12 months. But the absolute size or potential size of the opportunities, I think, has always been something that we found attractive. There's some changes there, but I think the overall answer is that the market – we saw the market a couple of years ago, it was one that would emerge and would be an attractive place for us to be in. I think we conclude today that that continues to be the case.

Q - In-Yong Hwang {BIO 18784369 <GO>}

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Great. Thank you.

A - John Robert Dacey {BIO 4437051 <GO>}

And I'd also add. It appears to us that the expectations of sellers have gotten a little bit more realistic about what's possible to achieve on a pricing. And so, the seriousness of the discussions has probably increased compared to what might have been some rather (18:46) discussions at the beginning of the year.

Q - In-Yong Hwang {BIO 18784369 <GO>}

Okay. Great. Thank you very much.

A - David Cole {BIO 7251632 <GO>}

Okay. At this point, we have no more questions in the queue. So we'll bring...

Operator

Sorry. Sorry to interrupt you. We have a last question.

A - David Cole {BIO 7251632 <GO>}

Well, thank you.

Operator

Okay. From Thomas Fossard, HSBC. Please go ahead, sir.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yeah. Yes. Good afternoon, David. Sorry for this late entry. Just wanted to better understand what's your view currently on the share buyback, because, in fact, in the press release, you indicated that we'll see the size of the share buyback, anticipated share buyback, was more or less anticipated the size of the deal you announced today. So I was wondering how much additional deals are currently already embedded in your expectation of upcoming share buybacks for £1 billion. Thank you.

A - David Cole {BIO 7251632 <GO>}

Thanks for the question. I was actually maybe (19:42) somewhat surprised that no one would ask about the share repurchase program. So I'm thinking about that hasn't changed. It hasn't changed from actually the moment that we announced it back in February and it got authorization from our shareholders in April. The type of transaction that we announced today is certainly in keeping with our medium-term financial planning, and therefore, we said it has no real impact in the way we think about things.

We continue to be focused on our capital management priorities which are maintaining a very strong financial position. I think you expect that from us. Number two, maintaining the regular dividend and to investing wisely in the business, creating an opportunity to

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increase the regular dividend. And therefore, when we see opportunities like we have announced today, we feel quite comfortable to make those investments go and face (20:27) in the long-term interest of our shareholders.

And when we come to the conclusion that we're sitting on a situation where we have the capital buffers that we would like to maintain and actually some excess capital above that, particularly for instance in a situation where loss levels have been very low, then we have said that going forward, we use the share repurchase structure as the way to return capital to shareholders.

Now, the difference between the last several years and our current situation is in the last several years, we would make those kind of announcements in conjunction with announcing the full year results in February, and then we have the one-off special dividend paid out in April, May. And through the share buyback program, we have the possibility to accelerate that somewhat if we come to the conclusion at a certain point during the year that actually we do sit in that excess capital position.

So just like to underline that for everyone our thinking about it hasn't changed, the way we communicate about it hasn't changed. What has changed is that we're no longer using the special dividend as the means to returning that excess capital to shareholders, but we'll have the ability to use the share repurchase program.

Q - Thomas Fossard {BIO 1941215 <GO>}

Okay. Thanks, David. Can I ask if you've got now a better timing when you missed out the opportunity share buyback program now?

A - David Cole {BIO 7251632 <GO>}

No, it's not - it wouldn't be appropriate for me to announce anything here today other than what we said around the Q2, which is at - we would imagine, right until after the big windstorm season in North America, before we even start drawing conclusions about what our position is this year. So I would expect we will come back to it discussing the program around our Q3 results.

Q - Thomas Fossard {BIO 1941215 <GO>}

Okay. Thanks.

Operator

Ladies and gentlemen, that was our last question.

A - David Cole {BIO 7251632 <GO>}

Okay. Well, listen. Thanks, everyone. We've come to the end of the Q&A session, so thank you very much for joining. Of course, if you have any further questions, please don't hesitate to contact any member of our Investor Relations team. Once again, we thank you for your participation today. Have a good day.

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Operator

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

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