Q2 2019 Earnings Call

Company Participants

- Andreas Berger, Unknown
- Christian Mumenthaler, Group CEO
- Edouard Schmid, Group Chief Underwriting Officer
- John Robert Dacey, Group CFO
- Philippe Brahin, Head IR and Head Governmental Affairs & Sustainability

Other Participants

- Andrew James Ritchie, Partner, Insurance
- Edward Morris, Equity Analyst
- Farooq Hanif, Head of Insurance Research in Europe
- Frank Kopfinger, Research Analyst
- James Austin Shuck, Director
- Jonathan Peter Phillip Urwin, Director and Equity Research Insurance Analyst
- Kamran Hossain, Analyst
- Sami Taipalus, Research Analyst
- Simon FÃ¶ssmeier, Head of Insurance
- Vikram Gandhi, Equity Analyst
- Vinit Malhotra, Banca di credito finanziario S.p.A., Research Division
- William Hawkins, MD, Head of European Insurance Research and Senior Analyst

Presentation

Operator

Good morning, or good afternoon. Welcome to Swiss Re's Half-Year 2019 Results Conference Call.

Please note that today's conference call is being recorded.

At this time, I would like to turn the conference over to Christian Mumenthaler, Group CEO. Please go ahead.

Christian Mumenthaler {BIO 6479864 <GO>}

Thank you very much. Good morning. Good afternoon, everybody. Welcome to our half-year 2019 results Q&A call. I'm here with John Dacey, our Group CFO; Edi Schmid, our

Group Chief Underwriting Officer; Andreas Berger, the CEO of Corporate Solutions; and Philippe Brahin, our Head of Investor Relations.

Before we go to Q&A, I will make a few comments to put today's reported information into context. Andreas will complement this by adding some additional color on Corporate Solutions.

The Group reported a net income of USD 953 million for the first half of 2019, supported by the strong results of our Reinsurance business unit and reflecting an excellent investment result.

I want to emphasize the very strong performance of P&C Re, despite significant adverse claims development of Typhoon Jebi in Q1. The enhanced earnings power of P&C Re, in an improved pricing environment, is supported by our core strengths: the scale of the business, coupled with a flat expense base, the diversification via Life & Health Re, our unparalleled client access and the expertise and risk knowledge built over many decades.

In the year-to-date renewals we found attractive opportunities to deploy capital and expect our pretax earnings to increase by more than USD 350 million as premiums are earned.

Life (inaudible) Reinsurance continues to deliver very good results, supported by improved mortality experience in the Americas and portfolio management actions.

In Corporate Solutions, we have now completed the previously announced business and reserve review, implementing decisive management actions to put the business unit back on track to profitability.

The group has contributed USD 600 million of capital into Corporate Solutions, restoring its SST capital position to a level which we consider adequate. Andreas will tell you more about Corporate Solutions in a few moments.

On to Life Capital. We obviously spent a lot of time and effort in H1 preparing for the ReAssure IPO. Unfortunately, market conditions were not favorable. And we decided to suspend the process. We still aim to deconsolidate this business and will continue to act in shareholders' best interest.

And with that, I'll hand over to Andreas.

Andreas Berger {BIO 15171017 <GO>}

Thanks, Christian. Good afternoon to everyone also from my side. I'd like to make a few remarks on the work undertaken at Corporate Solutions since I took over on 1st of March this year.

We conducted a comprehensive review of our portfolio and left no stone unturned. Specifically, we looked at historic profitability and volatility, both for Corporate Solutions and for the market; potential market size; legal trends; as well as our ability to efficiently service customers and provide a product that is differentiated from competitors.

Through this thorough review we identified the business lines where we wanted to focus our profitability growth and those which needed to be addressed. The pruning actions focused on 35% of the book and are expected to decrease our premiums by approximately 20% of our book. The remaining portfolio is in much better shape. And we also benefit from the positive rate momentum observed in commercial insurance. In the first half of 2019, the risk-adjusted price quality of Corporate Solutions portfolio improved by 9%. We expect pricing momentum to continue in the second half. But also beyond that.

As part of our detailed reserve review, we analyzed case reserves mostly related to prior accident year large losses and strengthened reserves where appropriate. The majority of the development was in recent accident years 2017 and '18. From a line of business perspective, liability, predominantly North America liability. And property were the most impacted.

In order to protect Corporate Solutions back book, an adverse development cover was put in place with P&C Reinsurance business unit. And we have set up our tactical and strategic reinsurance protection to reduce volatility, going forward.

As another outcome of our strategic review, I have installed a new management team, our executive committee for CorSo ensuring all parts of our business are represented at our leadership table. This ensures that our decisions taken are based on input from all relevant areas and that we deliver to our customers quickly and consistently across geographies.

We're confident that these decisive actions will drive a turnaround in the performance of Corporate Solutions and expect to achieve 98% combined ratio in 2021.

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

Philippe Brahin {BIO 19081619 <GO>}

Thank you, Andreas. And good day to all of you also from my side. So as usual, before we start the Q&A, I'd like to remind you to please restrict yourselves to 2 questions each and then register again if you have follow-up questions.

So with that, Operator, could we please take the first question?

Questions And Answers

Operator

The first question comes from Andrew Ritchie, from Autonomous.

Q - Andrew James Ritchie {BIO 18731996 <GO>}

I think the first question is for Edi. Could you give us a sense as to what the nominal rate increase was year-to-date and in July if you didn't allow for higher loss costs? Because I think your +1 and +2 has some reflection of higher loss costs in it. And on renewal, are you playing in the very high layers? Because I noticed your nat cat PML went up considerably again from the year-end. But obviously that's not matched by the sort of volume of nat cat premium. So where exactly is the best-priced nat cat business in the U.S. now, what layer? Is it being found that?

And secondly, on CorSo I'm still not sure of the longer-term ambition. Is it still to generate a 10% to 15% ROE? It doesn't look like the 98% combined in today's interest rate environment with a book that's becoming shorter tail is enough to get you there. And also on the strategy, is it still the aim to expand into Global Master and, generally, just further down the layers from excess. Is that still the long-term ambition?

A - Philippe Brahin {BIO 19081619 <GO>}

Thanks, Andrew. I think it's more, like, 4 questions. But that's okay. Go ahead, Edi.

