Q4 2016 Earnings Call

Company Participants

- George Quinn, Chief Financial Officer
- Mario Greco, Group Chief Executive Officer
- Richard Burden, Head Investor Relations & Rating Agency Management

Other Participants

- Andrew J. Ritchie, Analyst
- Andy Hughes, Analyst
- Dhruv Gahlaut, Analyst
- Farooq Hanif, Analyst
- Michael Igor Huttner, Analyst
- Nadine van der Meulen, Analyst
- Nick Holmes, Analyst
- Paul De'Ath, Analyst
- Ralph Hebgen, Analyst
- Thomas Seidl, Analyst
- Vinit Malhotra, Equity Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, good morning or good afternoon. Welcome to the Zurich Insurance Group Annual Results 2016 Conference Call. I am Maria, 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. Richard Burden, Head of Investor Relations and Rating Agency Management. Please go ahead, sir.

Richard Burden {BIO 1809244 <GO>}

Thank you. Good morning, good afternoon, and welcome to the Zurich Insurance Group's full year 2016 results Q&A call. On the call this afternoon we have our CEO, Mario Greco; and Group CFO, George Quinn. As usual, we'd remind you to keep your questions to two, and if we have time, we'll come back to you for additional follow-up.

But before we start with the Q&A, I would like to hand over to our CEO, Mario Greco, who will make a few introductory remarks.

Mario Greco {BIO 1754408 <GO>}

Thank you, Richard. Good afternoon, everybody. So let me quickly assess what has been done in 2016 and what these numbers have and what they don't. So I think 2016 was a year of profound changes at Zurich. We changed the organizational structure, but more importantly, the management team has been changed in composition and roles.

We went down into the campus (01:44) organization in the second half of the year. We also merged the Commercial and the Global Corporate organization in Europe, in U.S. and in the rest of the world. And in the meantime, we launched important portfolio restructuring actions. We reunderwrote a number of books. Through the year, we kept improving our results quarter-by-quarter. So what you find in the year-end numbers, I think is a good achievement of the first year of a journey, which is going to take us for the next three years. Also, what you find is very consistent contribution by Life, by Retail business where performance (02:34) has been especially strong, and also by the Commercial and Corporate business, which has been improving over the previous results.

I am also pleased to report on the $300 million reduction in nominal amounts of the cost basis, which is something that we indicated to you that will be the target for 2016, and it was achieved and give us good traction and confidence for continuing in 2017 and in the next years.

So, the way I would look at this result is we're getting traction, we're getting confidence on what we can do. The movements are all indicating the right direction. The re-underwriting skills are clearly there in the results, also clearly there. More will come in 2017 and in the next years, and the targets are exactly as reachable as we thought they will be.

Before I hand it back for question, let me also anticipate something that likely you will ask, which is on the M&A scenario and the market situation. There had been a lot of rumors and a lot chats on M&A. Our position is again unchanged with respect to November.

We have a strategy, which is not based on extraordinary transaction, it's not based on M&A. However, we have been doing in 2016 some transactions, which all share a common theme. They are focused transactions on given markets or given customer segments, and they strengthen our strength. So, they keep building on where we're already strong and keep creating further opportunities for us to maintain, acquire, develop our leadership position in market or in customer segments. That is to say that we will continue looking at the market in the same way we have been doing, but we don't participate to the last rumors in the market and we don't see anything that makes us changing our views.

With that, I will open the line now to questions. And George, myself and Richard will be happy to handle your questions.

Q&A

Operator

We will now begin the Q&A session. The first question comes from Farooq Hanif, Credit Suisse. Please go ahead.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hello, everybody. Good afternoon. Thanks for taking my question. Firstly, on Global Corporate, it remains disappointing in Q4 and for the full year, although obviously it's improving. Can you talk about the things that you think will disappear through re-underwriting in 2017? So, for example, perhaps financial risks or things that have been a problem in Q4 and what impact do you think – continued impacts will have on top line in Global Corporate?

