Q2 2014 Earnings Call - Q&A Session

Company Participants

- George Quinn
- James Quin
- Martin Senn

Other Participants

- Andrew J. Ritchie
- Andy D. Broadfield
- Atanasio Pantarrotas
- Daniel Bischof
- Farooq Hanif
- Marcus P. Rivaldi
- Michael I. Huttner
- Niccolo C. Dalla Palma
- Paul C. De'Ath
- Peter D. Eliot
- 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 2014 Analyst And Media Conference Call. I'm Stephanie, 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. Please go ahead, sir.

James Quin {BIO 18345789 <GO>}

Thank you and welcome to Zurich Insurance Group's results presentation for the second quarter of 2014. I'm joined by our CEO, Martin Senn and 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 it over to Martin.

Martin Senn {BIO 3241585 <GO>}

Thank you, James. And welcome to everyone on the call also on my behalf. And let me make a few introductory comments. As you have seen from the results we published this morning that we have made a good start to 2014. Business operating profit of $2.6 billion for the first six months is 15% higher than in the prior period and the BOP of $1.2 billion for the quarter is 32% above the period last year.

And we're also on track against each of our three key targets. We have also made good progress in terms of executing what we set out at Investor Day. We have largely completed the streamlining of the group above the business unit level, have taken actions in a number of our turnaround or exit operations and we have completed much of the preparation for future investment in priority markets.

That said, this is just the start, and there is a lot we still need to do to achieve the three key targets we set out for 2014 to 2016, particularly with respect to improving our business operating profit after-tax return on equity.

In terms of next steps, we plan to provide a half day investor update on December 5. We're going to do that in London. And we'll give full Investor Day updates on May 21, that's going to be then May 21, obviously 2015, that's going to be then in Zurich.

And with that, it will now hand over to George. Thank you very much.

George Quinn {BIO 15159240 <GO>}

Thanks, Martin. And good afternoon or good morning to everyone on the phone. I'll make a few short introductory remarks on the results. First, in General Insurance, we've reported a good combined ratio of 95.7% for the second quarter and just a reminder, this is on the new basis including expenses that were previously shown within the non-technical results. On the old basis, the combined ratio would have been 93.1% for the second quarter.

We're particularly pleased with the accident year ex-cat combined ratio, which was 3 points better than in Q1 and 4 points better than in Q2, 2013.

If you look more broadly at the first half of 2014 and compare it to the first half of last year, we see good improvement in the large loss experience as well as a roughly 1.5 percentage point improvement in the underlying loss ratio. As you've seen from presentation, the level of rate increases that we achieved in Q2 has slowed compared to what you've seen in prior quarters. And I think that's consistent with what you've heard from the rest of the market.

In addition, as you've also heard from peers, this is the consequence of the fact that most of our business is priced at levels that we would regard as adequate. Nonetheless, irrespective of this trend, we need to continue to improve our accident year profitability and there are number of ways in which we intend to do that.

And specifically we continue to achieve rate increases in those classes of businesses where we're not compensated for risk that we run and we're starting to see better results in some of the turnaround businesses, but we need to improve our own performance.

In relation to the Life business, we've had a solid start to the year. The main change, and you'll see in the results, is the introduction of source of earnings reporting. We've also published an in-depth briefing document which explains the numbers and the trends and hopefully this will have addressed some of perhaps your more detailed questions.

At Farmers, we've seen another quarter of encouraging development in the top-line, although GWP was still down around 1% overall, we saw growth in our core business in terms of both premiums and policies in-force. And we're also showing you additional metrics around NPS, numbers of agents, new business and retention, and I'm pleased to say that these are all pointing in the right direction.

We've also given you a forecast for expected full year cash remittances that we expect to be in excess of $3.5 billion. We're also pleased with this number, but it does include some one-offs, so it's important that you don't extrapolate it over the entire plan cycle.

We've also updated the free capital generation analysis that we first showed at the Investor Day. And this confirms what we said back in December and once again proves that we're a very cash generative business.

To summarize, as you've heard from Martin, we see this as a good set of results with encouraging progress across the group. Having said this, we all recognize that there's a lot more to do and this will be our focus for the next 30 months. The targets are our top priority. We expect to make investments to support future growth, but at the same time, we won't hesitate to take capital from businesses that cannot meet our expectations. Finally, we intend to take full advantage of our operating leverage to grow operating earnings.

With that, I now look forward to your questions.

Q&A

Operator

We will now begin the question-and-answer session. First question from Mr. Paul De'Ath from RBC. Please go head, sir.

Q - Paul C. De'Ath

Yeah, hi there, and good afternoon. Thanks for taking my questions. A couple of questions, please. Firstly on the $3.5 billion cash guidance for 2014. And you obviously mentioned that there are some one-offs in that, is there any chance you can give us any idea of the quantum of those one-offs? And I guess it is fair to assume from your comments that the three-year cumulative total is likely to be closer to $9 billion than $3.5 billion annual would imply. And – that's question one.