A - Edouard Schmid {BIO 18942809 <GO>}

Okay. On the first one, Andrew, regarding the price increase and how does this relate to, let's say, adjustment to models, that's basically what you were asking about. So yes, we have adjusted our loss models in some part of the business where we had new learnings. In Japan, out of Jebi, we adjusted the model to some extent. And obviously there was the experience with the wildfires in California where we also took action and made the loss model a bit more conservative.

So the 1% does actually reflect this. So without these adjustments, the price increase would look a bit better. But it's fair to say this would not make a huge difference. Obviously, we need to see -- this 1% is across a very broad-based portfolio, which has a lot of cat business but also a big quota share business. So the 1% really needs to be seen in that context.

So it would be a bit better. But even I think 1% across this (inaudible) portfolio is a significant improvement, which also explains why our combined ratio estimate moved from 100% two years ago, 99% last year. And now we are comfortable to get to the 98%.

And the second part of your question is regarding the nat cat growth. It's fair to say that this is geared more towards the peak perils: hurricane U.S., earthquake. So the increase in exposure, measured in valued risk, which we disclose externally, is more pronounced than the increase in premium and expected loss. So that explains why it's not moving in sync.

I don't think you can put out any, let's say, layers which we prefer. It's really across the board. We look at it on a client and ideal basis. Also, quite a few of these cat deals are structured in the form of a transaction. So it's not really possible to point to any one area.

There's a lot of factors that really come together and boil down to what we think is now a very adequately priced cat portfolio. That's why we felt very comfortable to deploy more capital. We are confident it will turn into an attractive return on capital because we have all the diversification and it will boil down to a significant contribution to earnings at the end of the day.

A - Andreas Berger {BIO 15171017 <GO>}

Okay. I'll take the CorSo question. Andreas, here. First of all, on your ROE target, we have no reason to change the ROE target for CorSo which stands at 10% to 15%. With our ambition and target for 2021 with 98%, we think we should end up at the lower end of our target corridor. So we're pretty comfortable on that one.

On the longer-term ambition, first of all, the focus this time here for the half-year results is profitability, restore profitability to set the foundation for future growth. And we'll come back in November, obviously, at the Investor Day to be a bit more specific on our strategy, going forward, with a strategic vision. We call it Strategic Vision '23-Plus.

Now on your Primary Lead, all I can say is, yes, this is the right move. It's quite logical that for a company like Swiss Re and Swiss Re Corporate Solutions, with the expertise, the risk knowledge and everything on technical capabilities that we have, we should drop down from excess positions. We should go down from wholesale markets more to where the risk is, through primary layers, because that's where we can differentiate and where you also get the premium levels that you require in order to sustainably meet also your target on the ROE side.

I think we can declare victory in penetrating the Primary Lead markets. We've invested a lot of money into people, into capabilities. And I think this is a tick in a box for us.

On the Global Master program business, this is sort of my home turf, I truly believe that there are very few players who really can play in this segment. We are probably one of the few ones that have identified a key differentiator, which is the delivery of the program. A lot of competitors in this segment struggle due to IT legacy. We've developed a state-of-the-art technology platform to deliver Global Master programs. I think this is something we're going to capitalize on and you will hear much more on our November Investor Day. But I'm very comfortable and very confident that we would have success with this one. That's the feedback that we get from clients and from brokers.

A - Philippe Brahin {BIO 19081619 <GO>}

Great. Thanks, Andrew, for your questions.

Operator

The next question comes from Kamran Hossain, from RBC.

Q - Kamran Hossain {BIO 17666412 <GO>}

2 questions. The first one, coming back to CorSo my read of it is that it looks like an exceptionally good job there. I'm really pleased you're addressing it. But when you think about CorSo it might be one for Christian. But could you maybe talk about the similarities between the Life & Health changes a few years ago and the Corporate Solutions restructuring changes that actually you've announced today? Is this -- what's your degree of confidence in here we make changes here and then we can move on and anticipate much better results? So that's the first question.

The second question, I saw the comments about ReAssure and committed to reducing the stake. You didn't make any comment about the second tranche of the buyback. How should we think about that for now?

A - Christian Mumenthaler {BIO 6479864 <GO>}

Thanks, Kamran. So on the comparison of Life & Health it's actually an interesting question. So to me there's some parallels and some differences.

I think the parallel I would drive is that when a business starts to get into trouble it's not a good idea to bleed it out over many years, even though that might be the first instinct because it's too hard to face reality. So I think clearly my aim was to take on the learnings from Life & Health and apply them to Corporate Solutions, which is why so much work has gone into these 2 quarters, on all different aspects. And the choices we made are painful.

I think the difference is that obviously Life & Health is a much less volatile business. In CorSo whatever we do, if there's a big nat cat it's going to hit CorSo and there's not much I can do. Whereas in Life & Health, I think some of these results are much smoother and easier to predict.

What's also difficult to predict is ultimately where will the trends go in U.S. casualty, in particular, where we saw some underlying trends increase. We had to make some assumptions. But obviously nothing is ever certain.

So I'd say we tried our best. We also through the ADC cover protect some of the old reserves. I wanted to make sure the team has a real chance to start from here. But I'm also aware that there are some. And you are aware that there are some, risk factors which could affect them. But I would hope that the underlying program that Andreas has come up with to me is very plausible and executable because of price increase in the market. We can prune; pruning is part of it. But I think, frankly, it's the price increases which are really, really needed and necessary and coming through at this stage which make this plan in my view executable.

Do you want to, John, you want the second one?

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

And with respect to the share buyback, first of all, just reiterate that the first tranche of CHF 1 billion is well on track. As of yesterday we've completed about 45% of it and look to continue to execute that over the coming months.

As we said before, the second tranche is not dependent necessarily on the ReAssure IPO; but rather, more broadly, on the excess capital position during the course of the year and the second half of the year, in particular. Unambiguously, I think it's safe to say that not doing the ReAssure IPO will make it a little less likely that we find ourselves with excess capital after we finish the first tranche of the buyback. But let's see how the next three months go. And we will give you an update I think on October 31 when we release our Q3 results.