And my second question, moving to the Z-ECM, clearly very strong. I presume this does not include the impact of investment portfolio de-risking, so if you could comment on that. But also, how do you think about your service cap (06:44) position and what your priorities are for using that budget? That's it, buddy. (06:50) Thank you.

A - Mario Greco {BIO 1754408 <GO>}

Can I start, Farooq, and then I'll pass it to George for further comments and especially on the capital side? I mean, on Global Corporate, what matters to me is that business is improving and results are improving. And one thing you should be mindful of is that through the year, we changed many responsibilities in Global Corporate, which also meant that we reassessed customers position and customer interest and we took different decisions on a number of them. That was important to be made, and so this gives me optimism for now a continuation of the journey in the next years.

I will pass it now to George for his part.

A - George Quinn {BIO 15159240 <GO>}

So, first of all, on Global Corporate, Farooq, you're absolutely right, the performance that we achieved in Q4 is not the one we've targeted, and it's clearly the area of most significant opportunity for us looking forward to 2017.

After Jim Shea's arrival, he's done a review of the portfolio. We've discussed that with him as part of the planning process, and he does have further plans to adjust the portfolio. But that will also mean, it's a combination of – I mean, some areas we will reduce capital allocation because returns are low. In other areas, we may increase capital allocation on the lines that we outlined at the Investor Day. So, we do have a detailed plan that is country-specific (08:31) business targeted to further improve Global Corporate and to bring it to the level of return that we require. I think it is a tough market, difficult conditions, it's probably the most competitive market that's out there. But for us, we have a required level of return for that business, and we'll keep making the changes required until we get there.

From a top line perspective, we don't expect to see as dramatic a change as we saw during this year. And in fact, some of the things that we've done this year should start to feature at the earnings as we move through 2017. So in contrast to the double-digit impact we had our premiums this year, something in the low-single digit range is what we anticipate from Global Corporate in 2017.

Q - Farooq Hanif {BIO 4780978 <GO>}

And just following upon expense ratio, which had some focus today, are you worried about some of your bottom line absolute expense reductions are going to get swallowed up in the ratio that you shared or is that really not a concern?

A - George Quinn {BIO 15159240 <GO>}

I think this came out when we discussed the same topic a year ago and I guess, it was a concern there that some of what we do on the top line may be offset by what we do on the expense side. We said then and it's still true today that we'll tackle the nominal expense first and if we meet further adjustments to achieve the target rates that we have, we'll do that afterwards. But the key focus for the time being, achieve the expense goals that we have and achieve the required technical hurdle rates on the base businesses that we've got.

On Z-ECM, there'll be some impact of the de-risking that's taken place already through the last quarter, say last year. The main impact in Q4 is interest rates. So, in particular, the steepening of the curve reverses some of what we saw in Q1.

From a budget perspective, and I guess, you don't think of it in terms of a budget per se around $100 million to $120 million, (10:47) it's really about capital allocation. And maybe we will share a regular review of where our capital is deployed and whether there are alternatives that would give us more attractive returns to investors and that's what led to some of things we did last year on the countries we've exited. And of course, we've redeployed that capital in other markets where we believe we can achieve an overall improvement.

We'll go through the same process this year, that's true for countries, it's true for the regions, and certainly only true for the group. But from a budget perspective, obviously, we're adequately capitalized. We are in a position today where, if we had opportunities to expand and the market offered attractive rates of return, we could do that although, as we discussed before, (11:36) that we have significant growth ahead of us in the short term.

Q - Farooq Hanif {BIO 4780978 <GO>}

Okay. Thank you very much.

Operator

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

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Good afternoon, thanks for taking my question. I have two questions. Firstly, could you talk about the Legacy portfolio what you have in UK, as well as Europe in terms of the size of liability, and what is the capital attached to it? Given the Odyssey (12:08) transaction which you've done yesterday, would that be something as in you would look for your liabilities as well?

