Q4 2018 Earnings Call

Company Participants

- Christian Mumenthaler, Group Chief Executive Officer
- Edouard Schmid, Group Chief Underwriting Officer
- Edward Morris, Analyst
- Frank Kopfinger, Analyst
- John Robert Dacey, Group Chief Financial Officer
- Philippe Brahin, Head-Investor Relations

Other Participants

- Andrew J. Ritchie, Analyst
- Ivan Bokhmat, Analyst
- James A. Shuck, Analyst
- Jonny Urwin, Analyst
- Kamran Hossain, Analyst
- Paris Hadjiantonis, Analyst
- Sami Taipalus, Analyst
- Thomas Fossard, Analyst
- Vikram Gandhi, Analyst
- Vinit Malhotra, Analyst
- William Hawkins, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning or good afternoon. Welcome to Swiss Re's Annual Results 2018 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 and afternoon everybody and welcome to our 2018 annual results Q&A call. I'm here with John Dacey, our Group CFO; and Edi Schmid, our Group Chief Underwriting Officer; and Philippe Brahin, our Head of Investor Relations. Before we go to Q&A, there are several remarks I'd like to make to put today's reported information into context. There are two main factors which over proportionally impacted Swiss Re in 2018.

First, we experienced elevated large losses in our P&C segments and absorbed $3 billion in large claims. This is in the context of 2018 being the fourth costliest year for the insurance industry. The second factor was the underperformance of global equity markets and the impact that had with the new U.S. GAAP accounting guidance on Swiss Re's results. The adverse pre-tax impact was almost $600 million. We were not subject to the same volatility in 2017 as accounting change was introduced last year. Bear in mind that our European peers are not subject to the same rules, making our results appear artificially more volatile.

Looking at the performance of each of the business segments, we had a challenging 2018 but remain optimistic about the outlook. P&C Re's underlying performance was slightly below expectations, but we maintain good cost discipline. Life & Health Reinsurance has continued to deliver solid results and strong growth including from large transactions. Asia remains a key driver of growth in this business segment.

Corporate Solutions performance in 2018 was clearly disappointing in spite of the measures taken to address underperforming business. We will continue with our corrective measures and expect to benefit from improving commercial insurance rates in 2019. We will also conduct a business review under the incoming CEO and we'll update you together with our half year results.

Life Capital delivered exceptional gross cash generation in 2018 and met its 2016 to 2018 targets. On the closed book side, preparations for a potential ReAssure IPO continue, while the open book business continue to grow dramatically.

Turning now to the January renewals on which we reported today. We are very pleased with the outcome achieved. We remain disciplined on lines of business with ongoing price pressures and found attractive opportunities to deploy capital. We achieved a volume growth of 19% and a price quality improvement of 1%. We expect further price improvements during the remainder of the year.

Finally, we're proposing an attractive set of capital management actions. Given the long-term economic earnings and sustainable capital generation of the group, the board will propose to the 2019 AGM a rebasing of the regular dividend to CHF 5.60 per share, representing a 12% increase. In addition, we proposed to seek AGM authorization for a new share buyback program to be executed in two tranches prior to the 2020 AGM.

The first tranche will be very similar to last year. The second one is conditional on the development of the group's excess capital position in 2019, for instance, if we experience a significant increase as a result of the successful reduction of Swiss Re's holding in ReAssure below 50%.

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

Philippe Brahin {BIO 19081619 <GO>}

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

Q&A

Operator

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

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

Hi there. I guess I just wanted to understand a bit more about the thinking behind the rebasing of the dividend. I think it was in April at the Investor Day, John, you gave us a slide suggesting that the net solvency capital generation per annum, economic capital generation per annum was about $7 per share or about $2.4 billion, you're now proposing a sort of recurring repatriation of about $2.7 billion of the unconditional buyback plus the dividend. Is that the kind of level of ongoing capital generation you now think the group is generating, is that how we should think about it?

Second question, reading the annual report, the comments from the chairman in particular are very bearish about the broader macro backdrop. I guess this is part of the reason why you are reducing the credit exposure through the sell down of ReAssure. But just to clarify, will you still – will you look to reinvest some of that credit risk that you've freed up to replace the lost earnings from ReAssure or this is a general you still, you just want to run a lower level of overall credit risk? Thanks.

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

Andrew, hi, it's John. I'll try and take both of those questions. On the first case, we think about the share buyback and the ordinary dividend separately. I think we're comfortable with the rebasing of the ordinary dividend as a level which is sustainable and where we can think about either maintaining or potentially enhancing it in future years, not necessarily 12% a year. I think it's also important to say that this is in the context of our shares having systematically reduced through the share buyback program over the previous years. And so the actual amount that we're increasing this by is not a big amount. As you identify, we go from $1.6 billion to $1.7 billion with this dividend payout.

The share buyback will be judged I think more systematically on a yearly basis as to where the overall position of the group's excess capital is. We've demonstrated there's a certain resiliency in the balance sheet over the last two years. I'd say the challenge of the fourth quarter in 2018 was a little different than what we'd seen as financial market turmoil and the blowing out of credit spreads in particular would have had a negative effect on our Swiss solvency calculations as well as on the underlying ordinary equity of the group.

So I think as we go through this, you should think about the ordinary dividend as something both we and the board have confidence in being able to maintain, if not, expand in future years. The share buyback will be a lever we will use when we believe that we've got excess capital that can be returned to shareholders and we don't see the opportunities for redeploying it otherwise and that's the way I think you should be thinking about these two.

With respect to the chairman's commentary on credit markets, I think again we came into 2018 with a fairly conservative investment portfolio We'd already moved ourselves higher up the credit curve in the corporate credit portfolio that we had. We've mentioned I think in the documents the relatively de minimis impairments on the fixed income side that we've had to endure in 2018 but also in previous years. And we continue to be conservatively positioned. I wouldn't necessarily expect that if we're successful in executing an IPO of ReAssure that we will immediately build up a big credit position. We'll take a view of where the market is at that point of time and where interesting opportunities are. It does create more flexibility should conditions be of interest to our investment office to be able to build in or take on more credit risk supporting the other businesses. But there's nothing automatic about a redeployment.

