Q2 2015 Earnings Call

Company Participants

- George Quinn
- James Quin
- Martin Senn

Other Participants

- Andrew J. Ritchie
- Andy D. Broadfield
- Andy Hughes
- Daniel Bischof
- Dhruv Gahlaut
- Farooq Hanif
- James A. Shuck
- Michael I. Huttner
- Nick Holmes
- Paul C. De'Ath
- Stefan Schürmann
- Thomas Seidl
- Vinit Malhotra

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, good morning or good afternoon. Welcome to the Zurich Insurance Group Half Year Results 2015 Analyst Conference Call. I am Psy, 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. James Quin, Head of Investor Relations and Performance Management. Please go ahead, sir.

James Quin {BIO 18345789 <GO>}

Welcome to Zurich Insurance Group's first half 2015 results presentation. I'm joined by our CEO, Martin Senn; our CFO, George Quinn. Martin and George will make a few short comments before we open the Q&A. As usual, please keep to two questions.

I'll now hand over to Martin.

Martin Senn {BIO 3241585 <GO>}

Thank you, James, and welcome everyone on the call on my behalf as well.

As you will have seen from the results we published this morning, we continue to make good progress in our Life and Farmer businesses, while the performance of General Insurance is below our expectations. We set out at the Investor Day the actions on the way to improve both expense and loss ratios. Let me be clear, delivering on these commitments is my number one priority.

While we are not fully satisfied with the progress made in achieving our business operating profit after-tax return on equity target of 12% to 14%, we are well-positioned with respect to our solvency ratio, which is at the top of our target range, and we now expect to achieve cash remittances in excess of $10 billion over the course of this three-year strategic cycle ahead of our target of $9 billion.

Let me now say a few words on the press release we issued last week regarding our interest in RSA Insurance Group. At this stage, there is very little that we can say on this topic. However, we believe that the transaction could bring significant benefits to us and to our investors – in terms of the complementary fit of RSA's business with our own operations and in terms of financial benefit from, for example, expense and other synergies.

But let me make one point absolutely clear, this or any other investment must meet the hurdles that we set last year, 10% unlevered. And as we said repeatedly in the past, if we are not able to achieve this organic or inorganic opportunities, we'd rather return capital to our investors. Let me also reassure you that this does not and will not distract us from our core focus on delivering on the commitments to investors that we made at our Investor Day this year.

And with that, I will now hand over to George, who will give you his perspective on the numbers. Thank you very much.

George Quinn {BIO 15159240 <GO>}

Thank you, Martin, and good morning or good afternoon to you. I'll make a few short introductory remarks on the results. As part of that, I'll try and answer some of the questions that we've been asked this morning.

Naturally, most of the focus has been on the higher than expected combined ratio and I'd break this down into three parts. First of all, we've experienced that particularly significant level of large losses in both Q1 and Q2. We're around 1.5 points above expected and around 1 point higher than we were to the full year 2014.

Second, looking at Q2 compared to Q1, we see an uptick in the attritional loss ratio around 1%. This is due to several individually small factors, and we don't see them as representative of the run-rate. We will steer you towards half-year result where the attritional loss ratio is essentially flat compared to full-year 2014 levels.

Third, a higher expense ratio is as we expected and in line with the indications that we gave to the market back in February. I've no doubt that you'll have lots of questions on each of these topics, but let me stand back in the detail for a second.

At the recent Investor Day, we told you that we have plans in place to improve our combined ratio by 2 points to 3 points from a normalized full-year 2014 starting point of 98.5%. Our half-year combined ratio is 98.3%. Our Cat losses are below plan. Large losses are well above recent experience. So the reported number, in our review is close to a reasonable starting point. In other words, we are in a similar position to where we ended 2014.

Of course, this is not where we want to be, but the bottom line is that we still need to improve our loss ratio by 1 point to 2 points, and we need to reduce our expense ratio by 1 point. This is our overriding priority, and we have plans in place to achieve that. Time is short, but we are confident that we can deliver.

Before we start the Q&A, however, I want to emphasize the progress that we are making in our Life business and in Farmers and in fact in many parts of our GI operations. And it actually remain in a strong place in terms of solvency, and our cash remittance and capital generation continue to be excellent.

With that, and I look forward to your questions.

Q&A

Operator

We will now begin the question-and-answer session. The first question is from Andrew Ritchie, Autonomous. Please go ahead.

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

Hi there. I wonder, I mean, there's clearly evidence that the pricing environment will continue to get a bit tougher. Now, I guess you flagged this earlier in the year, but at least give us perspective as to what should we be more concerned as to the feasibility of you hitting your combined ratio improvement targets given the pricing backdrop, has that changed materially in your thinking over the last quarter?

Second question, is there any specific areas inflating the attritional loss ratio in Q2? I mean, I'm thinking areas that have been problematic in the past. For example, you have some issues in U.S. commercial auto and we're seeing a lot of your peers have issues there. Maybe just give us a bit more color as to any specific blocks that affected Q2 attritional? Thanks.

A - George Quinn {BIO 15159240 <GO>}

Thanks, Andrew. So I'll start. So on the pricing environment, I mean, it's slightly tougher than it was at the end of Q1. I mean, we were coming down from our perception of about slightly less than 2% and rate increased a bit more than 1%. And that from a perspective of what we'd anticipated and what we'd included in the commitments that we made it doesn't change the overall picture materially. So I mean, this is not driven by a rate topic today.