Obviously, there's a lot of moving parts here. The good news is we're finding the ability to deploy real capital in the P&C Re business as well as in Life & Health. But with a fairly strong first half and expectations of a strong second half of the year, we'll build back up the earnings and, therefore, the overall capital of the group.

A - Philippe Brahin {BIO 19081619 <GO>}

Thanks, Kamran, for your questions.

Operator

The next question is from the line of Vikram Gandhi, from Societe Generale.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Firstly, on CorSo referring to Slide 17 and 19, I'm a bit confused as to how should we integrate the 9% rate increase in the first half alone against the 6percentage points combined (inaudible) improvement from rate increases by 2021? Is it just because the expected losses has changed? Or is there something else?

And secondly, on P&C Re, on the one hand these Slides 30 and 31 say the price increases for the nat cat business were mostly flat, apart from the loss-affected treaties, while on the other hand we see that the nat cat exposure has increased significantly. So just wondered why the sudden increase in appetite despite the rating momentum clearly not that strong.

A - Andreas Berger {BIO 15171017 <GO>}

So on CorSo the 9% rate increase, this is a risk-adjusted increase. The 9% in first half of 2019 reflects the year-on-year increase in risk-adjusted price quality of Corporate Solutions on the total portfolio. That also includes 2% pruning and business mix changes and 7% pure rate changes. The 7% rate changes is only for the first half of the year. So what you find in this walk, in the combined ratio walk, this is obviously then projected also to the three years until 2021. That's the difference.

A - Philippe Brahin {BIO 19081619 <GO>}

Edi, you want to take the P&C Re question?

A - Edouard Schmid {BIO 18942809 <GO>}

So the question is that the nat cat price increases this year seem rather moderate while we grow a lot. I think that's the gist of the question. If you look at it a bit over two years, I think out of the record loss year '17 we pushed a lot of price increases into '18. And we could achieve a significant quality improvement of the book. But we also let go quite a bit of shares.

Into this year now, in a further improving pricing environment, even though not massively, it made a lot of sense for us to recapture share but also grow the nat cat business. It goes to quality we have in our book and we can achieve in the market. Clearly, this is attractive. Given our global (diversification) and Life & Health diversification , this nat cat business achieves a very attractive return on capital.

What we've seen in this year, that business that has been significantly loss affected, like (inaudible) in Japan or Florida business, we saw significant rate increases, 15%. But it's fair to say in a lot of other places pricing line was more flattish. But the quality of the business we've put on board is very adequate. And that's why it made a lot of sense to deploy more capital into that space.

What we've also done, we seeded a bit more to serve the capital investors. So the business that goes beyond our appetite cannot be readily diversified. We see it more towards some long-term, third-party capital providers to make sure, over all, we keep a balanced book and always in our risk appetite.

But it's a very attractive space, the nat cat area, where we have demonstrated over many years that we understand this risk very well. So we feel very comfortable to deploy more capital. And we are confident it will turn into good contribution to earnings.

A - Philippe Brahin {BIO 19081619 <GO>}

All right. Thanks, Vikram, for your questions.

Operator

The next question is from, from Edward Morris, from J.P. Morgan.

Q - Edward Morris {BIO 16274236 <GO>}

The first is just on the $350 million that you talk about the increase in net earnings from renewals achieved so far year-to-date. I wonder if you could just help us in thinking about how quickly that is likely to earn through into the results. And also if we take into account how interest rates have evolved over the course of the year, where does that put you relative to your 10% to 15% ROE ambition in P&C?

Then, secondly, Edi, just picking up on that point about the increased use of third-party capital for nat cat business, something that Swiss Re hasn't in the past done a huge amount of, I wonder if you could just elaborate on why now you've decided to do more of that. Is it because you're getting closer to your thresholds of what you would like in nat cat? Or if you could just talk a bit more about that strategic change.

A - Philippe Brahin {BIO 19081619 <GO>}

John, you want to take the first part?

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

Sure. So on the $350 million, you should expect that that gets earned I think largely over the next two years. There might be a little bit of a tail into a third year. But the business that's come on starting with January 1, April, June, July renewals all we expect to help out here.

Also, don't forget that part of the strength of this portfolio was some relatively short-tail, SME-focused casualty underwriting that we put in place with a publicly identified transaction with AmTrust at the beginning of the year.

So net-net, we're comfortable with these new earnings.

The point you mention about a decrease in interest rates is a challenge for us. It's a challenge for the industry. We're pretty proud of being able to maintain the running yield at 2.9% in the first half of this year. We'll be challenged to keep that up going into 2020 if rates continue their recent path here.

But in the meantime I think we're comfortably in place with our target return on equity in P&C Re when we get our combined ratio delivering at a 98%. If the price rises that we've seen coming through during the course of this year continue, I think we should be comfortable also in 2020 with the underwriting of the book.

With respect to the retrocessions, I'd argue that this is not necessarily a change of strategy, just an expansion of some capabilities that we've always had. But Edi, why don't you explain where we are?

A - Edouard Schmid {BIO 18942809 <GO>}

Thanks, John, for the lead-in. It's fair to say Swiss Re was at the forefront to establish third-party capital maybe 20 years ago by introducing ILS and so on and so forth. And it's fair to say we have always been using third-party capital. But we didn't make a big fuss about it as maybe other players have done.

But it's -- clearly, we believe nat cat is a very attractive business for the Swiss Re balance sheet, given the diversification, our client franchise, the proprietary risk modeling we have. We are the natural home. So it's clearly our ambition to remain a leader in the nat cat business. And given the growth by just all the risk factors, the concentration of values in exposed areas, all this together just means this is a growing risk pool where we want to play in substantially.

And we already have a certain maximum appetite for hurricane U.S. and some other peak perils. So we get for some of these perils close to these levels. So for us it makes sense then to get as much of this attractive business on our balance sheet and diversify it. Where it becomes too big, there it makes sense to share it with some long-term, third-party capital investors. We've done that in the past. And given the growth outlook (inaudible) that we can also use more of that as we see fit.

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

And just for the absence of doubt, the vast majority of the business we write gross remains on our balance sheet net.

A - Philippe Brahin {BIO 19081619 <GO>}

Ed, thanks for your questions.