A - Philippe Brahin {BIO 19081619 <GO>}

Thanks, Andrew, for your questions. Can we take the next question, please?

Operator

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

A - Frank Kopfinger {BIO 16342277 <GO>}

Yes, good afternoon, everybody. I have two questions. My first question is on the capital position of CorSo. In 2017 you had to recapitalize the unit after significant losses. Now you had another $400 million loss. How shall we think about the capital position at this time? And then secondly on the price increase during the renewals, the 1%, there is a footnote saying that this is adjusted for portfolio mix effects. Can you comment on or elaborate on on this, what you mean with this portfolio mix effects and what an adjusted number would be?

A - Philippe Brahin {BIO 19081619 <GO>}

Thank you, Frank. Maybe John first and then Edi.

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

Sure. So with the CorSo capital position, you are right. We did make an increase in CorSo's equity at the end of 2017. We've also looked at the opportunities we see for this business on a going forward basis and want to be sure that we've got adequate capital. We'll disclose the SST for the subsidiary businesses in our April disclosures. But what I can say is we're comfortable the business currently has enough capital to write profitable business going forward basis. We did increase from a group level a subordinated debt in Corporate Solutions at year end 2018. But there's been no equity injection and we'll evaluate the capital situation partly in context of evaluating the reinsurance program for CorSo on a going forward basis.

A - Philippe Brahin {BIO 19081619 <GO>}

Thanks, John. Edi, on the price improvement.

A - Edouard Schmid {BIO 18942809 <GO>}

Yeah, thanks for the question on the 1% price increase. As you noted, we changed the way we measure price quality improvement. We moved away from the internal LTPA measure we disclosed in the past to what we think is something more comparable to what peers do and also what we think is a more objective way to measure price quality improvement. It's actually a very simple measure of underwriting margin. So it's the premium we get for the risk net of the commissions we have to pay discounted (00:11:30) and then divide it via the expected claims discounted. We think that's the purist view of a underwriting margin.

And then to really do an apples-to-apples comparison, we adjusted for the portfolio compositions. So we really get a fair measurement of the business that gets to us on a like-for-like basis and that leads then to this 1%. Apparently, there's the factor of portfolio composition. The way our portfolio developed from 2018 into 2019 with a bit more premium volume growth on the casualty side, it would have a slightly negative impact. The price adjustment would still be positive, but it will be a bit lower than 1%. I think that's the way to think about it. We also I think provided an explanation of how this LTPA compares to the new measure. It tracks quite closely. We really think the benefit is, it's less distorted from our internal capital cost and internal expense allocation, so we have this objective measure. So adjusted with all the improvement, it's about 1%, including portfolio mix change, it would be somewhat lower but still positive.

A - Philippe Brahin {BIO 19081619 <GO>}

All right. Thank you, Frank, for your questions. Can we have the next question please.

Operator

The next question is from Vikram Gandhi from Societe Generale. Please go ahead.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Hi, good afternoon, everyone. I've actually got two-and-a-half questions. Hopefully, Philippe forgives me for that. Firstly, on CorSo, obviously, the results are underwhelming. Can you shed some light on why the improved reinsurance program has not really worked? And I remember from the nine months 2018 conference call, you said the business was well protected with the covers you had in place. And then what is it that you intend to change going forward? So that's question number one. Secondly, sorry to come back on the dividend increase, but the 12% increase in dividend, I guess the message you want to stake (00:13:25) is that the earnings part of the group is really strong. But with the dip in future cash upstream from the ReAssure stake dilution and more so with the IPO plan, and CorSo still on shaky ground, what gives you the comfort for a 12% increase in dividend? And I guess the other half question is on ReAssure just philosophically, why would prefer an IPO to an outright stake sale and bringing a third party along with you in MS&AD? Is it simply because decision making would get too complicated with three parties instead of two? That's all from my side.

A - Philippe Brahin {BIO 19081619 <GO>}

Okay, Vikram, these are three questions, but we'll see (00:14:03-00:14:08) and dividend for John.

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

Maybe on the reinsurance side of course I can say something since I was more deeply into CorSo now for one-and-a-half month. So you remember, philosophically, 2012 we created CorSo, we said philosophically we're not going to protect it much with reinsurance, only very remote reinsurance. So the gross performance is always visible in that segment because it will be left pocket, right pocket with reinsurance. Last year after the big event, we increased reinsurance somewhat on the cat side to avoid a repeat of the last year, but the losses in CorSo really case reserve which have adversely developed. About 80% of the adverse development is single case reserves where there had been some reserves as an event, something was reserved in the current of 2018, we had to increase the loss reserve for that particular case. So the only thing that could have protected it would have been a ground-up adverse development cover or something like that which was not in the plans or foreseen last year. Going forward, I think this is an open question. This is something that I want to discuss with Andreas Berger. My strong instinct is that to ensure more compatibility with peers, we're going to have a more normal type reinsurance program for CorSo, but that's something we're going to update you on in mid of this year.

A - Edouard Schmid {BIO 18942809 <GO>}

What I would add also 2018 was affected by significant (00:15:32) number of current (00:15:35) large manmade losses. We had a substantial fire loss in Germany. We had this satellite loss later in the year and the change in the CorSo program was older than nat cat side as Christian said, but the manmade protection, the retention per risk is still at a significantly higher level than to peers (00:15:53) and that's clearly something we will review over the course of this year whether it should be a bit lower. And together with the adverse developments, that together explains the result.