Question two, just on the new common customers between Global Corporate and Corporate Life & Pensions over 2014. And how many new common customers have you signed up so far? I mean, you say you're making good progress, so is that roughly half of the 100 customers. And just on that, what's the mix of customers, is this mainly adding Life customers to existing non-Life relationships or the other way around or are these new new customers that you're adding? Thanks.

A - George Quinn {BIO 15159240 <GO>}

On the first one, yeah, I want to avoid that, trying to set expectations for three years beyond what we've given at the Investor Day in December. I think on the figures you've had today, the $3.5 million, we've got small amount of one-offs. We see a run rate underlying though that is higher than we would have anticipated given the $9 billion guidance for the three years. So there is some of the excess that was seen this year is additional cash that we've extracted that we would hope to repeat, but some of this is clearly one-off. I'm not going to give precise detail on the one-off elements because it's a forecast for the year.

I think on the other comment, would it be closer to $9 billion rather than the implied $10.5 million. I mean given what we said on the one-off, I think you have to assume that it'll be closer to $9 billion rather than $10.5 billion.

On the customers for Global Corporate and CLP, the cross-sell were about 70 customers. And I guess we're mainly adding Life to existing Global Corporate relationships rather than bringing in new relationships.

Q - Paul C. De'Ath

Okay, great. Thanks.

Operator

Next question from Mr. Andrew Ritchie, Autonomous. Please go ahead, sir.

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

Hi there. Two questions. First of all, thanks for the new disclosure on which are the priority and non-priority markets in non-Life. But just on that, do you think you can still improve the accident year performance in the priority markets? Clearly, there's less tailwind from rates. I know that you're seeking to improve performance in the non-priority or manage for value businesses. But in the priority markets, I'm thinking specifically U.S. particularly, do you think you can improve that given the rate environment? And maybe, within that, I know there were some specific initiatives in U.S. commercial on workers' comp and commercial auto, I don't know if you've got any updates on that, would be helpful.

And second question, on Farmers, useful slide on new business policy count growth. How do we translate that into when that would move into overall positive PIF growth at Farmers? I'm thinking sequential positive PIF growth. Thanks.

A - Martin Senn {BIO 3241585 <GO>}

(10:50) will take first question then hand over to George. Sorry, it was Andrew. Now, with regards to the competitive environment. I think we have the right strategy in place and we are executing it by duly investing in our priority markets where we think we have distinctive positions. And if we take the half-year comparison last year versus this year, we were able to grow in our priority markets by 3% in local currency. So that's pretty encouraging.

If I break that down to the segments, thinking of Global Corporate, we have here definitely a clear competitive advantage through our risk insight, through risk engineering approach. I think that's a think that's a relatively high entry barrier relative to at least many of our competitors in the space. The superior claim service and also our well established relationship model.

Then Paul asked the question before asking about new customer achievements. I was in Mexico about two-and-a-half months ago and at that time we had three Global Corporate customers, Mexican based companies. The folks down there told me in three years we're going to have 30. I said, well, put your hand on your heart. Is it 30? And they said yes. Today, we have 12. The point I want to make here really is as the world keeps interconnecting and globalizing and there is more customer sort of in new markets going global, they cannot then rely anymore on the local carrier, that's where we also have definitely a good advantage in that segment.

So back to your question, where is the confidence for us to be able to continue growing, even though the market becomes more competitive. And just the last example is North America Commercial, we're executing on our strategic growth initiatives, we make investments in data analytics. Many of you already have seen about two years ago when we brought some of the investors and analysts to the U.S. where we were there. We have made significant progress again on the back of our analytical capabilities. And particularly there we have profound strengths in some of the fields, construction, technology, healthcare. Keep in mind, we are the number one writer of construction risk in the U.S., number three writer of surety. That's a very strong base to start working on, and we continue having the confidence even in more competitive environment for us to be able to be grow in those segments and customer areas profitably.

A - George Quinn {BIO 15159240 <GO>}

Then if I take the second question on Farmers, so I guess you heard on the video, we're still down in the quarter on the policy count, but I guess if we focus in on the piece that we would regard as more core. So excluding the non-exclusive – or the independent agent, business insurance and standard auto, we've seen a rise of some 25,000. I think – actually, Andrew, if you look at the report card that was in Martin's presentation, I think that actually gives you a better sense of where things are headed because you have a longer history on that page. And I think those metrics are in many ways just as important as the policy count.

Obviously, we look at Farmers month-to-month. The trends we see are still improving, but we have to punch through that zero line. I mean, you've seen a sequential improvement of 4% there in Q4 last year, 2% in Q1 and 1% in Q2. We cannot be very far away from the point at which we see some positive growth in Farmers. I'm trying to resist the temptation to make a forecast.