Operator

The next question comes the line of Jon Urwin, from UBS.

Q - Jonathan Peter Phillip Urwin {BIO 6126952 <GO>}

Just focusing on reserves. So did you spot anything in P&C Re reserving that weren't intentional discussion during the CorSo reserve review? What drove the P&C Re reserve additions in casualty in the period? And what's your expectations for casualty reserve development from here in the context of some peers' flagging higher social inflation?

A - Philippe Brahin {BIO 19081619 <GO>}

Edi, you want to take it there?

A - Edouard Schmid {BIO 18942809 <GO>}

I can take the P&C Re reserving question. So as we have said, (inaudible) development, over all, was negative, by 5.1%, in terms of combined ratio points. The majority of that comes from the (Jebi) strengthening, which we did in Q1. Otherwise, if you break it down to lines of business there was some positive on special lines. Property obviously was quite negative, driven by Jebi, compensated a bit by some favorable from the hurricanes in '17. Then you have the casualty reserves, which developed slightly negatively during the first half of the year. That was stemming from U.S.. But only from 2 isolated client cases.

Over all, we feel very comfortable with the reserve level, also the U.S. one. As we have explained in the past, we reflected all the (inaudible) strengths and everything in the U.S. So what we have put up now as the reserves there is, in our view, adequate.

I think that's on the reserves.

A - Christian Mumenthaler {BIO 6479864 <GO>}

And I think part of the question was also the look-through from CorSo the learnings from CorSo both underwriting and claims side. Maybe you can say a few words?

A - Edouard Schmid {BIO 18942809 <GO>}

Obviously, it's important to always compare the 2 parts. I think one clear element of the CorSo learning is that we were overexposed to U.S. liability, particularly the large corporate risk. I think we have flagged that already in the past that we have clearly spotted that as a general industry trend, that large corporate risk, the development of the core decisions to settlement just have exploded over the last few years. That's clearly an area we have addressed on both sides. On CorSo we have taken significant actions to reduce that part. But also in Reinsurance we moderate this.

What we can say, the Reinsurance casualty portfolio is a much more diversified business. So it's much more global, much less U.S.-focused. And it has a much broader underlying risk basis. So it's much less focused on these large corporate risks. It has a lot of mid-market and also SME business. That's why the reserve base also in Reinsurance is much more diversified and not exposed to these, let's say, very large individual large limits. And you can also see it in the loss (planning), although we publish that the Reinsurance reserves are much more predictable and robust in nature.

A - Philippe Brahin {BIO 19081619 <GO>}

Okay. Good. Thank you, Johnny, for your questions.

Operator

The next question comes the line of Sami Taipalus, from Goldman Sachs.

Q - Sami Taipalus {BIO 17452234 <GO>}

The first one, it's just on the SST ratio. I know you haven't disclosed a number for H1. But is it possible to give -- there's a lot of moving parts. Is it possible to give some sort of steer on where you are there? And can you just remind us the second buyback, would that be to avoid building the ratio versus where it was at year-end? Or should we think about it relative to your target levels of capital? That's number one.

And number two, it seems like your business is getting a bit more capital intensive as you move into more nat cat business. And obviously, the duration of the casualty book has shrunk, as well. So should we expect that there's a mix shift impact on the combined ratio going into 2020 as well as a sort of tailwind on pricing?

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

Sure, Sami. So let me start with the SST. As you say, there are a lot of moving parts here. And we will give you the July 1st estimate of the SST when we report our Q3 results on October 31.

To help you a little bit with direction, obviously, the capital that was deployed in P&C Re has been or will have (inaudible) reduced the SST ratio. The first $1 billion of growth was already in on the January 1 renewals. And so that would have been in the 251% number that we published as of January 1. The second $1 billion would be worked through. And you should think of that to be a reduction of available capital for us or a utilization of capital.

I think on market movements we've got countervailing forces. Credit spreads have tightened in the U.S. and U.K.. And that's probably positive for us, somewhere between 30 and 40 basis points depending on the market.

On the other hand, interest rates moving down by 60 to 70 basis points will reduce the SST numbers for us. And that second one is probably going to be a larger impact, at least in the first six months, than the credit spread.

So financial markets, net-net, will be negative. The deployment in P&C Re will also be a reduction. We've had the earnings, which are reasonable I think for the first half of the year. But as we continue to deploy capital you should not necessarily expect a lot of other positive moves, absent something in the markets.

So I think we'll see where we are and we'll also see what happens during the next three months of the hurricane season.

A - Edouard Schmid {BIO 18942809 <GO>}

The second part of the question was around the business mix and kind of impact on duration. I think that's the question. I think it's fair to say looking at the growth we've achieved this year in P&C Re so far, nat cat was a driver and a lot of casualty transactions. But the underlying business is mainly short-duration, SME type, which is also short-duration. So there is a bit of shift to shorter tail.

And it's also fair to say in our portfolio outlook, given we see the attractiveness of nat cat and some other short-tail lines, that will be a bit of a shift. Given the broad diversification of the book, I think the mix and also duration is quite robust. So it doesn't change rapidly over time. But a slight shift to a bit shorter tail, that is a fair assumption into next year.

A - Philippe Brahin {BIO 19081619 <GO>}

All right. Thanks. Thanks, Sami, for your questions.

Operator

The next question is from Simon Fossmeier, from Vontobel.

Q - Simon FÃ¶ssmeier

First question is for John, I guess. Can you elaborate what you think is the return on investment on the capital injection into ReAssure and also the $600 million that you invest into CorSo?

And the second question I guess goes to Andreas. On the reserve addition that you're taking in CorSo is this a, shall we say, academically actuarial reserve addition? Or did you put in a little bit of a safety cushion there?

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

Thanks, Simon. Look, I think our belief is the $600 million that we injected into the Corporate Solutions business positions that business to be successful in the future. As Andreas mentioned earlier, we expect in 2021 to return not only to an underwriting profit. But to a return on equity that's within the range, probably a bit at the lower end of that range, of profitability. So when we think about the IRR of this capital, it's linked to the long-term earnings capability of CorSo and I think we're pretty comfortable that that's a reasonably robust return.