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

So with respect to the question on the dividend increase, again, I'd – while 12% is a significant rebasing, in absolute amounts, we're moving from $1.6 billion to $1.7 billion, and so our confidence in being able to sustain this dividend and potentially increase it on a more modest level in years going forward is basically related to the underlying economic earnings, which we've been able to share most recently. And in particular, the franchise of our Life & Health Reinsurance has been delivering a strong increase in economic earnings for the previous four years ever since the restructuring in 2014. And we don't see any reason to suspect that will back itself down in any material way.

You do mention that the cash generation and large dividends we've been getting from ReAssure will moderate if we don't own 75% of it or even if we do down 75% versus 100% of it, that's probably true, but we're confident that the combination of normal years for our P&C businesses and improving Corporate Solutions and our Life & Health Re business will provide ample opportunity to maintain this level of dividends. Again to reiterate, what I mentioned, Andrew, the discussion for the share buyback will be revisited on a routine basis depending on the overall level of excess capital.

Last with the ReAssure IPO, we continue with the preparations for that. The nature of your question I think needs a little clarification. What we said is we're running a process to be ready to do an IPO and we'll execute it in 2019 when we think market conditions are supportive. It doesn't exclude any other possibility. But the focus of our efforts are doing this and to the degree that we are 100% in control of going or not going with it. There's no gun to our head. We don't need to execute the IPO for capital reasons. But as we've said before, we think we're not the best consolidator of this business into our balance sheet. If there are other opportunities which provide adequate value to ourselves and interesting future for the business, we're not adverse to discussing them.

A - Philippe Brahin {BIO 19081619 <GO>}

All right. Thanks, Vikram, for your questions. Can we have the next question please?

Operator

The next question is from Paris Hadjiantonis from Credit Suisse. Please go ahead.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Yes, hi, everyone, from my side as well. The first question would be on the level of large losses, the level of large losses over 2018 which has clearly been very high. I was wondering if there was anything that surprised you and could lead to any model adjustments. And also given that you've written more business on the cat side in January (00:19:32) if you could actually guide us to what to expect in terms of budget for 2019, that would be helpful. The next question is with regards to the new business on the returning causality. I was wondering if you could give us an idea with regards to seeding commissions especially in the U.S., what the year-on-year change there has been? And also given that there is a lot of growth but that growth seems to be targeted and not necessarily in areas where we see adverse development on the reserve side such as motor, if you could comment on maybe motor and liability lines and pricing? Thank you.

A - Philippe Brahin {BIO 19081619 <GO>}

Okay. So, Edi.

A - Edward Morris {BIO 16274236 <GO>}

Yeah, thanks for the question. The first one on the large loss burden 2018 and learnings from it. So, utterly, nat cat has been a key risk pool for us for a long time. And we have developed sophisticated models and this goes through a very regular back testing and updating model. So already after 2017 (00:20:43) deep dives and we did some adjustments here and there. And we started to do the same thing again out of the learnings from 2018. Overall, I'm happy to say we're still quite comfortable with the modeling of our nat cat. If we assess actual claims versus our modeling over a number of years where we take out random volatility, we think we project the losses quite adequately. There's always some things to learn.

Now in 2018, there's some surprise element in these wildfire losses. So for the second year, we have significant losses out of California. It's also not a new risk because this exposure has been clear to us for a while but that we have twice in a row where a significant wildfire losses was a bit of a surprise so already into this renewal. We costed a bit more for this wildfire exposure in our portfolio and took a bit more cautious stance. But overall, the way we model the nat cat business globally, we feel very confident that we get this adequately right. And that's also why we're confident to deploy again more capital to the nat cat space. We could improve prices quite a bit last year. We see positive momentum also in this year and that's why we are comfortable to deploy quite a bit more capital into that space. Premium wise (00:22:05) as we explained is about 22% more premium at 1/1 versus expiring. And if rates develop as we expect in the April, June, July renewals, we plan also to deploy more.

Then obviously, what it means for the 2019 nat cat budget, it will be higher than last year. Last year was $1.15 billion. We have now grown the exposure by a bit more than 20%. Then you would add a bit more, let's say, costed loss burden for some of the model adjustment for wildfires, not much, but we will disclose the nat cat budget in the Q1 results and it will be higher, but I cannot give you a number now. But in the end, we're very confident with our assessment of these risks and that's why we will deploy more capital into that space.

A - Philippe Brahin {BIO 19081619 <GO>}

Great. And then maybe there was a second question around casualty new business, what have seen from Paris.

A - Operator

Also motor.

A - Philippe Brahin {BIO 19081619 <GO>}

Yeah, motor in particular.

A - Edward Morris {BIO 16274236 <GO>}

So back to the 1/1 renewal, obviously, we (00:23:16) in the nat cat space. We've also grown on the casualty side quite significantly actually just measured in premium volume terms. The casualty growth is even a bit more than the property cat growth. Now it's very important to see where this growth is coming from. Actually, casualty is a very broad, let's say, risk pool and have to look into it a bit more in detail. What we have been quite concerned about since two years and we have made this clear on the CorSo side but also on the reinsurance side, in the U.S., there was commercial motor which was not performing well where we do not write CorSo and also took a very cautious stance in reinsurance. But then there's the general liability side, in particular coverage for large corporations, Fortune 500, Fortune 1000 type of accounts that buy excess liability and lead umbrella type of policies. And there in CorSo, we started to prune (00:24:15) significantly also in reinsurance and this will continue.

The new business we now put on the books in 1/1 was mainly acquired via large tailored transaction. We had a significant one in Europe, but also we had significant ones in the U.S. And most of this business is actually what we would call really small commercial business and is also very small limits. And it's kind of what we call first dollar coverage and not excess. So what this means that the claims developed fairly quickly. So we have more predictability and it's not this long duration business that has more uncertainty. And also the business we took onboard, we have confirmed good track record. And it comes in a transactional form where it has structural elements, so upside and downside are more balanced. So that business we put on the book I'm very comfortable with. It will perform according to expectations and we clearly have no intention to grow in areas where we see the concerns around liability, lead umbrella, excess for large corporate risks. There, we will continue to prune (00:25:24) CorSo and also take a cautious stance in the reinsurance space.