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

Just my first question wasn't actually on growth, It was on the margin in priority markets in non-Life, the accident year margin. I guess I know you were trying to focus on improving the accident year in the turnaround businesses, but I just want to know if there's any – if you think you can improve it in the priority market?

A - George Quinn {BIO 15159240 <GO>}

May be I can add. I think some of the things that Martin pointed to around the investments we made in technology are not simply about growth, it was about trying to be – use our customer segmentation to target parts of the market that we believe are actually more profitable for us than to try and manage the broker relationships in a way that we see more of the business that we think would be in our sweet spot. And I think Martin's comments may be focused on growth, but I think it's equally valid for the bottom line as well.

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

Okay, thanks.

Operator

Next question from Vinit Malhotra, Goldman Sachs. Please go ahead, sir.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Hi. Good afternoon. Thank you. My first question was actually on the (15:40), but I think it's been addressed fairly comprehensively, so I'll just move to the second topic. In the video, there's also a comment on evaluating options in Global Life, whereas our understanding from the Investor Day was that it's more internal oriented. But is this new comment designed to communicate that there are other options as well or is it more to say that there's more of internal measures that you're also thinking?

And just to confirm, I will use my second chance here. Just to confirm that all these analytics investment does it also give you a portfolio mix control which should offset some of the pricing pressure, just if you could reconfirm that, it would be very kind? Thank you.

A - Martin Senn {BIO 3241585 <GO>}

Let me start on the question with regards to more structural options on Global Life. Now, we are still in the process, of course, of looking at all options one has and that is not limited to the usual options, but when we say structural, that means also potential disposal of businesses or portfolios, it would include reinsurance, securitization and any of the capital action of, you really referred to the capital side of equation. But let me also stress, there is a reason why these are three-year targets, i.e. one needs to take timing doing that. We are not in need of raising capital. We are clearly not under any pressure to pursue any of this action at any price and we want to do that in a very balanced economic sensible way and that what is the approach we're taking here, maybe George, you want to add to that or?

A - George Quinn {BIO 15159240 <GO>}

Well, that's a complete answer.

A - Martin Senn {BIO 3241585 <GO>}

Okay.

A - George Quinn {BIO 15159240 <GO>}

Maybe I'll take the analytics?

A - Martin Senn {BIO 3241585 <GO>}

Yeah.

A - George Quinn {BIO 15159240 <GO>}

I'll start with that. So on the analytics side, Vinit, I think there is a portfolio mix element if I guess we're more focused on the customer side of it, so we're looking for those parts of the customer map where we think our offering is most attractive and where we can generate the highest returns. So there is a portfolio mix element to it.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Nice. Thank you, George. Thank you, Martin.

A - Martin Senn {BIO 3241585 <GO>}

Thank you, Vinit.

Operator

Next question from Farooq Hanif from Citi. Please go ahead, sir.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi there. Thanks for taking my question. My first question is on the Z-ECM. You've commented that you're going to come back closer towards the 120% because of your reinvestment in riskier assets. I was wondering, you still have a margin, what are your other priorities for using that excess risk capital and where would you ideally like that to be? That's question one. And question two was just, I mean you gave a – you're talking about improving underlying accident year, but on the 1.5% of underlying loss improvement that you've achieved in these results, how much of that is just a decent quarter because of the large loss experience? How much of that can we start extrapolating? Thank you.

A - Martin Senn {BIO 3241585 <GO>}

Start with the first question. Now, the Z-ECM, how we look at our capital base is obviously that is our ambition to have a AA rating, and that translates back into a 100% to 100% (sic) [100% to 120%] (19:21) range. And the economic capital models, as you all do know, they can be very volatile and very volatile from quarter-to-quarter, and that's the reason why we deal with this range. We consider the excess capital to be indicated by the ratio, well in excess of this range for a extended period of time. And while the ratio has now been above that target for the last few quarters, it is also to be recognized that that's been mainly due to model changes.

Now, with the additional risk taking throughout the first half in Q1, we have reported there was an impact on Z-ECM of 4 points. With action and the deployment of capital into investment management in the second quarter, we expect a further reduction of that of 3 points to 5 points. This is still bringing the Z-ECM then slightly above the top of the current target range.

What is very important to stress again here is that in terms of our priorities for capital deployment, first comes the dividend; second, the growth of the business; and then third, if you cannot use the capital in the business then obviously, you'll have to find sensible ways to return this capital to shareholders in a very effective manner. And that's how we do look at Z-ECM. I'm sure later on, there might be a question in terms of what specific risks we have taken, but I'll leave that for the time being.