On the capital put into ReAssure, I think that is a little different story. Again, in preparation for the IPO we moved the Solvency II capital level from where it had been, at around 120%, up to something close to 145%. That required a total injection of GBP 480 million, of which we put in 75%, about GBP 360 million.

Again, in the long-term value creation of ReAssure, we're confident that this will have a fine return. To give you a sense of what that could look like, the dividend yield that we calculated for ReAssure, had it priced at the lower end of the IPO range, would have been a 9.5% dividend yield, to give you one parameter of the kinds of returns that this business is capable of.

We obviously didn't do the IPO. But we're confident about the business' ability to deliver. We talk in the document sent out this morning about the GBP 2.1 billion that we expect ReAssure to generate in gross cash generation over the next five years, 2019 included. And with that kind of cash generation we think the GBP 265 million of dividend that they committed to is entirely feasible. If we own 75% of that, that will be a nice return.

A - Andreas Berger {BIO 15171017 <GO>}

Okay. I'll take the (case) question whether there's some cushion or buffer built in. Again, I can only repeat. As we did the strategic review we looked at the portfolio and at all cases. And here, I must say we looked at all the rules that we had in place, the timeliness, the accuracy of the claims reserves. And in the roundtables, we looked at the low, the high point, the midpoint. And all available information that was at hand led us then to a best estimate. And this is exactly what we have seen here in the numbers in Q2.

In general, we can say that we already saw a trend that started a couple of quarters before; that was a trend that we acknowledged. And we saw an increased number of claims, not only at the large end now but also at actually the medium-size one, meaning the claims between the $5 million and $10 million range. So before we only predominantly looked at the large ones. And then we saw that below the $10 million range we saw an increased number of claims closer to the $8 million to $10 million. And I think that's a reflection of what we have done here.

So best estimate is exactly the right term here.

A - Philippe Brahin {BIO 19081619 <GO>}

Thanks, Simon, for your questions.

Operator

The next question is from Farooq Hanif, from Credit Suisse.

Q - Farooq Hanif {BIO 4780978 <GO>}

Just going to the adverse development cover. To give us a sense or some confidence on whether that will feed through into P&C Re, can you give us an idea maybe of the confidence level that you price that at? Or perhaps a size of reserves that the $100 million pertains to? Just so we get an idea maybe of if you're charging an arms-length price what is that risk as a percentage of the book that you are pricing in.

And maybe, secondly, going back to the GBP 2.1 billion capital generation in sterling in ReAssure, if I remember correctly that included re-risking benefits, which under SST were difficult to put into place. Are you going to be willing to let that business unit now run and price on a Solvency II basis and maybe take some short-term pain on an SST basis to allow them to sort of continue with the plan that they had before anyway, including re-risking?

A - Edouard Schmid {BIO 18942809 <GO>}

Okay. I can give a bit of color around the ADC. The (inaudible) was really what Andreas has been explaining, that we did a lot of diligence to review the case reserves in Corporate Solutions. And the ADC now attaches at what we think is really a prudent level of reserves in the CorSo back book. And that was also again, as we always do it, reviewed in an independent matter by (inaudible) control, also confirming that the new reserve base is really at the prudent level.

Then on that level, Reinsurance P&C was comfortable to provide that ADC cover. Then also we structured it in a way that only 80% of the risk goes to P&C Re. So Andreas Berger and team is still on the hook with 20%, to have some alignment of interest.

And what is important that as for any other transaction between 2 business units is this has to be (inaudible) on at arms length. So on the P&C Re side, this goes through the normal underwriting and transactional review process, as any other deal. So they come up with their own view. And in the end they felt comfortable at this price that this makes sense to be put on their balance sheet.

And also of this reserve strengthening and CorSo putting it at a prudent level if it did make actually sense to them, keep the residual reserve risk within the group. Otherwise, again, we would just see some marching out of the firm. But we have the capital to hold that residual risk.

But at the end of the day, this is a transaction that is at arms length. And P&C Reinsurance felt comfortable at that price to take the risk with the structuring and everything we have put in place.

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

And just for the absence of doubt, there is a certain asymmetry to this cover, where P&C Re is responsible for 80% of any deterioration, should there be deterioration. But CorSo will actually get 80% of the upside if we find that our reserves are, in some cases, redundant. So I think there's a balance here. But the underlying point is we believe the reserves are well set as a starting point.

With respect to the ReAssure gross cash, the GBP 2.1 billion, you're exactly right. There is a belief that there would be a re-risking component to that.

I'd make a couple of observations. One, I mentioned before the capital that we've injected into ReAssure. Most of that actually came over from Life Capital, which had the capital already in the business unit. A relatively small amount came from the group. But that provides them with a stronger capital base to be able to manage a couple of things, including the potential adjustment of asset risks for the company.

Your larger point I think is as we consolidate it up to the group SST, are we prepared for that hit. And I think within reasonable bounds, probably yes. But again this is a 5-year plan and, as we've said, our midterm objective is to find the means to reduce our stake from the current 75% to 49%. I hope that doesn't take five years. If we don't see any good answer and we're getting our dividends, we may hold on to it. But my expectation is that in this time horizon we will become a minority owner and the freedom on the asset risk side will be unmitigated.

A - Philippe Brahin {BIO 19081619 <GO>}

Okay. Thanks, Farooq, for your questions.

Operator

The next question comes from Vinit Malhotra, from Mediobanca.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Just 2 questions, please. So one is a follow-up, if you like, on buyback. And the second one is on CorSo please. So on the buyback, just it's obvious that SST is a bit lower than the 250% you last reported. If we think of a scenario where interest rates remain where they are the next three months and if the hurricanes or large losses are within the budget, does that make this buyback a bit more likely? Or there's no such probability (inaudible)? I just want to understand how you think of it, because basically the interest rates and the hurricanes are the 2 unknowns.

Secondly, just on the Corporate Solutions, this concept of pruning is obviously needed. But in the past we've also heard from Christian that we are not trying to slow this business too much or not 'shrink it to greatness,' was the phrase I think. And also seeing a 7%, 8% growth rate now. So Andreas, are we looking at actually a lower volume base in CorSo going forward? Or are you saying that there is the shrinkage in this 20% of the $900 million. But you will be very open to finding the growth, arguably, open to making it up somewhere else?