On specific areas impacting the attritional, I mean, let me just be clear for everyone. If you compare Q1 versus Q2 and look at the sequential, there was a deterioration on the attrition of about 1 percentage point, even as we still have retained about 0.4 points compared to last year in the half.

I mean the main driver, Global Corporate in North America is a piece that stands out, and within Global Corporate and North America there are really two drivers: so one is property. And it's, by the way, the largest part of it. And we've seen not only elevated large loss and we've seen much higher attritional losses in the quarter, I mean, far larger than the rate change would suggest you would expect to see. And our conclusion there is that that really is, again, natural volatility in the result rather than a trend that we expect to continue into the second-half of the year.

Liability is a smaller contributor to the overall. If you look at U. S. commercial auto, we were booking across all our businesses around the 1.04 mark last year, which of course was too high. In Q1 we saw pretty good rate across most of the portfolio, certainly exceeding our expectation of what was certainly on the loss cost side.

However, rate has – well, not declined, because the pace of the increase has slowed in Q2. And at the end of the half for the six months we've booked commercial auto at 1.07. I mean, again, in the scheme of things, it's a relatively small move, but it gives you evidence of an area that we have to tackle to be able to achieve the overall goal.

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

And you've looked into the large losses in terms of identifying any trend to do with economic recovery or any – I mean, is there any sort of commonality across the large losses?

A - George Quinn {BIO 15159240 <GO>}

That's a good point. As you can imagine, we've looked at it pretty intensely as we (09:36) – I mean, just to give you something. I mean, in Global Corporate alone we have 13 large losses in the first half of this year versus four in the first half of last year and 4 of the 13 are more than 10 this half versus one last half. We have large losses in the Zurich municipal business in the UK. We've got two that total $80 million. And we've done the normal postloss review, which means we go back. We look at the risk engineering. We look at the underwriting, and we compare the total identified risk drivers of loss.

And through all of these things, well within the P&L's identified in all cases, for these items, the cause of the loss as the primary risk driver is identified. I mean, I don't see anything from an underwriting or acceptance perspective that would have us conclude that this is a frequency issue, and there's clearly severity on the property side in Q2, but there's no reason for us to see that as a trend. And so, I mean, hence, what you've heard from us today that we don't think that Q2 is representative of the underlying run-rate. We think the half is a better guide.

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

Okay. Thanks.

Operator

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

Q - Daniel Bischof {BIO 17407166 <GO>}

Yes. Good afternoon. Two questions from my side. First of all, on your debt capacity. At the Investor Day you mentioned that Zurich might increase the leverage and to move the hybrid debt share from 14% to 20%.

In addition there is this 5% volatility buffer, now my question is this buffer mainly for market movers and unforeseen events, or could you see this entirely for M&A?

And then the second one, a rather broad-based question, on the industry consolidation that's taking place, what's your view on the potential impact of this in some of your main business areas such as Global Corporate and on net (11:44) commercial and products?

A - George Quinn {BIO 15159240 <GO>}

Right. So, on the first one on debt capacity, the 5% that you saw on the slide at the Investor Day was intended to be (11:53) passive movement. So I mean, I don't expect you see us actively use that to eat up some of (12:0) natural volatility, equity or the EFR, and they normally – they'll be using in that calculation.

On the industry consolidation side of things, I don't have the sense that that's a big driver of current trends. And my sense is that we're in an industry generally that is very well-capitalized. There's more capital chasing the available risks that is there, and of course, that puts pressure on price. It started in reinsurance, particularly in the property side, has fed through into the primary market. I think – I mean for me, Daniel, that's part of the main driver, some of the dynamics that you see currently.

A - Martin Senn {BIO 3241585 <GO>}

If I may quickly add to that. Good afternoon, Mr. Bischof. Just on the industry consolidation and the impact on sales specifically, naturally observe that very closely and think about the impact on our sort of positioning and with that as well the behavior on our customers and clearly some of the larger transactions (12:58) referring specifically to it, there is not – in some of them, there's no customer interaction, i.e., in some of the customer segments in some of the regions, they actually do not even cover. So with that the immediate impact on Zurich as such, I would say, is in no way material.

Q - Daniel Bischof {BIO 17407166 <GO>}

Thanks a lot.

Operator

The next question is from Paul De'Ath, RBC. Please go ahead.

Q - Paul C. De'Ath

Hi there, and thanks for taking my questions. And the first point was on the capital position because, obviously, it's kind of a quarter delayed that then we get the numbers through on that, and so just kind of any indication on where that might have moved in Q2, would be good?

And second point kind of related to it, I guess, is you've said before about the $3 billion of deployable capital that you have and has there been any new change to that figure over the last quarter given the higher level of cash that you're now targeting for the year, et cetera? That would be great. Thanks.

A - Martin Senn {BIO 3241585 <GO>}

Thank you, Paul. Let me start with the first part of the question. Now obviously, the Zurich Economic Capital Model of 120% at the up range refers to the first quarter. And if you just look on how interest rates have moved, all other factors being equal, you probably would have to assume that our economic capital position, if anything, has improved in the course of the second quarter. I do not want to see that now as a very firm guidance in anyway, but I just would like to guide you in looking at interest rate changes and respective sensitivities and then you can come to conclusion that if anything our economic capital model as of the end of the second quarter will be better than we have reported now for the first quarter.