A - George Quinn {BIO 15159240 <GO>}

On the second point, on the improving underlying accident year loss ratio. Again, to look back at maybe half one half to try and get a more stable view of what's taking place. Our view is that of the total improvement that we see, we would estimate, it is an estimate because it's not a precise mathematical science and we have about one percentage point improvement from good luck on large losses, and we see the remaining 1.5% is at the actual underlying rate improvement. So depending on how bullish you are, you can extrapolate it straightaway or you can give another quarter or two quarters to see further evidence if it sticks. But I mean, we have no reason to believe that the 1.5% is not a sustainable improvement.

Q - Farooq Hanif {BIO 4780978 <GO>}

Thank you very much. Thank you.

Operator

Next question from Atanasio Pantarrotas from Kepler Cheuvreux. Please go ahead, sir.

Q - Atanasio Pantarrotas {BIO 5933123 <GO>}

Yes, thank you for taking my question. First of all, thank you also to provide more visibility on your life business with new data. I have two question. First one is on GI investments, you just mentioned that you would like to take some more risk on the investment side. If you can provide some more color on this, or these new investments in the liquidity instruments and what could be the impact on G&I running yield in the next couple of years?

The second question on your German Life business. I remember there was some options in place to apportion to defend the portfolio by low interest rates environment. I would like to know if you can provide some color on what could be the evolution on this part of the portfolio, if it is a totally closed – the originals part of the (22:57) business totally closed to new contracts? And what could be the evolution in the next future provided that interest rates will remain as low as they are? Thank you.

A - Martin Senn {BIO 3241585 <GO>}

Let me start with the first question, the investment action we have taken to date. I should mention here as well that we have finalized in Q2 the deployment of additional risk capital into investment. What we specifically have done is to increase the asset allocation by about $2.5 billion in equities. That brings the current exposure in equity to 4.8% from before that 3.8%, so it's about one percentage move. In absolute numbers, at current FX rates, it's from $8.2 billion to $10.5 billion equity composition.

The other major initiative on risk deployment was an increase in our credit exposure from 40%, i.e. $85 billion to 41%, i.e. $90 billion, that's also been completed at the end of Q2. And the impact on that with regards to business operating profits means, you got to understand, there are obviously some moving parts to that given market movements. It's the timing of it, there are some tactical considerations against that. But if you take this sort of limiting factors in the analysis into consideration, you should expect an additional $60 million to $75 million of net investment income coming through this year, this is before policyholder allocation.

Q - Atanasio Pantarrotas {BIO 5933123 <GO>}

This is on a consolidated basis?

A - Martin Senn {BIO 3241585 <GO>}

Yes.

Q - Atanasio Pantarrotas {BIO 5933123 <GO>}

So Life and GI.

A - Martin Senn {BIO 3241585 <GO>}

That's correct, yes.

Q - Atanasio Pantarrotas {BIO 5933123 <GO>}

Okay.

A - George Quinn {BIO 15159240 <GO>}

So on your second question on German Life. We had some receiver swaptions in place, but we no longer have them, these have all now been sold, so we no longer have receiver swaptions in place to provide us with additional protection on interest rates.

Q - Atanasio Pantarrotas {BIO 5933123 <GO>}

Okay.

Operator

Next question from Mr. Michael Huttner of JPMorgan. Please proceed

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

(25:24) Thank you so much. So on the $3.5 billion, how much – you sound very certain, but we're not at the event obviously. How much of that's have you already received or have your subsidiaries already kind of said they will do, how much of that is actually certain already?

And then the other question is on the combined ratio. I noticed that there's $40 million of expenses in other operating business, which might normally belong to GI and I just wondered what was the impact in your 1.5% underlying improvement? I'm sure you reflected that, but just a concern. And then it sounds as if now reserve releases are completely out of the picture, the zero numbers is the new normal. Thank you.

A - George Quinn {BIO 15159240 <GO>}

Yeah, Michael, I'm going to have a go at these and Martin can – so how certain are we on the $3.5 billion, how much have we had already? I mean, I think you can hear from the confidence in our voice that we've had a very large proportion of the $3.5 billion already and you'd expect that, I mean given the way that dividends flow, so these things are going to be typically front-end loaded. But I think it's more important to focus on what we'll generate for the full year. So we've given this guidance, more than $3.5 billion. We're highly confident, but of course things can change. But we've got a very large proportion of the cash already.

On the improvements, as I mean, well-spotted, you're right, we have this flipped between OOB and both – in fact all three of the segments in the quarter. For GI, the 1.5 point improvement that I talked about earlier is a loss ratio improvement, so of course that expense impact has no impact on that number. And your last question was PYD, Michael?

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

Yes, please.