And then similar on the motor, you also asked about the motor, the commercial motor is also still difficult. Personal lines in U.S. looks a bit better. So we will look into that space. If it comes as a good priced transaction, we'll definitely consider it. But commercial motor continues to be also an area where we are quite skeptical.

A - Philippe Brahin {BIO 19081619 <GO>}

All right. Thank you, Paris, for your questions. Can we have the next question please?

Operator

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

Q - Sami Taipalus {BIO 17452234 <GO>}

Yeah, hi, good afternoon, everyone. Just coming back to CorSo on my first question. You mentioned that you're going to update on this segment with H1 results. Just wondering how much freedom is the new CEO going to have to change the strategy? Is it just the case of maybe buying a little bit more reinsurance or is there going to be a broader review of the strategy in the business? And then the second question is on M&A actually. I think, John, you were - there were some headlines on Bloomberg earlier today about you saying that pricing on deals is still a bit high. Could you just comment a little bit on what you're seeing in terms of stuff being offered to you? Is there a lot stuff being offered to you and also on your internal capacity for deals? Thank you.

A - Philippe Brahin {BIO 19081619 <GO>}

Maybe question on CorSo (00:26:50) and then ...

A - Christian Mumenthaler {BIO 6479864 <GO>}

Yes, with pleasure, right. I think obviously the situation we're in and the disappointing result ask for a decided action. But to me, there's two components to that. One is sort of remedial action you can take, pushing for price increases, cutting some portfolios much more than we have done before. But then there's – to me, there's also a strategic dimension where to play, when to play, how to play, so I want Andreas to have significant freedom. I think the only thing I wouldn't want is to sell CorSo. That would be in any case a bad idea in the bottom of the cycle, but everything else is basically on the table. And I think we have a unique opportunity to have somebody with 20 years of experience to come in with an outside-in view. He will – I expect him to look at all the portfolios, all the process, all the setup, all the philosophy, the people, everything to be able to give us a benchmark of how does he see things, where are we in advance, where not, where can we compete against others, where not. And so I'd give him a lot of freedom. I think that's what we expect.

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

With respect to M&A, I'd say we are obviously a major – purchase have been (00:28:03) in the insurance and reinsurance market. We evaluate what possibilities there maybe for improving our strategic position. We said explicitly that we don't necessarily see much real opportunities for strategic transformations in our reinsurance business, Life and Health or P&C. And obviously, we've not been in that market doing any transactions in terms of the consolidation plays in recent years. Never say never, but that's the, I think, the current view. We have said that we'd be happy to reinforce the position of Corporate Solutions if we saw the opportunity and saw it a price levels which we thought made sense to us. We've done some small bolt-on acquisitions in previous years. Last year, we completed and benefited in some ways from the transaction with Bradesco in Brazil. That's after investing in Colombia and taking over RSA's China business. But net-net again, we've I think been fairly disciplined in the way that we've deployed capital on inorganic plays and we'll continue to be so.

A - Philippe Brahin {BIO 19081619 <GO>}

Thanks, Sami, for the questions. Can we have the next question please?

Operator

The next question is from Jonny Urwin from UBS. Please go ahead.

Q - Jonny Urwin {BIO 17445508 <GO>}

Hi there. Thanks. Thanks for taking my questions. Just a couple on the reserves. So, in P&C Re, can you just tell us how that favorable reserves development of 0.9 points was split across property, casualty, and specialty? That's the first one. And then, secondly, could you please update us on the latest claims inflation trends that you're seeing in U.S. casualty, and also how does profitability develop on the liability book on the recent underwriting is? Thank you.

A - Philippe Brahin {BIO 19081619 <GO>}

So, Edi, I guess these are two questions for you.

A - Edouard Schmid {BIO 18942809 <GO>}

Yeah. Thanks for the question. So, the first one is on the reserve development, P&C Re. So, overall, it's 0.9% positive. And that I would split out into the three main pockets property, which was positive. Special lines was also positive. And then, casualty overall was negative. So, giving a bit more color around these negative in casualty, it comes from a few places, one actually is related to asbestos and environmental in the U.S. where we strengthened quite a bit and it's mainly related to actually very old years, where we agreed a settlement with one cedent for late reported claims. So, that's a significant contribution. And then we had also some strengthening in motor portfolio in Europe, also rather old years from the UK.

And then to some extent, we strengthened a few pockets in U.S. liability, in line with the trends we have seen to larger verdicts going through our robust reserving process for all the segments. For some, we updated reserves and strengthened, to some extent, so that overall again we are comfortable with the total reserve level, which as you know, we stand, in addition, reviewed independently by our Group Actuarial Control function, confirming that the overall reserve base is still within a good range, between 60% and 80% of what is considered a reasonable best estimate. And this in fact applies to the total reserve base. And what is also important, it also applies to the more recent underwriting years. So, that's about PYD.

And the second one was regarding inflation in the U.S. Actually, it has been quite benign. As you know, this is something we monitor very closely as it affects our long-term business, of course, to a significant extent. So, at all times (00:32:05) healthcare cost inflation and wage inflation are monitored and are reflected in the latest projections to cost to assess the business we put on our books. So, inflation is still benign. We have seen a bit of uptick on healthcare.

I mean, to share my frank view, I am not concerned about the inflation, really, the next couple of years. I would rather say recession risk is a bit higher over the next couple of years. But clearly inflation is a big risk factor, so we monitor it very closely. We put it into our costing. And also, it's one of the significant risk factors in the group risk model, so the businesses that are exposed to inflation get a decent capital charge, so it produces the adequate return. That's what I would say about inflation, particularly, in the U.S.

A - Philippe Brahin {BIO 19081619 <GO>}

Thanks, Jonny, for your questions. Can we have the next question please?