A - George Quinn {BIO 15159240 <GO>}

Paul, its George. So, on the $3 billion number, so I mean – I guess, I updated on the $3 billion number back at the Investor Day in May. I mean, I think, we believe, we have a good line of sight, I mean, where cash generation is coming out, and we've been very fairly confident at some time that we were going to exceed the expectations both last year, and again you've seen – we'll exceed the target we've set for this year. So, I mean, what it really means though is that when we put the $3 billion together at the Investor Day, I anticipated, I mean, what you're seeing today, so I'm not at this stage listing the $3 billion number.

Q - Paul C. De'Ath

Okay. Thanks.

Operator

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

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah. Thank you. Good afternoon. Two questions. The first is on the combined ratio improvement you said and remind us that you want to improve by 2% to 3%, and that you had specific action, and if I understood you correctly on the transcript you said, these action should already strongly materialize by year-end. Can you share with us what type of actions you have in mind that should lead to such quick materialization of an improvement of the combined ratio and loss ratio in particular, and especially in the context of as you already mentioned, the rather weak pricing development in the recent quarter?

And the second question is, on the reserve release side, we know that Zurich is much lower in terms of reserve lease than peers. I wonder, what is the driver? Is that basically you're not experiencing the same benign claims inflation or why is it that peers basically report on much stronger reserve releases?

A - George Quinn {BIO 15159240 <GO>}

Thomas, on the first one, just to make sure that we're very clear on when we expect to see various elements. So I think there are two comments in the transcript, I mean, Martin made the comment that you start to see improvement by the end of the year, which I think we all expect. I think be careful though around the expense topic. I mean, the expense piece takes a bit more time because it needs to move people around as part of that process. So in my transcripts I had to make it clear that I think you'll see the benefits of that more clearly from the beginning of next year.

I mean for us, I mean, what would drive the improvement on combined ratio, I mean, market rate is not going to be the driver of this, so there's no assumption that the rate environment will help improve it. I mean, again going back to what we had at the Investor Day, we have an approach that we described as tearing, it's been very successful for us in the past, I mean, and I guess, at its simplest, I mean, pruning out or pushing for a much higher rate increase on the weaker part of the portfolio.

And I guess, I mean, what that really means is it puts volume at better risk in the short term as we make sure we get the required level of profitability from the portfolio. I mean, the second chance we have and it goes back a bit to Andrew's comments earlier, I mean, the – I mean, it's not a fixed target we're aiming for in terms of the outside world. Things are moving, so, of course, we have to adopt and adjust to the external changes. And again, going back to, for example, the commercial auto topic, I mean, we saw rates that was more or less as we expected in Q1, the market again is more competitive in Q2, and again, it's an area that needs increased focus from us and that will mean reducing our footprint in U.S. Commercial.

On the expense side, we have a number of things under way at the moment. I mean, the first waves have started, so we started communication to the staff, but again because of the need to transition, for example, for shared services. I mean, we'll be up and running for a number of the functions at the very beginning of next year. So, you'll only see a more significant impact to that in 2016, and that will continue the wave not just through the course of next year, but also beyond that as we achieve the larger $1 billion target that we have for expense saves.

Reserve releases, so, why we're much lower than peers. And I mean, without an in-depth knowledge of, I mean, where the peers were, where the peers are, and the immediate drivers, and we tried to be relatively transparent on what we expect. We gave guidance about more than a year ago that we expect it to be broadly in the range of one to two, I mean, and generally, we have been, I mean, a bit we were up and down, but I mean, given the way that we reserve, and assuming that our reserves are adequate, which we completely believe, the reserving process we think will unwind prudent margin that we add in the pricing process and hence the guidance that you hear from us.

A - Martin Senn {BIO 3241585 <GO>}

Yeah. Hi, Thomas. Martin Senn speaking. I just wanted to add to the first part on the question and this is very important because the rollout of the current strategic priorities, one key action is definitely looking for the turnarounds South Africa, Middle East, Latin America, Brazil in particular, the motor business, and one very specific still high on our priority list follow-up is the continuous improvement potential in South Africa, the Middle East and LatAm, and we believe and as we have made good progress, particularly South Africa, Middle East that there is still about a half percentage point improvement potential, which is going to be one of the priority still for the next 18 months.

Q - Thomas Seidl {BIO 17755912 <GO>}

And the pruning of the portfolio that you mentioned, so basically, you would expect to come as quickly through as by year-end already?

A - George Quinn {BIO 15159240 <GO>}

I mean, it's in flight already, Thomas, I mean, I expect to see impacts by the year-end.

Q - Thomas Seidl {BIO 17755912 <GO>}

Okay. Thank you.

A - George Quinn {BIO 15159240 <GO>}

You're welcome.

Operator

The next question is from Farooq Hanif, Citigroup. Please go ahead.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi, everybody. Thanks very much. Clearly, that you talked regularly about volatility in double the (21:19) corporates and sometimes you get it, now you do during 2Q, but this is obviously something you can't control easy with reinsurance, but it's the nature of how the losses are distributed, but can you give us a sense of what you think normal volatility is and large losses. So, what – you've got a 2-point to 3-point combined ratio improvement target, but how much of that just could be swallowed up because of misfortune?