A - George Quinn {BIO 15159240 <GO>}

So I guess – I mean obviously, we've guidance of 1% to 2%, and you see 0% in the quarter, so does it have an impact on us? But I guess, we're trying not to be complacent. We've looked extremely carefully at what drives it. I mean we can pick a number of very large, including one extremely late reported claim, which is significant for us. And of course, if I exclude those, you'll find we're in a 1% to 2% range. And I guess the key question is do we see things in those losses that would give us concerns that these would be something that would continue over significant periods and we conclude. I mean, while there's always the risk of further development, we don't see these being systemic issues into future quarters, so we're confident in the 1% to 2%.

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

Good. Thank you so much.

Operator

Next question from Daniel Bischof from Helvea. Please go ahead, sir.

Q - Daniel Bischof {BIO 17407166 <GO>}

Thank you and good afternoon. Most of my questions have already been asked. So just quickly, could you update us on how large the gap was between the new money yield and the running yield at the end of Q2? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Dan, it was about 1%.

Q - Daniel Bischof {BIO 17407166 <GO>}

Thanks.

Operator

Next question from Niccolo Dalla Palma from Exane BNP Paribas. Please go ahead, sir.

Q - Niccolo C. Dalla Palma {BIO 16052945 <GO>}

Yes, good afternoon. Two questions from my side. First one on the cost savings, the $250 million. Could you perhaps give us any indication of how it will break down by division and how much you expect to be reinvested? And secondly, if I may come back to the comment you made at the December Investor Day on the 12% to 14% operating ROE target, you said you would be disappointed if you only achieve the lower end of this range at the end of the period. So I just wanted to hear about whether you're confident that the high end is in reach without making strong assumptions on the macro side?

A - George Quinn {BIO 15159240 <GO>}

So if I take the first one, I think Martin will take second. On the cost savings, to highlight something I mentioned in the video already, it will mainly fall to the divisions because it'll impact the recharges that are made. I don't have the precise split yet of where it's all going to fall, so I can't give you very precise guidance. But given that GI is the largest business, I expect more of it to fall there. But I guess in due course, we'll give you more clarity on where that's going to fall. I think you had a second point on the cost saving which I forgot, Niccolo.

Q - Niccolo C. Dalla Palma {BIO 16052945 <GO>}

Yeah, it was how much could be reinvested in growth, if you have any view on that yet.

A - George Quinn {BIO 15159240 <GO>}

I mean, I think it depends on the opportunities we see. If we're seeing very attractive opportunities to deploy capital that requires expense support then we're absolutely going to do it. So it depends on what Mike, Kristof, Geoff and rest of the team bring to us. I mean, we would be prepared to reinvest all of it if the economics make sense. But we'll see in the future as opportunities emerge.

A - Martin Senn {BIO 3241585 <GO>}

On the first part, Niccolo, the point we made at Investor Day, that's still valid, definitely so. And with the BOPAT ROE number we have shown now 12.5% that shows and indicates that we are in our target range. But we also made the point that, George and I, that this is a good start, but there is still much more to do. And the key component is to put through action to keep moving this business operating profit after tax return on the equity upwards. And that's the core of our strategic initiatives.

Q - Niccolo C. Dalla Palma {BIO 16052945 <GO>}

Very clear. Thanks.

Operator

Next question from Andy Broadfield from Barclays. Please go ahead, sir.

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

Hi. Good afternoon. Just one quick question on the capital management side of things. As we look at the – you've talked a little bit cryptically about the ECM model being at 128% and that you want to maintain some buffer because of volatility. But I guess the question that will increasingly emerge is will you consider other actions to maintain that or to keep that to the range of the 100% to 120%, such as buybacks, or are we just nowhere near thinking about that sort of thing at this stage?

A - George Quinn {BIO 15159240 <GO>}

Apologies, Andy, if we were cryptic. I think just to repeat what Martin said on priorities. So number one dividends; number two, business growth where it meets the hurdle requirements that we have. And then number three, if we have access that we can deploy, I mean just to repeat, we'll look for the most efficient way to return it to shareholders. I think in terms of timing, we're not ready today to give guidance on when that's going to be. I mean, I think it's a bit like the – it's a bit like Niccolo's question on the expenses. We want to see what the businesses have as possible growth options. I mean, some of those will extend more than one year ahead of us. I mean once we've had a chance to evaluate them then we can make a decision about what the best deployment of the excess capital is going to be. But I means we can't answer that question today.

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

But do you have a numerical framework that we should be thinking about, accepting that you might use 8 percentage points for some transaction? But sitting above 120%, is that generally a level that you're prepared to sit at for some time or will you get tired of that pretty quickly and want to bring it back down to the 120% region?

A - George Quinn {BIO 15159240 <GO>}

The target range is 100% to 120%, so I mean ordinarily we look to operate around the middle of that range, I mean it'll partly depend on what our outlook is. And I think if we think we're in uncertain times, we'll let the thing rise to the top end of the range. I guess, if we're more bullish and we have more growth opportunities we'll let it shrink slightly or fall slightly to the lower end of the range, but we want to be in that range.