Operator

The next question is from Thomas Fossard from HSBC. Please go ahead.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes, good afternoon. Two questions on my side. The first one would be related to CorSo and the pricing environment. I think that last year, you were shooting for plus 5% price increase across the book. I think that at the end, you came with something which was more around 3%.

Looking at, I would say, your combined ratio and also combined ratio of your peer group, which are all significantly above on the 10% in 2018, I mean, what would be a reasonable pricing – or better pricing environment for 2019? It's still, I would say, very surprising. I've seen, I would say, more momentum coming up with everybody trying to improve underwriting (00:33:56) targets to bring the combined ratio down below 100%. That would be the first question.

The second question would be relating to the PC Re (sic) [P&C Re] (00:34:06), combined ratio target of 98% in 2019. Actually, it's down 100 basis points from the guidance for 2018, which seems to be in line with the price increase you managed to get on the 1/1 renewals. So, on the 98% for 2019, what's your pricing expectations for the upcoming renewals? And how should we see this guidance, if by any chance, you were reporting better pricing momentum during the year? Thank you.

A - Philippe Brahin {BIO 19081619 <GO>}

So, Edi (00:34:48).

A - Edouard Schmid {BIO 18942809 <GO>}

No, thanks for these questions on the pricing environment, actually both in the commercial space and in the P&C Reinsurance space. So, of course so, you've correctly reflect it. Last year, off the significant loss in 2017, we targeted a price improvement across the course of portfolio, 5%. And disappointedly, we only managed to get 2% to 3%. I mean, it's very clear in line with what we said earlier, the commercial business in the market overall, but also specific also needs to improve much more significantly than 3% or 5%.

The trends we have seen in the segments, I alluded to a bit earlier, you clearly need to see much more price improvements than the numbers we have just mentioned. We will still find our action plans to improve the portfolio more, but it will be significant – or it will be targeting significant price improvements across the board, but then also much more targeted. Most clearly, those segments, as we mentioned a bit earlier, around large corporates, general liability coverage, where we don't think it's realistic to get to a sustainable rate level anytime soon. So, there we will actually take away capacity quite dramatically.

So, clearly, the commercial markets overall, but in particular, U.S. liability, they need significant improvements. And in our improvement action plans for this year we target significantly more than the numbers we have just been mentioning. I cannot go into specific numbers at this point, but it's clear. The industry overall, and CorSo specifically, will need to drive much more than this 3% or 5% we have been talking last year.

Q - Thomas Fossard {BIO 1941215 <GO>}

Great. And then maybe on the second question, maybe on the P&C Re combined ratio, 98%. How is your pricing developing further this year?

A - Edouard Schmid {BIO 18942809 <GO>}

Yeah. So, our estimate for P&C Re combined ratio, 98% for 2019. So, that's a point lower than last year. And that's actually – there's several contributing factors to this 98% estimate. We say it's about 50% of the improvement is coming from better quality of the business, and the other half is coming from what we would call a scale effect.

So, the scale effect is pretty simple. You're right, about 20% more business, that's stable expenses. That explains why the combined ratio will get a bit lower. And the rest is price improvements. And that is important to keep in mind, the earnings patterns for the business. So, we wrote the business in 2018 at what we disclosed, 2% higher. So, some of that is now earnings through into 2019. As I mentioned earlier, the business we wrote at 1/1 is a bit better, measured objectively, (00:37:41) business mix. This does not help much in terms of combined ratio improvement.

But the estimates for the whole year, obviously also projects the forthcoming renewables in April, June, July. This will earn only partial this year and into next year. But still it has a bit of an impact, and there in our plan clearly, because this is the more loss affected business in places like Japan or U.S. We have factored in some quality improvements, and that's also reflected in this 98% estimate. So, that's the contributing factor that leads us to this 98%, which we feel very comfortable with at this point in time.

A - Philippe Brahin {BIO 19081619 <GO>}

Thank you, Thomas, for your questions. Can we have the next question please?

Operator

The next question is from Edward Morris from JPMorgan. Please, go ahead.

Q - Edward Morris {BIO 16274236 <GO>}

Hi. Thank you for taking my questions. The first, just coming back to ReAssure. It sounds like you're sort of keeping your options on the table in case other alternatives come up. Can you just clarify, if you were to go down the route of a tradeshow rather than IPO, would your preference be to retain a significant minority stake? Presumably any buyer would want at least control, but if you could just talk about whether you'd prefer to retain a stake, or could you, in fact, completely exit your holding there?

And the second question, if you could just help us a little bit with the trajectory of things in CorSo. You're talking about intensifying some of the pruning of underperforming business there. And yet on the other hand, you're also talking about the opportunity in primary lead? Overall, are we expecting premium to grow in CorSo in the next year? And a little bit of help on where we are on an underlying combined ratio basis would be helpful. So, if you could just give a feel for what you think might be a good outcome for CorSo this year? Thank you.

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

So, I will start with the ReAssure discussion and probably frustrate you a little bit. Reality is it's not particularly useful to think through hypothetical situations of potential trade sales. I would stand by what we said, when we announced the IPO plans. We don't think this is a bad business. Actually, it's a very interesting business. The cash generation is interesting and has been useful to us.

I think we'd need, in the first case, to deconsolidate it, and take it off of our consolidated balance sheet. Once we do that, there's probably a certain level of openness for whatever stake below 49% we might hold on to. The important move by MS&AD to come in for another 10% makes it a little simpler for us to get down to below 50%, where we would stop either in the IPO, or in some other transaction to be seen in the future.

A - Christian Mumenthaler {BIO 6479864 <GO>}

I think, on the CorSo – I'll take the question on the CorSo trajectory. Because as I said, this January and February, I looked at it very closely obviously in lieu of these results. And I worked with the team. So, to me, there's two stages. One is short-term fixing of the business; the other one is more of the strategic angle, which I really want Andreas Berger to look at, but for the fixing I didn't want to wait for him.