And the second question, I have is, on your 10% hurdle for use of $3 billion surplus capital, or any acquisitions you may or may not make, I mean, do you still give yourself the same timeframe for 2016 for that or will you give yourself an extra one year or two years worth of leeway? Thank you.

A - George Quinn {BIO 15159240 <GO>}

So, Farooq, I mean, I'll start. I guess, Martin may add to this. So on the volatility, I mean, you ordinarily see – we look at the total volatility of the property portfolio, I mean, we haven't in the past broken out the large loss piece, and in fact you'd probably remember that we added large loss into the attrition, I think, about 15 months ago, to try and simplify some of the explanations. But of course, given the size of the impact that we've had in this quarter, we have to break it out again. I mean, I can't immediately give you a clear sense of what a large loss tolerance for volatility, I mean, we have clear earnings volatility tolerance, but all sources of claim, I don't have a piece that would break out the large loss. I mean, we'll have a look at it out of the combined year.

On the timeframe for the TAM to the reinvestment or the return, the timeframe remains exactly the same.

Q - Farooq Hanif {BIO 4780978 <GO>}

So just coming back on the large losses, I mean, would I be correct in thinking that you're not thinking of changing anything in the way you reassure your book to help this, because it's just bad luck, is that correct?

A - George Quinn {BIO 15159240 <GO>}

Yeah. I mean the – I mean, part of the challenge of a quarter, this is that, I mean, I guess everyone starches their head a bit and ask me why do you end up here, I mean, you get compared to peers, and I think there's a risk that maybe you get pushed to do the same though uneconomic, and we annually review the reinsurance program, we'll be through that process as we come up to the year-end. I mean, I think the – I mean, given what we see in terms of volatility, given what we believe with the underlying drivers, I mean, it wouldn't actually help us achieve our goals if we want to – buy a much more significant reinsurance program, I mean, end of the year, we'll look at reinsurance again, but I mean at this stage if we have no plans to change the stance on reinsurance.

Q - Farooq Hanif {BIO 4780978 <GO>}

Okay. Thank you very much. Thanks.

Operator

The next question is from Nick Holmes, Société Générale. Please go ahead.

Q - Nick Holmes {BIO 21515144 <GO>}

Hi, guys. Thank you very much. Two questions, the first is on expenses. You say that the higher expense ratio is mainly due to mix effects and the Brazilian warranty business, but when I look at each geography, there don't seem to be a general expense ratio drift, I mean, I'm looking at UK, Germany, Switzerland, Italy. It all got worse in the first half.

And my question is really, what's causing that and when do you expect it to stabilize? I mean, George, I think you said, we won't see improvements until beginning of next year and I just wondered if you could elaborate at least on that.

And then the second question is on German Life. Can you remind us where you are with the ZZR, presumably you still have to add to it and my question is, just is there still a cost to shareholders from making additions, I mean, it's a bit of an opaque subject, I think. Thank you very much.

A - George Quinn {BIO 15159240 <GO>}

Yeah. Thanks, Nick. So on the expense, I mean, just to broaden the explanation, you picked out some of the bigger drivers, so the impact of the extended warranty deal in Brazil, we have the impact of the comparison with the pension positive impact in the prior year. But I think in the transcript, we've also flagged the fact, I mean, there are other expense increases, especially around some of the growth initiatives we've been running, which is why, I think you see some of the expense increases in some of the countries that you've mentioned.

I mean, so, what does it take to – the beginning of next year to turn around the expense picture? I mean one, I mean the – on the extended warranty transaction in Brazil, I mean, that contribution is driven by the fact that, we're amortizing an upfront cost, but with no margin yet being earned, that will start in a more significant way in Q4. And of course, we'll start to have that benefit with the revenue start to actually match some of the expense.

The pension piece, you're aware of it from last year is 0.4 points on the expense ratio. Mix, we have a backdrop the first half versus second half, so that also has a small impact. And then again, the investments that we have been making and we continued in Q2 to position us for growth in some markets and clearly to improve customer experience in some of our key product areas. So, the turnaround for us would be combination of the extended warranty premium coming in with the margin.

And on top of that, all of the additional steps that we're currently working on across the fund, and in fact, you may see in the quarter that we've incurred a bit more than $70 million of restructuring charge as we start to take steps to create shared service centers, start to inform staff of the changes we're about to make. I mean, you can imagine that to do that in a controlled manner we're introducing management risk into the process, there needs to be a reasonable transition period and that's why it takes till the beginning of next year.

On the ZZR topic, I gave an update at the end of last year, where I indicated, I mean, the total impact we anticipated from ZZR I'd given an indication that if we did nothing, given where interest rates were at the end of last year, we'd anticipate seeing, I mean, €100 million to €150 million impact from ZZR, which is shareholder relevant from about 2018 through 2021, while we would build the ZZR reserve up to the level acquired and applied by the, I guess, the smooth average impact of the interest rate. I mean obviously, as interest rates rise, it's beneficial so that reduces the impact, but I mean if you look at the last six months, we've been down a lot. We've been up a bit, I mean, at this stage, I mean, that wouldn't change the guidance I've given you at the year-end.