Secondly, slide 11, you've given a blended rate in terms of change still around 2%. How would you say claim inflation stacks up with this on a blend basis?

A - George Quinn {BIO 15159240 <GO>}

So, let me start with the first question on Legacy. So, within our – the European side of our Legacy portfolio, the largest piece by far, is our UK employers' liability exposure. We've got approximately $2 billion of reserves in that portfolio. From a capital perspective, it's a relatively small part of the overall reserve position of the group. If the group has, say, $50 billion, $55 billion of reserves, we look at something, say, less than 5% of the total.

From a capital perspective, it tends to diversify away in the economic systems. So the economic impact of disposing of it is not particularly significant, has a larger impact for S&P. So, we're talking about few hundreds of millions of dollars of S&P Capital. Everything that we have in Legacy is not something that we intend to nurse and look after for the rest of its natural life. We are looking to try and find exits – attractive economics. And we have been exploring, we continue to explore the capital side of it. It's not unimportant that to be honest, just to remove the risk factor, be a more important motivation for us.

Beyond that within Europe, what we typically have is, small amounts of relatively long tail lines in some of the Continental European countries, but they face more in comparison to the UK yield book.

Your second question was about the loss cost inflation compared to the...

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

The 2%. Yeah.

A - George Quinn {BIO 15159240 <GO>}

Yes. We estimate Q4 around 1%.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

All right.

A - George Quinn {BIO 15159240 <GO>}

So, we're still seeing positive margin improvement.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Perfect. Thank you.

Operator

The next question comes from Andrew Ritchie, Autonomous. Please go ahead.

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

Hi, there. Just reading the commentary on results, I'm still a bit confused. On the accident year ex-cat loss ratio in Q4, is that still containing an above-normal level of large losses? I'm talking ex-cat. So, I think the implication is, it's still slightly inflated versus what you described as normal. And in relation to that, when you talk about the outlook for the combined ratio, what's the assumption now on a normalized level of cat? Obviously, you've done a few changes in reinsurance and exposure, they used to be around 3.5%, is that still the case?

And the second question is just on expenses, I'm still confused what the bottom line impact of the cost savings was in 2016. I appreciate you achieved $300 million run rate, but what was the bottom line impact? Because there's some confusing commentary. Clearly, I know the IFRS expense base reduced by more, but some of that is some accounting effects. Now to just, clarify bottom line impact in 2015 (15:32) and the expected bottom line impact in 2017. Thanks.

A - George Quinn {BIO 15159240 <GO>}

So, on the first question, on the large loss component, compared to what we had planned for, we're still slightly above. So, it's probably what drives the outcomes for Q4. We've been really cautious both in the commentary and in other comments we've (15:53) this is volatility. We've taken the view that it is what it is. We have an expected return and that's we expect people to achieve. But I mean...

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

And just to be clear, is that one of the reasons why the combined in Q4 didn't hit what you talked about at the end of Q3?

A - George Quinn {BIO 15159240 <GO>}

It's one of the reasons. Well, you can see, if you look at the numbers, overall for the group, the loss ratio is actually in a very decent place, notwithstanding what we discussed earlier on Global Corporate, the expense rate challenge in Q4.

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

Okay. So, it's still slightly above what you've planned for...

A - George Quinn {BIO 15159240 <GO>}

In that quarter.

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

And on the cat?

A - George Quinn {BIO 15159240 <GO>}

On the cat, given the covers that we now have in place both for last year – in fact, we've increased the amount of cat cover we have in place for 2017. We expect, and again, long-term expectation, around 3% compared to the prior 3.5%.

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

Okay.

A - George Quinn {BIO 15159240 <GO>}

On the bottom line impact of expenses, Richard and I was talking about it earlier, I think at times, we try and do too much to explain what takes place. And I think had the unintended consequence of confusing people. The simple way to think of this is that we have this $300 million bottom line impact after (17:09) currency. If you look at the financial (17:12), you see a larger number but we don't give ourselves credit for the currency impact, the $300 million.