So, there's clear instructions to the team. We worked through a plan of how much do we expect in price improvements, where – and how much and where do we have to cut to get to where we need to be, using basically the of the combined ratios we had last year. So, there will be some significant cuts of business and of portfolios. And my expectation would definitely be that we're going to shrink somewhat.

Now, who knows if anything changes completely and prices go up higher, or if we sign new business, that's fine. But clearly, the instructions to the team is not to make sure we maintain the top line or grow the top line, the instruction is absolutely fine if we shrink. And I think if we execute as we do, that's just a relatively high likelihood that we're going to shrink. This is really a year we just need to do whatever needs to be done and not to watch cost ratios and things like that.

A - Philippe Brahin {BIO 19081619 <GO>}

Thank you, Ed, for your questions. Can we have the next question please?

Operator

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

Q - William Hawkins {BIO 1822411 <GO>}

Hi. Thank you very much. First of all, Edi, I just want to challenge the answer you gave earlier about your net cap budget and being happy with it. Sorry, this is ancient history and slightly technical, but if you remember, just before Matt Weber left, he significantly reduced your cap budgets disclosed to the market. It was prior to 2016, about $1.5 billion.

And when you cut it in 2016, the explanation was that you were doing that, because you had a period of light knockouts and positive reserve development. And so, you were making an adjustment to remove double accounting. As it seems to me now that knockouts have at least normalized and reserve development has gone back to a more normal level, it's odd to me that you haven't returned the cap budgets to where it was prior to 2016. So, I just wanted to – it's more of a statement, but I'm not sure why you think you're happy with $1.5 billion as a starting point.

And then secondly, just a follow-on from that previous question. Is there any chance you could try and just help us with normalizing the Corporate Solutions' combined ratio? I appreciate that everything is influx, but given that it's been such a large number for two years, just trying to get a feel for what would be bad luck and what would be just bad business, would kind of be helpful?

So, I'm assuming that all of your reserve developments ideally should be zero. I'm assuming that your Nat Cat budget, if you were a normal commercial (00:43:30) would be about 3% versus the 6% you had. What I'm really uncertain about is the level of large manmade losses. Should that figure actually be zero, because it should all be captured in attritional, or would you always have some budget for it? Thank you.

A - Edouard Schmid {BIO 18942809 <GO>}

So, on your first question regarding the Nat Cat budget, so what I wanted to make clear and repeat that we are very comfortable in the way we assess the Nat Cat business. So, the models we update on a regular basis, that makes us believe that we had a good way to assess the claims we have to expect in the longer term from the Nat Cat business. And that's why we're comfortable to also deploy capital into that space.

I think it happened before my time. We made some changes, you're correct in the way we calculate the budget. What I can say, the way we do it now, I feel this is the best way to really assess what is the expected impact of the Nat Cat business volatility to our financial year. And what we changed in the approach versus earlier is, for example, that this is not just the expected losses we consider, but there's other factors that play a role, like it considers the reinstatement premium we would get if there are claims on the non-proportional side, or there's profit commission arrangements in many transactions that would also moderate impact. So, we just changed to a basis that we feel much better reflects the true impact of the expected net cash low burden to the current financial year.

Understand it was a bit difficult, because there was a change, but actually the methodology has nothing to do with the fact that there are large nat cat losses or not. It's just we came up with the way we best quantify the impact of the expected nat cat losses. And the $1.15 billion for last year, we felt, that's really the best quantification. And we will come up with the same, and again which we will disclose in Q1, which as I already indicated will be significantly higher, but not because of a change in methodology, but because we write more business, and because we update some of the models to most objectively reflect the true underlying risk in this portfolio.

Q - William Hawkins {BIO 1822411 <GO>}

And maybe on the second question, regarding the possibility to normalize the combined ratio for Corporate Solutions, which I think we talked about a bit in the past when we discontinued the guidance on the combined ratio.

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

Yeah, maybe I'll jump in here. While I appreciate your desire, I can imagine that the fourth quarter and the full-year 2018 for CorSo's results has been frustrating to anybody who's been trying to model it. But I don't think this is the time for us to introduce or reintroduce guidance on what that combined ratio should be. So, we'll see later in the year when the portfolio actions are bearing fruit if we can give you a little bit of help there. But today, I think it would be premature and potentially misleading if we put anything down for you.

A - Philippe Brahin {BIO 19081619 <GO>}

Thanks, William, for your questions. Can we have the next question please?

Operator

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

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi, everyone. Just comment about CorSo. Could you remind us on (00:47:03) percentage point benefit or kind investment cost that you think added to the CorSo combined ratio. From memory, it was 4 points. Could you maybe update some of that, given you've improved a couple of points in the last year?

And then the second question relating to that, I guess, that premiums of course are pretty large going forward, $7 billion (00:47:23). Does the business we need more scale to kind of hit reasonable operating cost? So, any thoughts on that would be great. Thank you.

A - Philippe Brahin {BIO 19081619 <GO>}

Edi, maybe on the impact of these investments, primarily drive the opportunities (00:47:41).

A - Edouard Schmid {BIO 18942809 <GO>}

But of course, (00:47:44) yes. I mean, if you try to normalize that the course of the performance to make it more compelled to peers, there's these two factors we showed in the past. I mean, one is the cost base, because we invest significantly to build these Primary Lead capability. That's adding between 4% to 5% to the cost ratio.

Then the other factor is, as you know, the reserves that were left back in the reinsurance business, when we put cost on a standalone basis, that has delivered significant favorable primary developments. And again also for last year, this would be, I think, 3.4% combined ratio points improvement if EBIT were reflected. That's what we described as total financial contribution.

In addition, there will be some investment return on that, but I will not go into that level of detail, yeah. But clearly, these two facts together would bring the course of combined ratio down quite a bit, but it would still be a very bad year. There's no doubt about that.

A - Philippe Brahin {BIO 19081619 <GO>}

And there was a second question on.