A - Philippe Brahin {BIO 19081619 <GO>}

John, you take the first question.

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

Yes, I'll try. So with respect to the buyback, I'd say we'll look at the comprehensive capital position of the group towards the end of the Third Quarter. Those 2 items that you mentioned, interest rates and large losses or nat cat losses, will be part of the factors.

We haven't changed our long-term target for the SST of 220%. Our starting point in the beginning of the year was 251%. We built the optionality of the second buyback to deal with the situation where we found ourselves with unambiguously excess capital. I think, as I mentioned before, the absence of the IPO reduces the probability. But let's see where we are towards the end of Q3. And as I said, we'll give you clarity on our intentions on October 31.

A - Christian Mumenthaler {BIO 6479864 <GO>}

I think it may be worthwhile repeating what I said before on why do we have the second potential tranche. It came from last November. We had a SST ratio of 280%, which is really very high, the highest we had in a long time. And as we did the business plan, we were worried that it was clear that this year there could be a series of factors, including recovery in financial market, IPO, low nat cat, et cetera, that could be a combination which would lead a year later to an even higher one, which is not really acceptable.

So we said we would like to have this instrument at hand to avoid this situation, for this particular case. And the time we want to take a decision is really in November, because that's when we have all the facts together.

So I think it's very hard at this stage to say if this. But that. There's no formula in our head. We're not on autopilot. There's a real business decision to be taken in view of all the factors we will have there.

So it's not like we try to be difficult; it's really more that I try to make it clear what our intent was with this second buyback. So the goal is certainly not to be above 280%. The risks are much lower right now with the IPO and the capital we could deploy. But who knows? And again, we're not on autopilot.

A - Andreas Berger {BIO 15171017 <GO>}

I'll take the pruning question on CorSo. No. We don't want to shrink to greatness. But what we did in our strategic review, we looked at the portfolio and created 3 different buckets. One bucket was portfolios where it will not see sustainable improvement of our risk exposure and price to risk. So those areas, we said to ourselves, we will not be able to influence this market. We don't have the size and the leadership position to influence this market. So we will have to take action here. So that's where we reduced significantly our engagement. That's bucket #1.

And #2 is the bucket where we said we're so sub-scale in this market. We will in the foreseeable future not reach a position of a leader, a market leader, to also bring in our strengths to differentiate, as well. So that's another area we said if you don't make money in those areas and can't scale up properly. So why be in there? Because we can't bring in our strength.

And the third area are risk sub-portfolios where we believe it might be an attractive market. But the way we are trading and handling the risk is not efficient. So it could be a market inefficiency; it could be ourselves. So that's something we look in detail into it.

And marine, for instance, is such a market, where we say we'd like to be in the marine market. But not in the way it is traded today. So you can't operate with an almost, like, 40% expense ratio in that market. That's not sustainable. Here, we would like to redefine how marine can be done, mostly digitally, in future. And you've seen that we have created a Chief Innovation and Transformation Officer. That's a signal already for the future strategy.

Now the risk landscape is changing dramatically. And I think now is the time to address profitability, to restore profitability, in order to set the foundation for future growth. And I think it requires really fresh thinking and fresh ideas and solutions to bring to the party. The clients welcome if we have the right positioning, we have the right ingredients and assets to bring to the party to really address the risk management changes in the industry.

And we're very confident that we can do this. I already mentioned one area with the global rogram platform that we are providing. But I'd like to give this detail more in our November Investor Day, if you may.

A - Philippe Brahin {BIO 19081619 <GO>}

Thanks, Vinit, for your questions.

Operator

The next question is from the line of James Shuck, from Citi.

Q - James Austin Shuck {BIO 3680082 <GO>}

My first question, again on CorSo. So you show the bridge on the combined ratio from a normalized level of 110% in 2018 down to the 98%. I think about the portfolio pruning, the rate increases and the expense savings. Most of those will be earning through in the sort of second half of '19, into '20. And into 2021. The slide on Slide 15, though, is showing that the combined ratio for CorSo excluding the kind of management actions and the impact from the ADC, is actually running at 101% in H1 2019. So can you just help me square that as a starting point, versus 110% as a starting point?

The second question, thinking about the group ROE targets. So CorSo we're now looking at an ROE at the lower end of the 10% to 15%. You'll be holding on to ReAssure for the foreseeable future, which obviously has a low-single-digit ROE. It looks like you've deployed $2 billion of capital in the period just gone, for $350 million of earnings pretax over two years, which looks like a net-of-tax return on solvency capital around 7%. I guess when I put all that together and think about your target for 700 basis points over U.S. risk-free, which is currently around 2%, I'm sort of looking at that and thinking it looks a little bit challenging in order to hit that as an across-the-cycle target. So maybe you could just give an update on how you see that group ROE target, please.

A - Andreas Berger {BIO 15171017 <GO>}

I'll handle the first part of the question, on the combined ratio on Slide 15. It's fair to say that in Q1 and Q2 I think we had the underlying business that we brought on book is actually very good. We had a benign nat cat situation. So over all, I think we were very happy; also, in particular, with the rate increases that we could generate. So we are very healthy as far as the new business. And I think, going forward, it will look very good.

So the point we tried to make here on Page 15 and the gap between the 132.8% and 101.2% is really the management actions. And here, it's fair to say we had 2 buckets of management actions is Q1 and Q2. And as we said, in Q2 we had a reserve impact after the review of $328 million. This is subdivided into prior years reserving and in current year reserving. So those are the 2 buckets.

Now if you look at the first half-year and only look at the prior-year development, then you take the Q1 $225 million and now the Q2 $264 million, which brings you then to the $489 million as first half-year prior-year development. So that's the situation.

Then if you add again the adverse cover development, the $100 million, this will bring you then to an H1 2019 management actions number of $653 million. So that sort of gives you the overall picture of that Slide 15.

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

And James, my quick answer to the question is, yes, the first half was actually pretty benign. And that's where Andreas started with, for CorSo's core business; nat cat, especially. So the 110% is the right place to start this walk. We expect a glide path through 2020 to get to the '21 (inaudible) target of a 98% combined ratio.