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

So, is it incremental $400 million in 2017 then?

A - George Quinn {BIO 15159240 <GO>}

But the currencies will move around over time.

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

Sure, (17:25).

A - George Quinn {BIO 15159240 <GO>}

So, yes. Correct.

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

Okay. Thank you.

A - George Quinn {BIO 15159240 <GO>}

You're welcome.

Operator

The next question comes from Nadine van der Meulen, Morgan Stanley. Please go ahead.

Q - Nadine van der Meulen {BIO 15200446 <GO>}

Hi. Good afternoon. Thank you for taking my questions. The first question is on, your comments around claims inflation that you just made that they're around 1% for the group. Could you give more details on the regions with regard to the claims inflation and the rate increases that you're putting through?

And the second question is on the cash remittance, the guidance of over $9.5 billion for 2017 to 2019, if I sort of simply compare this to the $2.8 billion in 2016, that means on an annual basis, it's about 12% higher each year in the next three years. Can you explain where that uplift is coming from? Is that all from the operational earnings improvements or are there other sources as well for example reduction in surplus capital in certain units?

And then (18:40) quickly on the ultimate loss ratio for 2016, it looks a little bit low relative to previous years. Would this have by any means an impact potentially on future reserve releases? Could you comment on that? That's it. Thank you very much.

A - George Quinn {BIO 15159240 <GO>}

Thank you, Nadine. So, on the claims inflation topic, it's hard to do just the claims inflation (19:07) pricing region by region. Overall, you've seen the figures for rate, you've heard my comment on loss cost. If you break it down, the positive end of the spectrum in general, Europe is in pretty good shape. Italy is the only area where we'd see more pressure on the margin side of things. But UK, Germany, Switzerland, Spain, all looking at very good shape and above the average for the group.

And North America, more challenged sort of midmarket commercial, also the corporate end of America. And things are probably closer to flat then improve in that particular market, much more competitive dynamic, and much harder to get rates that's significantly ahead of loss cost.

And I think Global Corporate generally follows that same trend. So, stronger in Europe, slightly weaker in North America. And I would say of the two key regions, LatAm is in decent shape, maybe slightly below overall Asia-Pac because of the changes that we've made in the portfolio. So, for example, we've been reducing our exposure in Australia, which is one of the weaker markets, but maybe slightly above the average overall APAC.

On the cash remittance topic, just to repeat something that I said at the Investor Day just to make sure that the frame of reference is correct. So, we've had a target for the last three years of $9 billion. You've seen what we've announced today, so we've significantly exceeded that. We set $9.5 billion as the target for the next three years and that includes absorption of the restructuring costs that we've talked about before. So, gross of restructuring, the cash target would be significantly higher than the one we've published today for the last three years.

The vast majority of that comes from operational improvement. As you'd expect, we always have some plans around capital movements or extraordinary dividends that we've taken. Most of that over the course of the last two years particularly around Farmers. So, we've taken the capital of at Farmers Re because it wasn't required to support the business there. We don't have an equivalent impact planned for the next three years. And we do have an expectation that some of the things we talked about before around some of the excess capital in North America, on the Commercial side coming back to us, but the uplift is to the vast majority driven by the improvements on operational performance and the higher dividends that that permits.

On the ultimate loss ratio for 2016 compared to previous years, it depends what you look at in terms of previous years. Obviously, if you compare to 2015, it's significantly lower, but I guess we'd all expect that, given that what we know happened in 2015. You think a mix of years going back and I think if I look at what we end the year in ultimate loss ratio perspective, I look at the triangles, I look at the paids, we're in a good place compared to what I've seen from the group starting prior years. And as far as reserving goes, we feel comfortable with where we are reserved overall.