A - Christian Mumenthaler {BIO 6479864 <GO>}

Yeah, on the scale, yeah, yeah. I mean, it's obvious, right. I think the Corporate Solutions business, once you go over to a Primary Lead type activity, you need a lot of costs, a big infrastructure all across the world, which is what we have invested in, right, on the technological side, but also legal entities et cetera, et cetera. Once you have that, you can scale up with much, much less cost increases. So, clearly, getting to scale is an important prerequisite to get more competitive over time. That I would say is the strategic consideration, obviously. It doesn't override the fact that we need to get the portfolio right, which is what we were going to focus on this year.

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

And maybe if I could just chime in here, actually, as they continue to build out the Primary Lead capabilities, the average cost on the expense - or on the combined ratio is probably a little lower in 2018-2019, closer to 3% than 4% to 5%. But it's still material, and we're still finalizing this work. We believe the technology that we'll have as a result of these investments will be important for CorSo's future success.

A - Philippe Brahin {BIO 19081619 <GO>}

Thanks, Kamran, for your questions. Can we have the next question, please?

Operator

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

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes. Good afternoon. Thank you very much. So, one on the Life area and one on the investment income, please. Just on the Life EBIT, so using the disclosure on slide 38 and adjusting for realized gains, if I try to get a clean EBIT in both 2016 and 2017, that was at around $1.2 billion. But in 2018, we get $1.05 billion range. Is there something that is going on outside this whole debate around mortality model changes, et cetera, in Life?

And just a slight add-on question to that is also that page 19 today has the Life economic transactions going up about 15%-plus (00:51:00) in terms of economic profit. So, should this mean that whatever has led to this kind of decline in Life in 2018 should kind of recover in the future? So, that's really, sorry, a two part question on Life.

And then, just on the investment income. I've noted your comment about running yield being about flat. But when I look at the slide 39, I see - the very first number is $830 million in P&C Re fixed income which is compared to $700 million last year and also, in the Other line, a $257 million number. I'm just trying to understand. These have – this makes a very big difference for the, say, (00:51:48) P&C Re investment income is not flat. It's quite a lot more. Is there any one-off here we would like to flag and so on (00:51:58)? Thank you very much.

A - Philippe Brahin {BIO 19081619 <GO>}

So, I don't know. Edi, (00:52:05) on the EBIT Life developments (00:52:08)?

A - Edouard Schmid {BIO 18942809 <GO>}

On the Life side, I mean, you're referring to (00:52:12) mortality and the experience there and how this affects the earnings. So, what we observed in 2018 is there was some adverse development on mortality in the U.S. The main reasons for that we see is some seasonal effects like flu earlier in the year. But also, we had some inevitable (00:52:39) large claims. Obviously, in our portfolio, we have some very expensive individual lives (00:52:42) and we had a few more of those unfortunately that we were paying out last year.

But it's important to say we still feel comfortable with the long-term assumptions on mortality trends in the U.S. More recently, there have been some pockets in the population that showed the slowdown in mortality improvements or even the reverse, but it's only for certain pockets like younger ages where we have these obsolete (00:53:10) impacts. But if you look at the insured pool, we have no reason to believe that the long-term assumption of mortality improvements should change. So, we're comfortable with the basis there. So, that's what I would say about the impact of mortality on the EBIT.

A - Christian Mumenthaler {BIO 6479864 <GO>}

(00:53:33) in the – we're maybe a bit victim of our own success, right? But when we fixed Life & Health (00:53:38), as we said, 10% to 12% ROE is the target. We had a bit more in the first year. So, I think the expectations have risen up and I try every time to repeat that it's 10% to 12%. Also, because we couldn't fix everything in the U.S., there are still some books there that have a very low ROE. And so, we compensate that by some business that is very attractive overall in the world. So, we certainly don't manage by quarter. So, we look at the full year. We're confident we can keep the 10% to 12% range. We had good new (00:54:07) business, so there's no negative some recent (00:54:10) transactions I'm aware of. And so, I think it's really more that the last year is we're just above our range.

A - Philippe Brahin {BIO 19081619 <GO>}

John, on the investment income?

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

I think that's absolutely true. The other thing I would say is the impact of the U.S. GAAP accounting change cut (00:54:28) across our businesses. And in, Life & Health Re, there, I think, was a total impact of about $70 million after tax. The vast majority that showed up in the fourth quarter for that business.

On the fixed income in P&C, I don't know that I've got a specific explanation for why the $831 million is a material increase. We did move some positions out of cash and into positive yielding investments. I don't know if that would have been enough to explain the difference you're referring to. But we can have one of the members of the IR team to see if we can follow up on you.

A - Philippe Brahin {BIO 19081619 <GO>}

Yeah. (00:55:19), Vinit, on this one. Okay. Thanks for your questions. Can we have the next question, please?

Operator

The next question is from Ivan Bokhmat from Barclays. Please go ahead.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Hi, good afternoon. My first question would be on the conditional buyback. So, you've mentioned that ratio is one of the conditions. Could you perhaps talk about what other conditions may satisfy paying out this $1 billion in case the ReAssure deal is not completed this year?

And secondly, I've got two small follow-ups, actually. Firstly, on Life & Health, maybe you could speak a little bit about any impact that you anticipate from the fiscal reform and Australian supranational system. And one more follow-up. On the subordinated debt to CorSo that you mentioned, can I just check that this is the $300 million that we see an increase in long-term debt for the unit? Thank you.

A - Philippe Brahin {BIO 19081619 <GO>}

That's another three questions. But these two will manage quickly. So, maybe, John, on the buyback?