With respect to the group ROE, the continued ownership of 75%, not 100%, of ReAssure will be a drag on ROE. But as I suggested before, the price firming that we see both in P&C Re as well as CorSo lead us to think that the opportunities to make money in these lines is significant on a going-forward basis. I'm not concerned about the group's target of 700 basis points over the 10-year risk-free. And as you say, right now we're diving down to something very close to 2% for that U.S. benchmark. We will work through the asset side of the balance sheet as best we can. But those financial targets I think are entirely achievable by the business mix we have.

A - Christian Mumenthaler {BIO 6479864 <GO>}

If I may add, because I think it's an important question, we are fully committed to this group ROE target and we think it's feasible. You can see the underlying, with 98%, is maybe 11.5% ROE in P&C Re. But hopefully that's not the end of it. We still see some price increases. Over all, the P&C Re market is still in the softer side of the cycle. So I think you can expect a bit more there.

Then CorSo we have to get certainly to the lower end of this range by 2021.

Clearly, we need to do something about ReAssure. That's a key focus. And I think it would be wrong to assume just because we didn't an IPO now that we're going to have it for five years. As we said, the goal is clear and it's midterm. And I think we talk about one year, two years. But in my view -- if we can do it for the right price for the shareholders, obviously. But it's clear there's a focus on that.

Then the excess capital is being deployed as we talk. The earnings are on top. The GAAP capital doesn't change.

So I think we're very focused on that. It just takes time from where we are. It's clearly 2 businesses have now just crossed a bad soft cycle.

A - Philippe Brahin {BIO 19081619 <GO>}

Thank you, James, for your questions.

Operator

The next question is from the line of Frank Kopfinger, from Deutsche Bank.

Q - Frank Kopfinger {BIO 16342277 <GO>}

I have 2 questions. My first question, is there -- on ReAssure and coming back to your point, Christian, on the potential environment you're looking for to restart this project again. We are potentially at peak equity levels and (inaudible) are potentially further declining from here. So what could be the environment you're looking at? Or what would be the catalyst here?

Then, secondly, on Corporate Solutions, in the past whenever you presented combined ratios you always pointed also to a track of 3 to 4percentage points coming from your investment expenses. How should we look, think about those in the context of this new 98% target? Are they also reflected in? Or you don't have any more investment expenses anymore so you have a 3% to 4% release? How are they reflected?

A - Christian Mumenthaler {BIO 6479864 <GO>}

Good. So I'll take, I guess, the ReAssure question. I think about 70% of the work has been done now for the IPO preparation. It is something we can use anyway because it allowed us to extract ReAssure from the Swiss Re group but in a much bigger extent. So all the functions were folded in. We have a new CEO. We have a board. We have basically a new management team. We recapitalized it at a standalone level. And all of that. And so that's precious work and we won't bring that back.

So I think what needs to happen now is that the new management team needs to execute on the plan they have. There's a perspective. There's planned dividends. A lot of things. Some of the investor feedback was that it's not a -- the management team is new and they are not proven. So I think they have now a good opportunity to prove themselves.

We decided clearly not to go for an IPO at the second half of the year because this is a new time window in the second half. But I think in view of the political situation right now that will be unwise to kill everybody in the work to do that. So I think the next date to look at it is probably early 2020, to see where the markets are (inaudible).

I think an asset yielding 9.5% in a market like the U.K. with pension funds and local investors who are not caring about the pound, for example, is not a completely unreasonable -- I think it's an attractive opportunity, honestly, for local investors.

So I'm not particularly worried about the value of this asset over a medium term. So I think it's only a question of time. And obviously, should there be any other opportunities we will also look at other opportunities. But I think we have several potential ways to continue the deconsolidation of this asset. And we're going to pursue them.

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

And Frank, maybe the one thing I would say, what we found in the marketplace, while equity markets, broadly. And in the U.K., specifically, seemed to be functioning fine at the end of June, early July, the primary market was a different story. And the combination of a couple of other IPOs which had gone out the door and performed badly and an emerging concern by institutional investors about putting new money into the U.K. just created an environment where this appeared very, very difficult.

You can claim that our aspirations on price might have been too high. We'll evaluate that over time. But I do think that the weakness in the pound that we've seen in the subsequent weeks is indicative of concerns that were emerging as we were trying to build the book for the IPO, in the first case.

With the second case, on CorSo maybe I'll jump in first and then Andreas can talk about a bit. But a lot of this comes from before Andreas' time. You're exactly right. We have been making these investments both in the Primary Lead capabilities as well as some other technologies. Most of that will, in fact, finish by 2021. But I don't expect CorSo to not invest. There will be important technology-related moves that we will expect to continue.

Having said that, the 98% is a firm number and doesn't have caveats around it. It's not 98%, plus 2 points. It's 98%.

A - Andreas Berger {BIO 15171017 <GO>}

Just to maybe elaborate on that, when we did the review we obviously looked also into the expenses. And investments were always singled out as 3 to 4percentage points. And we saw that the investments went mainly into the Primary Lead initiative.

And the Primary Lead initiative had again 3 buckets. One was domestic primary leads. So we hired people. We developed the skills and the capabilities. And I think this went actually quite well. So you see a much stronger engagement in primary leads. And so not everything is bad. So those lines of business is where we are very strong. That's primarily due to the Primary Lead investment.

And the second bucket was additional lines of businesses. For instance, Accident & Health, we acquired a company and portfolios in this area.

So those are all initiatives that were under the flag or under the heading of Primary Lead.

And the third bucket was the international program platform, the international business program platform.

Now the first 2 that I mentioned, I would say let's declare victory. Those are basically running up as investments and they as business as usual. The third one, that's an area where we are going to drill deeper. We still continue to invest.

So what you see in the walk of the combined ratio slide, you will see 2% expense savings. And this is on a gross basis actually 2.5%. Then you get back to the investments, in particular, on this side of the technology platform. And that brings you then to the 2%.

So we continue to invest. And again, in our Investor Day in November we're going to be a bit more specific about what that means for the strategy, going forward.

A - Philippe Brahin {BIO 19081619 <GO>}

Thank you, Frank, for your questions.

Operator

The next question comes from the line of William Hawkins, from KBW.