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

Okay. Thanks.

Operator

Next question from Stefan Schürmann, Bank Vontobel. Please go ahead, sir.

Q - Stefan Schürmann

Yes. Good afternoon. Just two questions. The first, on non-Life, I saw that your retention was increasing to, I think, roughly 86%. Is that a trend that will go on? And can you maybe more specifically say if that is special lines of business or across the board? And the second one is on duration gap. Can you give some update here on the duration gap in Life and non-Life in the view of your investment rebalancing, if there is any change here?

A - George Quinn {BIO 15159240 <GO>}

Stefan, I'm going to take the first question on retention, you may have to repeat the second question because we were just debating what the first question really meant while you were speaking the second part. On the first one, we don't really see a significant change in retention for non-Life. There's certainly a change in retention for Farmers, I mean that certainly improved and that's a positive sign for future across GI. I don't think we see significant deviation.

Q - Stefan Schürmann

Okay, yeah.

A - George Quinn {BIO 15159240 <GO>}

So can I ask you to repeat the second question. Sorry.

Q - Stefan Schürmann

Yeah, the second question is just on the duration gap, if there's any change here in the Life and non-Life segments from your investment rebalancing?

A - Martin Senn {BIO 3241585 <GO>}

No, there isn't actually, same duration. As you know as the principle, we try obviously to match durations and if anything then it has slightly lengthened, but very much unchanged, weighted, I think at 5.9 years, 3.5 years on the General Insurance and somewhere around – to give the exact numbers we can deliver, but somewhere around 7 years, 7.5 years for Life.

Q - Stefan Schürmann

Okay. So no changes?

A - Martin Senn {BIO 3241585 <GO>}

Yeah, no change.

Operator

Next question from Thomas Seidl, Sanford Bernstein. Please go ahead, sir.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yes. Thank you. Good afternoon. First question, on the P&C expense ratio, it seems a bit higher than expected, and given the typically lower expense ratio in the second quarter, I wonder what the mid-range run rate is on this new basis expense ratio that you're disclosing. Should we hence expect it to be higher than the 29.7% shown today?

And secondly, on the investor day, I think, I remember you told us that Farmers, one of the strategies they have is they want to grow the confident planner segment, and I wonder if you can give us an update what actions have been done and what the success has been on those actions to-date?

A - George Quinn {BIO 15159240 <GO>}

Thomas, on the first one, I'd point you to the comments on the video. So the 50 basis points, we think is the one-off benefit that we have. So if you adjust for that, that'll give you a sense of all things being equal where we go. And I'd also point to – I mean what I discussed earlier with Niccolo that I think we've opened the possibility that we are prepared to let it rise, if we think that's a smart investment for the future. But certainly on a running basis the 50 basis points is the best guidance that we can give you. Can you repeat the Farmers question again?

Q - Thomas Seidl {BIO 17755912 <GO>}

The Farmers was just going back to the Investor Day where I think you've told us that the strategy to turnaround the growth was you want to grow not in the price sensitive segment, but in the confident planner segment. I wonder what actions Farmers has really taken year-to-date and what the impact was of those actions? In other words, do we see impact from this strategy?

A - Martin Senn {BIO 3241585 <GO>}

Hi Thomas, this is Martin. Yes, definitely, we do see impact and actually the initial action we took was the re-pricing on the more price sensitive segments, which are very cost conscious representation of the customers, which we are pricing out. That's part of the decline in GWP we have seen last year, along that side as well somewhat an improvement in the combined ratio. We continue pushing that, particularly the confident planner segment. Keep in mind this is 17% of all U.S. households we are focusing on. We have some good early indication in terms of the receptiveness of this prioritization through the agency channel.

On the back of that also commenting is that we keep growing agents that's why we're mentioning this time, there is some correlation to that that this is a segment which needs higher maintenance and that goes in line. There has been some investments which starts coming through with regards to the billing procedures and the way the customers do receive then their respective statements. You get one statement no matter what policy you buy as a retail customer. That's been a very important part of improving the service to the customer. There's also been a renewal on the web and particularly as well on the web accessible for specific customers only through password protections.

So that's a series of action which is starting to flow through, but it's definitely supporting the targeting and the validation of Farmers' consumer strategy to the segment of confident planners.

Q - Thomas Seidl {BIO 17755912 <GO>}

Okay, thank you.

Operator

Next question from Marcus Rivaldi from Morgan Stanley. Please go ahead, sir.