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

So, let me – actually, I'll have the last one immediately. Yes, that $300 million is exactly what I referred to earlier in the call. With respect to the conditionality of the second tranche of the buyback, I think it's important for everyone to be clear on the words. You can imagine we spent a lot of time agreeing on this. So, the conditionality is not on the ReAssure IPO. The conditionality is on the development of the group's excess capital, which we would assume, if we were successful in the ReAssure IPO, would be materially affected. But there could be other things which would affect that excess capital during the course of the year positively and negatively. And the Board has reserved the right to judge the position during the course of the year. The first tranche, the first $1 billion, should launch assuming it's approved at the AGM very soon after. And like we did in 2018, we would expect to move forward with that with all due speed.

The second tranche, were the Board – management proposed to the Board and the Board agreed to launch it, could operate simultaneously and overlappingly so long as we stay within the restrictions of any daily purchase. But I think it's important to say that it's not automatic vis-à-vis the ReAssure IPO. And there's no other specific condition, but we'll evaluate the excess capital position of the group during the course of the year.

A - Philippe Brahin {BIO 19081619 <GO>}

Maybe, Edi, on the Australia developments on the Life side?

A - Edouard Schmid {BIO 18942809 <GO>}

Yeah. I'm a bit unsure what you referred to. I mean, what has been going on in Australia is the investigation by the Royal Commission into some inappropriate sales approaches by the life industry. Obviously, that's something we monitor very closely. So, it could impact the volumes that are being sold in other aspects. So, clearly, we look at this with a very careful eye and then take appropriate actions.

Also, I think the Australian market has become a bit more competitive. We had this issue, as you remember, quite a few years ago particularly with the group disability business and we fixed that and brought the business to very good profitability levels more recently, as the competition has increased. And now, in addition we have this outcome of the Royal Commission. So, it's clearly a market where we need to have our eyes wide open.

A - Philippe Brahin {BIO 19081619 <GO>}

Thanks, Ivan, for your questions. Can we take the next question, please?

Operator

The next question is from James Shuck from Citi. Please go ahead.

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

Good afternoon, everybody. Two questions for me, please. I just wanted to return to the points around the kind of contingent language on the special dividend as I see it, so the $1 billion. I think, John, listening to you, it seems to be that, as long as the capital position goes up following the ReAssure disposal, then the $1 billion special buyback will go ahead. I'm just struggling a little bit to understand that because 269% is your SST ratio, but that's obviously above the 220%, well above and you're getting a lot of ROE dilution from the buildup of surplus capital. So, I'd expect it to be managed down closer towards the 220%, at least, over time. So, I'm just struggling to understand a little bit that contingency element.

And particularly, as you do the ReAssure IPO, trade, sell or whatever it is, that should lead to further funds so that actually should increase the outlook for further buybacks rather than just allow this particular one to be done. That's my first question.

Secondly, on the SST ratio, so the - I think one of the slide shows that the P&C Re economic capital had deployed has gone up by 20% in the year. Your solvency - your SST ratio though is kind of broadly as I would have expected it. It's a little bit light versus kind of market movements (01:00:52) in the same sort of camp. So, it's a forward-looking ratio at that, so it's taking into account the economic capital. So, I'm just struggling to understand some of the moving parts and why the SST ratio isn't lower as a result of that deployed economic capital. Thank you.

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

James, thanks for the question. And maybe we haven't been entirely clear. So, let me see if I can sort things out a little bit. The 269% you referred to was the SST ratio as of January 1, 2018. We announced, during the course of the year, that at the six-month view the July 1, estimate which we had for SST had actually risen from 269% to 285%. But we've not provided yet the year-end figure for SST. We've said in the documentation that it's comfortably above 220% and I can maybe provide some further guidance which says that we expect that when it's finally – the calculations are finalized which should occur in the next three weeks that we should be above 250%. But the precise number has not been shared with the public. So, you're right. We maintain a robust balance sheet, and I think the resiliency of that balance sheet in the context of 2017 and 2018 is reassuring.

I would also say that the market volatility that we saw in financial markets in the fourth quarter did have this negative effect and materially brought us back down from the 285% mid-year number. So, as we go forward, we believe that maintaining a strong capitalization in the context of our – very clearly state of capital policy is in our interest and we look forward to taking opportunities for being able to expand organically our business and – but we also don't see the need to build up excessive capital.

And so, the contingency is in the context of a successful IPO of ReAssure. That is one of the places where we'll go back to the Board and evaluate is this time to launch the second tranche. I think it's fair to say that we are not interested in accumulating additional capital beyond a certain level. What that level is depends a little bit on both the perceived volatility of the asset side of our balance sheet and opportunities on the liability side. So, I'm very comfortable saying we're guarantying you the first $1 billion is coming through the door. We are going to have the authorization or ask for the authorization from the AGM for the second billion and we'll manage it during the course of the year.

A - Philippe Brahin {BIO 19081619 <GO>}

Thank you, James, for your questions. Can we have the next question, please?

Operator

The final question is a follow-up from Vikram Gandhi. Please go ahead.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Hi. Thanks for the opportunity. Just looking at slide 40, cash and short-term investments represent nearly 8.3% of your investment portfolio. So, any thoughts on if and when you're going to deploy that cash, would be welcome. Thank you.

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

I think the goal of our team has been to reduce this position over time short-term investments in the context of a very flat yield curve probably are less painful than they might otherwise appear. And if we can in fact continue to move that cash number down, we will – it's – I think we've got the right level of incentives for our investment team to look for every opportunity to do that. Having said that, we do have a business which involves some cash flows. And we need the certain liquidity to be able to provide our clients with the recoveries they're expecting from us.

A - Philippe Brahin {BIO 19081619 <GO>}

Thanks, Vikram, for your questions.

So, indeed, we have come to the end of our Q&A session. If you have any follow-up questions, please don't hesitate to reach out to any member of the IR team. I also wanted to just mention that we would host a conference call on March 14, when we will publish our Annual Report together with our economic results and group SST figures. And then, also please note that we will organize a series of Q&A sessions with our management on May 23 in London. So, we hope you can make note of these two dates. Thank you again for joining today. Operator, back to you.

Operator

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