I mean, I understand there is some discussion in Germany about how the practice of ZZR should be applied across the industry. I mean, there may or may not be changes, but in the absence of changes, the year-end guidance that I gave would be the best point to watch from.

Q - Nick Holmes {BIO 21515144 <GO>}

Okay, sound good. That's very clear. Just one very quick follow-up. On expenses, would you say that you are happy with where you are at the moment, or I mean, with the progress that you're making, obviously, you're not happy with the expense ratio, but with the progress you're making, is everything going as you would expect and everything on plan?

A - George Quinn {BIO 15159240 <GO>}

So, on the expense side, it is.

Q - Nick Holmes {BIO 21515144 <GO>}

Okay. Great. Thank you very much.

A - George Quinn {BIO 15159240 <GO>}

You're very welcome.

Operator

The next question is from Michael Huttner, JPMorgan. Please go ahead.

Q - Michael I. Huttner {BIO 21417183 <GO>}

Thank you very much. Two questions, on the cash remittance, the over €3.5 billion and the new higher target of €10 billion versus €9 billion before, can you say a little bit where it's coming from or – what I'm not quite – we're not sure, is this dividend from the way – from the Non-Life to General Insurance year 2014, 2015, or was this your expectation of the current business trends?

And then the other question, to lighten things up a little bit, so could you talk a little bit about the nice thing, which is the improvement in Life and maybe where you see that going? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Okay. Thank you, Michael. So on the cash, first of all, I mean, you remember last year that we reported €3.7 billion for the year, €0.5 billion of which was really one off. This year, we've indicated more than €3.5 billion, and therefore in total, we now expect to see more than €10 billion for the three-year period. I mean, typically the cash that you receive in the current year is a reflection of the – it's actually declaration of the results of the prior year.

So what you're really seeing here is cash flow is up from the subsidiaries that, I think, by and large but not exclusively will relate to statutory earnings from 2014. I mean, drivers of this, so I mean why do we continue to see outperformance, I mean, there'll still be some one-offs we anticipate this year. So, the impact of the sales of the immediate duty (30:57) portfolio in the UK, which of course will be positive. We have another sale of an asset management business in the U.K which will also provide us with another small positive. And again, I mean, we would expect – and you see a bit in the free capital generation slide to maintain a very high array of conversion of earnings into cash. And I mean, given our outlook, I don't see that that's going to significantly change over the course of this year or next.

Q - Michael I. Huttner {BIO 21417183 <GO>}

Fair enough.

A - Martin Senn {BIO 3241585 <GO>}

Maybe we'll take one more. Sorry. Hi, Michael, before George goes into his Life question, well, let me just clarify a little detail you mentioned the revised targets. The targets have not changed. Its €9 billion plus by end of 2016. We just give you additional guidance though we have a clearer expectation to exceed that target. Just want to be precise, as this was not a resolution but guidance on the excess of it.

Q - Michael I. Huttner {BIO 21417183 <GO>}

Yeah. Lovely.

A - Martin Senn {BIO 3241585 <GO>}

Thank you.

A - George Quinn {BIO 15159240 <GO>}

On Life, I mean, if you look across the entire book (31:58), we have a number of areas of strength, I mean, even some unusual areas Germany Life had a very strong performance in the quarter. I think the standout one for me is Zurich Santander as Zurich Santander has growth in local currency of 50% in the quarter.

Q - Michael I. Huttner {BIO 21417183 <GO>}

Wow.

A - George Quinn {BIO 15159240 <GO>}

I don't think that's going to be sustainable, but it the same that – I mean, the performance there is very powerful. I think the combination worked extremely well. And again, going back to what we talked about at Q2 last year, our operational leverage and around that transaction, I mean, growth rate I think will stay high, north of the 50% level, lower double-digit range. But I mean, a large yarn of the cost piece there is fixed. So that should continue to help drive Life in the right direction.

Q - Michael I. Huttner {BIO 21417183 <GO>}

Okay. That's very good. Thank you very much. Thank you.

Operator

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

Q - Stefan Schürmann

Yes. Hello. I have two questions. The first one is on U.S. Global Corporate view, you mentioned that you have taken steps to improve. It hasn't been a nice quarter here. Can you maybe just give a little bit more details on what exactly you do in what sub-segments or what large or small accounts you're active to take corrective measures?

Then the second one just shortly on duration management, can you give us any – an update here? Is there any change compared to last quarter or not?

A - George Quinn {BIO 15159240 <GO>}

If you look at the Global Corporate North America business, I think there are two issues we've been focused on as we prepare for the quarter. So, one is, I mean, obviously, it's a source of the large loss volatility. I mean, there's a large element of that that we see as temporary, so it will reverse. However, having said that, when we look at the tiering approach, we're going to add a second step to tiering, which is around the volatility of the accounts.

So, I mean, a bit going back to Farooq's question about your appetite for volatility, we'll address it partly and through risk acceptance approach. So, if we see clients that have traditionally – frequently been a source of volatility that will push them down in the tiering and will therefore require much higher rate increase of renewals. So, that's one area.

The other area is – I mean it's a – and we discussed that, again, earlier in the call, commercial auto is a challenge for us. I mean, if you break out just the Global Corporate component of commercial auto, we saw good rate increase after the results of last year, which of course were pretty poor. So, we saw good rate increase in Q1. I think our expectation whether that would be sustained over a longer period and that would bring the overall combined ratio from – for commercial auto down from its current low hundreds level back into a territory where you could make a reasonable proposition that you're earning a good return on capital.