Q - William Hawkins {BIO 1822411 <GO>}

Just one small one. Can you update us on where the absolute level is of risk-adjusted price quality for P&C Re and CorSo after these rate increases? From memory, the last time you gave us a P&C Re figure it was 103%, at the beginning of last year. So given that you've had 1 or 2 points of rate increase, I'm guessing that figure is quite easily 104%, 105%. But I have no idea where CorSo is. It's good you've had the 9% rate increase. But I don't know where that actually takes you absolutely.

A - Philippe Brahin {BIO 19081619 <GO>}

Edi, you want to take it?

A - Edouard Schmid {BIO 18942809 <GO>}

I think we stopped disclosing it. The interim price (inaudible) in the past. Because the main point we always want to make is what is really the price change, comparing the renewal basis and the basis we put on our books.

Then I think the big change to new measure, which we explained, is a more simple measure, which would be more comparable to also what peers disclose. And on that measure we now say for the first half of year the basis of renewal this is 1 point better than the expiring is. But it's fair to say that it is an improvement in price quality. It does not reflect some capital allocation and other things. But I would also then say this internal measure, this long-term price (quality), is up a bit. But it's not a number that we disclose, going forward.

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

And that's also true for CorSo.

A - Philippe Brahin {BIO 19081619 <GO>}

Okay. Thank you, William, for your question.

Operator

The next question is a follow-up from Vikram Gandhi.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Very quickly, on costs. So how do you define the normalized combined ratio? So how should we think about the average nat cat losses when we think about the 98% combined target?

Then, secondly, with respect to the aggressive pruning in some lines and growing in others, I'm assuming there must be a natural limit to doing this, as that would reduce the diversification. So any thoughts there would be welcome.

A - Andreas Berger {BIO 15171017 <GO>}

The CorSo normalized loss ratio has a large nat cat budget of $190 million for the full year 2019. We expect something north of 45%, or something, 46%, expected in the first half of this year. That's the main part of the combined ratio normalized.

A - Philippe Brahin {BIO 19081619 <GO>}

Vikram, the second part of your question, can you remind us?

Q - Vikram Gandhi {BIO 18019785 <GO>}

The couple of actions, which is one is the aggressive pruning in lines of businesses, while growing in others where there is good pricing. I'm assuming there must be a natural limit to doing this, as continuing this would reduce the diversification in the portfolio at some point. So any thoughts around that would be helpful.

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

Maybe I'll jump in. I think there's both in terms of geographies but also in lines of business, there remains a robust diversification, even within CorSo. Then when we think about within the group, the concentration on some of the more profitable lines is not going to be a problem for us.

So I don't expect any particular issues with respect to either capital charges and/or earnings concentration to be the issue here as the CorSo portfolio gets rebalanced. I think the important thing you see on one of the pages when we talk about pruning, there's a number of lines where we're going to significantly reduce. But not exit. And part of that is due to be able to serve clients, let's say, that might be great clients for our property book and still ask for some covers, which we're prepared to do for those better clients.

A - Christian Mumenthaler {BIO 6479864 <GO>}

We actually came to the conclusion that the CorSo portfolio was too concentrated, for example, in U.S. liability. So it was not enough protected by Reinsurance. So going forward, with better insurance protection and a bit less, let's say, U.S. liability focus actually becomes a better average in that portfolio. But the diversification may be managed then as a group. And we can use Reinsurance for CorSo to get it all in balance.

A - Philippe Brahin {BIO 19081619 <GO>}

Thanks, Vikram, for your questions.

Operator

The next question is a follow-up from the line of James Shuck.

Q - James Austin Shuck {BIO 3680082 <GO>}

Just a question on the new money rate, really. So can you just give us an idea of as of today what the new money rate is and what you're actually investing in? Obviously, U.S.

rates are higher. But in Europe the situation is very different. And you're seeing yields around 50 basis points. So how are you thinking about risk-adjusted returns on investments? And what does this mean for your strategic asset allocation, please?

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

Sure. So you've correctly identified a challenge for us. The majority of our assets are dollar-related, reflecting the majority of our liabilities. And so the matching, the estimate new money rate that we've got for the reinvestments is something close to 2%. That's below the running yield of 2.9% and, obviously, something we're going to have to manage.

I would say that the Asset Management team has been able in a challenging environment to maintain that 2.9%, in part by going into some alternative investments, infrastructure, other plays, increasing in some cases parts of the real estate portfolio, which are providing solid yields; nothing exceptional. But adequate.

The quality of the portfolio has not changed. We maintain a fairly conservative positioning on the credit book, in particular. And I think that's also reflected in the de minimis level of impairments that we've had in the last quarters.

So this will be a challenge to us, going forward, as it will be a challenge to everyone in the industry. Let's see how we work through it.

A - Philippe Brahin {BIO 19081619 <GO>}

Thank you, James, for your follow-up questions.

Operator

The next question is a follow-up from Edward Morris.

Q - Edward Morris {BIO 16274236 <GO>}

Just a quick follow-up, please. The reinsurance purchasing strategy, going forward, for CorSo could you just confirm whether you intend to consider buying reinsurance externally? Or are you likely to continue just buying it from P&C Re?

A - Andreas Berger {BIO 15171017 <GO>}

So in principle, we prefer to buy internally via P&C Reinsurance business unit. But we're not excluding external markets. Going forward, we are strategically positioning ourselves in buying reinsurance. And we will use external markets, as well. But obviously, we prefer to use internal markets.

A - Christian Mumenthaler {BIO 6479864 <GO>}

It has already been in the past a combination. It's a business we like and if it was within our overall risk tolerance should, as a first priority, stay on either the CorSo or the Reinsurance balance sheet. And only if it gets above what we can digest within our own balance sheet we go externally. But it's important also for CorSo to be a bit more direct in the market. It's also feedback signals. So it's both. But the first priority is to keep the risk we can diversify in our balance sheet internally.

A - Philippe Brahin {BIO 19081619 <GO>}

Thank you, Ed, for your follow-up questions. This is actually the end of the Q&A session, as there are no more questions. So if you have any follow-up questions don't hesitate to reach out to any member of the IR team.

Thank you, again, everyone, for joining today. Operator, back to you.

Operator

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