Q - Marcus P. Rivaldi {BIO 5739374 <GO>}

Hi good afternoon everybody. Two quick questions from me. First on the cash, if you are far that ahead of your expectations or sorry the $3 billion run rate, what are you planning to do with that excess cash? And then secondly just on – a quick question on the UK, the combined operating ratio – combined ration there is 88%, an exceptional performance there, very tough market. Could you give some sort of color as to what's driving that performance? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Marcus, on the first one, I guess, I can only point to what we said earlier as to the – I mean the cash is really – demonstrating our ability to turn the earnings into cash and bring it through the group to a place where we have freedom to choose what we do with it. And I mean, I'd point to the priorities we mentioned earlier that our priorities are, number one, dividend; two, business growth; and then three, if we still have excess and excess determined by the target capital levels, going back to Andy's question, we would look to return it to shareholders in the most efficient form possible.

On the UK, the real driver is PYD, that's why you're seeing a combined ratio that's, I guess, slightly abnormally low.

Q - Marcus P. Rivaldi {BIO 5739374 <GO>}

Thank you. Just on the cash flows, coming back to that, given that I guess you're also guiding that perhaps over the three year it's still closer to the $9 billion is where you're really thinking, I guess this should be read that this just gives you more comfort that can be achieved and ultimately gives greater comfort over the dividend at the current level. Would that be the best way to think about it?

A - George Quinn {BIO 15159240 <GO>}

Yeah. I think that's not a bad way to think about it.

Q - Marcus P. Rivaldi {BIO 5739374 <GO>}

Okay, thank you.

Operator

Next question from Peter Eliot from Berenberg. Please go ahead, sir.

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

Thanks a lot. Just one remaining question, please, and it was just on the – within Life, on the new German regulations. You refer to a negative impact of $37 million offset by some modeling changes. Just wondering if you could just sort of clarify the impact you expect on an ongoing basis from those new regulations. Thank you.

A - George Quinn {BIO 15159240 <GO>}

So from an ongoing perspective, we don't expect it to have any significant impact. And we expect to deal with it through the discretionary allocations.

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

Thank you.

Operator

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

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

Hello. Hi there. Sorry, just a follow-up question. Could you just talk about claims trends on the P&C side? I'm more interested really in the spread between written rate change and loss cost trends. Is it fair to say now written rate change more or less equals loss cost trends, or shouldn't we look at it in aggregate because obviously it's a different picture in individual portfolios? Maybe just some sense of what you're seeing on claims trends in the key areas would be helpful. On German Life, just to clarify, did you say that the swaption program has now been taken off? Is that part of a deliberate re-risking or why has that not affected the duration which you said is unchanged? Thanks.

A - George Quinn {BIO 15159240 <GO>}

So first of all on claims trends, I think that overall I think your summary is a decent one. I think, we have the benefit in the quarter of the earn through of a prior positive margin impact from rates that we think that loss costs are certainly rising. It's certainly coming close to what we're seeing from rates. So I mean from an overall – the element that falls to the bottom line probably not as significant as it was before, and it may well be close to flat in the current market conditions.

On the swaptions, so again to repeat, we have removed them and I guess we're not running this business anymore either. I guess, we're going to look at alternative ways of managing the portfolio. But in terms of why it hasn't impacted duration I don't know, I need to come back to you, Andrew, I don't have the immediate answer to that question.

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

And does it mean, there's a bigger interest rate sensitivity to the overall capital model or it's because you've found alternative ways that mitigates it?

A - George Quinn {BIO 15159240 <GO>}

Sorry, I was just listening to someone else. So the...

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

Obviously, because it sort of reduced the interest rate sensitivity somewhat having those...

A - George Quinn {BIO 15159240 <GO>}

Yeah.

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

...in the capital model and the EV or MCEV. Does that mean the interest rate sensitivity has now risen or have the alternative ways of managing it mitigated that?

A - George Quinn {BIO 15159240 <GO>}

The interest rate sensitivities will be higher.

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

Okay.

Operator

We have a follow-up question from Mr. Huttner from JP Morgan. Please go ahead, sir.

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

I've been called Mr. Huttner, I've been promoted. Thank you. Just two questions. On the reinsurance slide, 32, so you did – you had part of the (44:13) program which you did in July. Could you talk a little bit about what the changes were both in terms of how you position yourself and in terms of the cost of it? And then I probably got this completely wrong, I was trying to read your speaker notes, but I was also trying to compare with what you said, and I'm sure I got it wrong, but – has Farmers now, has it reduced the amount of reinsurance it buys in total, and what is the new number? In the speaker notes I can't see anything, but may be you said it and I've probably completely missed it. Thank you.

A - George Quinn {BIO 15159240 <GO>}

So on nat cat reinsurance, I don't have the precise number, but obviously we benefit from the market movements, so there'll be a margin improvement overall for us given the reinsurance market trends you can see at the moment, but I don't have a precise figure for you, Michael, in terms of the benefit.

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

I mean, the reason I asked is it was a little bit a trick question, because in January what you did is you bought more cover higher up with the saving. In other words, there was no cash saving. It was just you had more higher up cover, which if there are no nat cats actually doesn't deliver. But I'm guessing from your answer here you actually kept the same cover and you paid a bit less, but maybe I'm wrong.