Having said that as I mentioned earlier, Q2, the trend hasn't completely reversed, but the achieved rate increase has dropped and has dropped to a level that we don't believe would maintain pace with the loss cost trend in commercial auto given the – we talked a bit earlier on some of the economic frequency driven topics and commercial auto is clearly one of the lines that's impacted by that.

So that again is another area that will push harder for rates and that will almost certainly hit at the margins we shared some of that volume. I mean, those are two of the most obvious example, Stefan.

Q - Stefan Schürmann

Okay. Yeah. Thanks.

A - George Quinn {BIO 15159240 <GO>}

On duration management, I mean, we don't have a particular stance on duration. We're by looking to be broadly ALM matched, I think we are slightly long in the scheme of things. It's not particularly material overall.

Q - Stefan Schürmann

Okay. Thank you. Yeah.

Operator

The next question is from James Shuck, UBS. Please go ahead.

Q - James A. Shuck {BIO 3680082 <GO>}

Afternoon. I have two questions, please. Firstly, just I think you're conducting a retail portfolio review, which has been ongoing for some time. I just want to – some kind of update on how that was progressing? In particular, I'm kind of interested in how you actually look at profitability metrics on that basis. And for example, I mean, you have your BOP ROE target, but I'm kind of interested in divisional return on risk adjusted capital within that division, please. Thank you.

And then secondly, the point you made around sort of capital compressing prices somewhat in commercialize. Could you just shed a little bit more light on that? I'm interested in kind of more insight into which lines of business and which territories you're seeing that most impacted. Thank you.

A - George Quinn {BIO 15159240 <GO>}

So, on the retail portfolio review, maybe I'll start, and maybe – I can explain some of the – I mean, the metrics that we use as we evaluate the portfolio. The one thing I can do, James, is give you a sense of, I mean, where we are on process against each of the different components. Maybe just to recap what we said at the Investor Day, we've looked at the entire retail footprint. We've put it through a series of decision points that we described at the Investor Day and we've concluded, I mean, where do we believe we should grow either from a particular customer segment perspective or from a broader market perspective. Why do we believe we have niche, and we don't have many niches in the portfolio. And then we have everything else. And everything else, I mean, there's a minimum return on capital requirement for businesses to pass the first test. I mean, we look at it from two perspectives. One is the end return on capital for our business, and the second is the market, the expectation of what the market will deliver over the medium term.

I mean, when we look at what we have in the, I guess to determine the range for the bucket that doesn't fit into the group that we're actively looking to expand either organically or inorganically or looking into niche, I mean, we have a mixture of things in there, I mean, many of which don't pass reasonable test for return on capital. And we actually have some things in there that actually produce decent returns on capital. Just as we look at it today, it's not obvious that we are the best owners on some of those businesses in the long term.

And obviously, as we prioritize the action that we're about to take here, we'll prioritize dealing with the underperformance, but I mean, there are parts of the portfolio where I think the, I mean, our ability to grew it within our strategic priorities is maybe less and perhaps (38:53). So you see a mix of things from us over the course of the next year, some of which are clearly underperformance, some of which are simply about your long-term strategic fit.

A - Martin Senn {BIO 3241585 <GO>}

Just from my side to add on the retail footprint question, I mean, I think we have spoken about that advance on the May Investor Day, and we showed you at the time on how we evaluate that retail footprint. There was also decision tree in respect of this pact. This process is very much ongoing. After the sale of the Russian retail business still in 27 markets, lead is on in a few markets, which sort of, obviously, I would say guides in a direction that we have to address the issue, and we're in the midst of this devaluation. Our large size positions account for about two-thirds of the retail GWP for both GI and GA, respectively. So, if there's more to say and to be much more specific and concrete, we will obviously come back to all investors and Zurich stakeholders.

A - George Quinn {BIO 15159240 <GO>}

On the capital topic and capital impact in pricing, I mean, it's not particularly unique, so – I mean, starting from the reinsurance and the emergence of alternative forms of capital as expanded supply puts pressure on pricing. That push through as the primary comes of benefit from lower reinsurance rate, that's particularly impacted property and maybe to put a number on it, I mean, for example in the U.S., I mean one of the largest territories. I mean, we see rates on U.S. property falling about 4% in the first half. And that we see is a continuation of – I guess, the factors I just described.

Q - James A. Shuck {BIO 3680082 <GO>}

And is it fair to say that some of the trends that you're seeing in the U.S., is it starting to spread beyond U.S. and into Europe, particularly on the commercial line side?

A - George Quinn {BIO 15159240 <GO>}

I'm not sure draw that conclusion. I mean the cycle in Europe looks as though it lags a bit. So I mean there's a possibility that it's starting to feed in. But when you look through a portfolio, I mean, U.S. property the only one stands out with a number that's as dramatic as the one I just gave you, I mean, everything else is either flat to positive around that type of level in U.S. property, it's the one that does stand out and has stood out for some time.

Q - James A. Shuck {BIO 3680082 <GO>}

That's very helpful. Thank you.

Operator

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

Q - Vinit Malhotra {BIO 16184491 <GO>}

Hi. Good afternoon. Vinit from Mediobanca. So if I can just ask George on the Z-ECM level, because in the 1Q the comment was that – in the 1Q result rather and the comment was that at 1Q, it was in the upper half of the 100% to 120% and it's coming a little bit more than one would have been anticipated, has there been any changes and any kind of market risk or any other treatment in the models or anything else that you think we should think about?

And the second question is, I mean, all these years, one of the topics that was supposed to help was the use of analytics and predictive analytics, which you have also pointed to in the transcript as now running in 21 countries and NEC was a successful example. And so where do you think the GC bit went wrong? Was the analytics still ramping up, or was it relied too much on or any feedback that would be great? Thank you, George.

A - George Quinn {BIO 15159240 <GO>}

Thanks, Vinit. I mean I guess on Z-ECM, no model change in the number, so this is simply parameter update. And I guess, I mean, the upper half of the range I guess, comes back a bit conservative, I mean you would imagine that, I mean, I didn't know it to be 120% when we gave upper half of the range. I thought it could be slightly lower than that.

But I mean the calculation is purely based on parameter updates. There's no model change. On the use of analytics, I mean, I don't think I'd point to a lack of analytics that's driven the issue at Global Corporate. I mean, as I said earlier, I mean, large loss is the predominant driver of the issue there. I mean, there's a bit of weakness on the liability side I described earlier, but the standard factor is the impact of large loss and the impact in attritional in the quarter. And again, I mean, we see both of these as natural volatility that can occur and it's something that we accept with the business model that we have. So we retain probably more risk than most of our peers, I mean, we don't conclude there's an analytics problem or there's an underwriting issue.

And again, I mentioned earlier that what we have done to evaluate the losses that we've seen is to try and draw conclusion as to whether there's some flaw in our underwriting process or risk engineering set, and I mean from what we see there's no evidence of that.

Q - Vinit Malhotra {BIO 16184491 <GO>}

And, George, can I just follow up on the – just quickly. So there seems to be a slower GC growth outlook. It used to be three-odd percent and now it's zero to slightly down for the year. So clearly, you seem to be taking an action, but then – I'm not clear whether it's something that were naturally improved or you need to take an action because something has been found to be dramatic point (44:38) or...?

A - George Quinn {BIO 15159240 <GO>}

Again, I think it was – I mean, probably I think I had somebody ask the question earlier, but the – and the question I mean, what you're doing about what you see there. So, I mean, things like the commercial auto side, which is clearly not going to reverse. I mean, we have to take action and that will impact volume. So hence, the guidance I've given you around the expectations of top line growth for the remainder of the year. So, I mean, we'll become a bit more cautious around that.

On the property side, I mean, I think we will evaluate, I mean, how we see our clients in addition to a rate profitability also on volatility. And I think that's a prudent addition to the way that we look at things. I don't see there's a major analytics problem.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Thank you. Okay. Thank you, George. Thank you.

A - George Quinn {BIO 15159240 <GO>}

You're very welcome.

Q - Operator

Yeah.

The next question is from Andy Hugs (sic) [Andy Hughes] from Macquarie. Please go ahead.

Q - Andy Hughes {BIO 15036395 <GO>}

Hi. Sorry, it's Andy Hughes, but you can have a hug anyway. So, I kept the questions if I could, the first one on the Zurich rate tracker. So, I'm just wondering if this tiering approach is distorting those numbers in any way. So, for example, if you have a client and you put it in the lower tier buckets that you don't like. You put rate increases, so they're going to leave and you're going to be cutting rates on the top of tier that you're going to keep, because obviously, the Zurich rate tracker has looked quite good in the past relative to market rates and obviously market rates did tick down according to the indices in Q2, but your number is starting to look a bit weak on the index. I'm just wondering is that's having an impact.

And on the second bit, I'm just trying to give a head around is the outlook for top line and I guess this is the probably the key thing. The outlook for flat to declining top line, I mean, I'm trying to square that with the comments you made about the expense ratio ticking up when volumes fall, it sounds like it's more like decline to declining top-line and actually the combined ratio target is much more important than the top line in the General Insurance business. So, could you kind of put these things together? And do you see some GDP growth helping that top-line? Is that why you think that things are going to be okay? Thanks.

A - George Quinn {BIO 15159240 <GO>}

Thanks, Andy. On the rate change, so obviously, the rate change does reflect the outcomes for us. So, I mean, it reflects what we're renewing as opposed to the totality of what was there and I mean, what may avenue. Our approach to tiering does impact that. So that's why it will loop different than the market overall. I mean, I'm not convinced that we have a more negative position than this on the market. In fact, I mean, overall I'm not convinced that our perspective on rate or loss cost is significantly different from what I hear any of our competitors across the key line.

On the outlook top line, my comment was really about Global Corporate. So I mean, be careful about extending that to all of the other businesses. I think we still have investments in anticipation of growth, and we have growth in a number of other markets. But it was really intended to be a Global Corporate focus comment.

On the GDP, I think, I mean, GDP I think will help, but not in the timeframe that we are talking about. I mean my sense is that the benefits from GDP feel to me is really a lag at the moment and the pricing dynamics feels a bit stronger than the GDP risk growth dynamics that's the only thing that over the next – the remainder of this year and next year, I don't think GDP growth will be a significant positive.