A - George Quinn {BIO 15159240 <GO>}

No, you're correct.

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

Okay. Thank you.

A - George Quinn {BIO 15159240 <GO>}

I'm getting short-term memory problems today. Can you repeat the second question again?

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

Yeah, I'm sorry. So, really simple. I had in mind that Farmers buys 18.5% reinsurance. I thought this was still the case and I just wondered, A, am I right and has it changed?

A - George Quinn {BIO 15159240 <GO>}

Yeah, you're absolutely right. I guess what we signaled on the video and in the speaker notes is that, I think at Q1 we've said that Farmers is kind of operating above its target surplus range ,that we'd planned to use its capital strength to reduce the quota share at the year end. Through Q2, it's roughly back where it started the year given the frequency and the nat cat experience that it's had in Q2, but it's still above the range. So we still expect it to reduce reliance on the quota share, but at the end of this year.

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

Thank you very much.

A - Martin Senn {BIO 3241585 <GO>}

Just to add to that, Michael, the all lines quota share with us is still the 18.5% and then they have obviously an agreement in the marketplace, I think that runs to around 1.5%.

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

Thank you doubly. Thank you.

A - Martin Senn {BIO 3241585 <GO>}

Just That's virtually unchanged from the last time we reported that.

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

Yeah. That's clear. Thank you.

Operator

The next question is a follow-up question from Mr. Dalla Palma from Exane BNP Paribas. Please go ahead.

Q - Niccolo C. Dalla Palma {BIO 16052945 <GO>}

Yes. Thank you. Just one follow-up question on the Z-ECM, and specifically on the model changes. We have had a few points up last year, a few points down this quarter. Just if you could clarify whether there is any further refinements already planned, or whether it will be only driven by potential regulatory changes from here on? Thank you.

A - George Quinn {BIO 15159240 <GO>}

We're doing our best to try and avoid model changes that would drive this thing up and down. We look at maintenance of the system every year, but I'm currently not aware of anything that would have a significant impact on the model going forward. I mean, there's always the possibility that we have a particular area where we see a need to make a change, or a regulator has a view where they would propose something. But I don't see anything at this stage, Niccolo, either up or down.

Q - Niccolo C. Dalla Palma {BIO 16052945 <GO>}

Thanks.

Operator

We have a follow-up question from Mr. Thomas Seidl, Sanford Bernstein. Please go ahead, sir.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah. Thanks for taking my follow-up question. It's on slide six, the Life waterfall. Just two questions here. The in-force management, I think at the Investor Day you mentioned the UK is just at the start, I wonder to what extent have you already now seen the tangible benefit of this in-force management? And the second is what do we have to expect on the other category in this waterfall chart?

A - George Quinn {BIO 15159240 <GO>}

Maybe if I talk through it a second, Thomas, just to give everyone the benefit. So I mean the VIF unwind is the natural runoff of the portfolio. In-force management is mainly focused on Europe. So I guess we've seen a relatively small proportion of that yet, but I think the team has very solid plans that are pretty detailed and we have high confidence in that.

On priority market growth, I think there is a risk that you would look at that and think, well, that's something that they have to grab in future and that would be partially true, but of course some of this will come from, for example, some of the bancassurance deals that we've done that tend to be less profitable, again, because of the shape of amortization of the initial commission or the initial expense. I mean, those are the key items on the waterfall.

Q - Thomas Seidl {BIO 17755912 <GO>}

And just on the in-force management, can you give us a percentage? How much do we see year-to-date of this $20 million to $25 million?

A - George Quinn {BIO 15159240 <GO>}

I don't have a precise figure in my head, but it's less than half.

Q - Thomas Seidl {BIO 17755912 <GO>}

Less than half, okay. All right, thanks a lot.

Operator

Ladies and gentleman that was the last question. I would now like to turn the conference back over to Mr. Senn.

A - Martin Senn {BIO 3241585 <GO>}

In closing, while we do recognize that there is still much work to be done. We are pleased with the progress we have made to-date and we remain confident that we're on track to fulfill our ambitions for 2014 to 2016. Our achievements include good progress on our strategy in General Insurance to turnaround or to exit under-performing businesses and to deliver an improved accident year combined ratio.

Global Life is implementing its in-force management initiatives and progressing its priority market growth strategy. And we definitely do see further positive trends from the Farmers Exchanges with improved customer satisfaction and also agent retention we have shown you in the slides. And at the same time, we continue to generate strong cash remittances, which do underpin our attractive and sustainable dividends.

And with that I want to thank you all for your attention for your continued interest and also for your good discussion and good questioning today. And I very much look forward to soon connect again. Thank you very much and do have a good day.

Operator

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