Q - Andy Hughes {BIO 15036395 <GO>}

Can I ask a follow-up on the first one, the rate tracker. So I'm just trying to work out how this actually works. So if you do the tiering approach, would you expect its prices – the rate in tiering approach to impact this tracker negatively anyway? Or is this market impacts that are going on? Maybe can you separate out in terms of what's market impacts and what's actual rating action being taken by you to rebalance the book? Thanks.

A - George Quinn {BIO 15159240 <GO>}

I mean, it's hard to do that. I mean, as the outcome from our portfolio, which will be a combination of, I mean, other requests for rate increase in the market and competition against that offer. I mean, I certainly couldn't just know what the split would be for you, Andy. And I'm not sure we can do it, but we'll have a look.

Q - Andy Hughes {BIO 15036395 <GO>}

Okay, brilliant. Thank you.

Operator

The next question is from Andy Broadfield from Barclays. Please go ahead.

Q - Andy D. Broadfield {BIO 7273415 <GO>}

Hi. Just one quick question. My apologies – I came a bit late on the call, but George the comments around the volatility being part of the metrics that you're now looking at on – it's not like on a per risk basis, because I would have thought and you referred to a little bit later the core essence of your businesses is to take the volatility out of other people's out of corporates, individuals' lives and absorb it within yourself. Is there a sense that on a per risk level that your business is – I mean, this seems an extraordinary question, this is not diversified enough to absorb a $50 million loss, so we can get excited on the quarterly basis because (49:51) with your business is there to do. So I'm just intrigued a little bit more to know whether this is just a small thing that's going on or whether this is a core part of a transitional change that's going on within the business at a grass root level.

A - George Quinn {BIO 15159240 <GO>}

So I mean, it's not a core – I mean, you're absolutely right. I mean if we start to force volatility of the system, there'll be no system pretty quickly. So I mean, our proposition to client is that we protect them from uncertain events and the challenge we've had this quarter is we've had more of those uncertain events that we normally anticipate to see. I think what we're trying to do on the tiering side, I think it's just to be a bit smarter about it. So I mean, apart from pure rate, we pay attention to volatility. If we're charging someone who produces relatively stable results over a long period, the same price that someone has the same average answer, but much greater volatility. I mean, that's part of the wrong approach for us.

So I mean I don't think you'll see a fundamental change, and all of a sudden Zurich becomes allergic to volatility and that wouldn't work for us. But I think at the margin we can take steps that would reduce some of what you see in Q2.

Q - Andy D. Broadfield {BIO 7273415 <GO>}

Okay.

Operator

The next question is from Dhruv Gahlaut, HSBC. Please go ahead.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Good afternoon. Thanks for taking my question. I've got two questions. Firstly, you've talked about the rate evolution on some of the lines. Could you say us in how does the claim inflation compares with rate on a groupwide level at this point in the GI book?

And secondly, you've taken an impairment of about $30 million is in – could you say what this was for? Thanks.

A - George Quinn {BIO 15159240 <GO>}

The rate evolution we would see a loss cost inflation running at or slightly less than the headline rate improvement. So, some relatively immaterial margin...

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Right.

A - George Quinn {BIO 15159240 <GO>}

...taking place currently. On the impairment, I don't want to identify the particular asset, and I mean, it's part of Life portfolio. It's a relativity small number overall. We've taken a $30 million goodwill impairment in the period.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

All right. All right, thanks.

Operator

The next question is a follow-up question from Michael Huttner, JPMorgan. Please go ahead.

Q - Michael I. Huttner {BIO 21417183 <GO>}

Thank you very much. Two points, one your neighbor Swiss Re mentioned that they'd like to move to half yearly reporting, which I imagine would deal with a lot of the issues you identified and just Q1 is less representative than half year, what's your stand on that?

And then, the other – if you take what sounds like more urgent action now that maybe you are contemplating in Q1 or in May, does it mean that there is a risk, sorry, a chance that you could overshoot the targets? I mean, George got a huge amount of experience on all these things, so maybe you can kind of a bit of an impartial view of that? Thank you

A - George Quinn {BIO 15159240 <GO>}

Thanks, Michael. I mean, the one who is absolutely clear to me this wouldn't in a day for us to talk about dispensing half yearly or other quarterly reporting, I mean, I believe in transparency. I think that the fact that you and the investors can see what we can see produces – actually our system that helps people improve. So maybe we can debate the quantity of stuff that we all pump out in your direction and where we need it all, but I'm actually a believer in, I mean, relatively frequent clear information on where we stand. I think it helps to achieve your goals.

On the second, I mean, I appreciate the flattery, but I mean you'll appreciate that – I mean, my immediate goal is not to overshoot the target, but to deliver it. And I mean, as you can see from today, we've got some distance to go yet. But again, I mean, we understand what we have to do. We have a plan to deliver it, and we are confident that we'll deliver the target that we set out in May.

Q - Michael I. Huttner {BIO 21417183 <GO>}

Thank you.

A - James Quin {BIO 18345789 <GO>}

Thanks very much. I think that's a very good place to finish the call. That was our last question. Obviously, if you do have any follow-ups, do call us in Investor Relations. Thank you very much for dialing in and good-bye.

Operator

Ladies and gentlemen, this now concludes today's question-and-answer session. Thank you for participating and wish you a pleasant rest of the day. Good-bye.