We talked already about the PYD and our intention to keep it in a reasonably narrow band and try and maintain some consistency. And if I look at what we've done over the course of the year, in my view, and I appreciate it's subjective is that, even with the PYD delivered in the range that we've talked about, our view would be that we've actually strengthened the overall reserve position. So, today, we'd be, if anything, slightly more confident than we were a year ago.

Q - Nadine van der Meulen {BIO 15200446 <GO>}

Thank you.

Operator

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

Q - Paul De'Ath

Hi there, and a couple of questions, please. Firstly, just a point of clarification, really. On the dividend, you made the comment that you pay this - how are you going to pay the dividend part and reduction of capital contribution reserve and part from retained earnings. And it'd be interesting to know what's kind of driving that and is that markedly different to what you've done in the past? That's question one.

And then secondly, and just looking at the - and the (23:55) alluded to the fact that and obviously (23:58) part of the reason why you missed on the guidance in terms of combined ratio was due to large losses and partly due to expense ratio. I mean, I guess, what was the surprise on the expense ratio side? Was it that you couldn't cut the cost that you thought you were going to, or was it due to top line being lower than you thought? I guess, what was the surprise to you there? Thanks.

A - George Quinn {BIO 15159240 <GO>}

So, on the first one on the dividend, I mean, you've probably seen in prior years that, I mean, we talked about dividend but technically, it's been a distribution from the Senate (24:33). And because of Swiss law, I mean, we are able to make those distributions certainly (24:39) to retail shareholders in a form that's free of withholding (24:43).

There's a given amount that we have defined by prior capital issuance that we're committed (24:51) to do that. And as we pay the dividend this year of the CHF 17 per share, as we get probably through that number, we exhaust our ability to make distributions from those reserves.

So, we technically make the CHF 17 payment in two pieces. One is a distribution and one is a more traditional ordinary dividend. And with that, we will have exhausted our capacity to distribute capital in a more technical way and in the future, it should be ordinary dividend.

On the expense ratio side of things, I mean, I think if you look at the number for the quarter, I mean, we anticipate that we'll see a step-up in Q4. We have a seasonal pattern to expenses that, I mean, we've had over several years. So, we would expect to see around 1% (25:42) and move up. I mean, we still have - I mean, beyond that another 1.5 points there to explain. I mean, if you dive into it more deeply, I mean, there's a combination of effects that drive - I mean, premiums are probably the thing that drive it most. And of course, maybe the thing that we haven't anticipated as well as we may have done was the way that GWP would feed into the end premium.

If you look at the GWP numbers for Q4, it moves not as significant. If you allow for RCIS and the impact of disposals that we would have seen earlier in the year, and given that we have an expectation that next year, premium volume is fairly flat, and that will be a temporary impact. But what it does too is, of course, it rebases the expense ratio that we start from.

But, I mean, as we go through the course of 2017, you'll see the expense ratio start to move down again as we get the benefit of the expense and efficiency program that we're still pushing through the organization come through with a relatively stable top line.

Q - Paul De'Ath

Okay. Thanks.

Operator

The next question comes from Thomas Seidl, Bernstein. Please go ahead.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah. Thank you. Good afternoon. First question is on your guidance for the year, 12% ROE. I think the underlying ROE last year was 11%, so you would probably need to achieve some 9%, 10% improvement in operating profit from the guidance you put out today for P&C, I only get to $300 million. So, I wonder what are the missing part to get to the, at least, $200 million operating profit improvement.

And the other question is on page 11, again on your rate change, about 40% of your U.S. portfolio is long-term liability and with the steepening of the curve, should we not expect basically rate to come down as you and others start to thrive in (27:49) the better interest rate environment?

A - George Quinn {BIO 15159240 <GO>}

Thanks, Thomas. So, I guess, on the first one, we obviously got to – we need to sit down together and get through you a more detailed model a little bit. I guess, what I point to, maybe but everything else (28:03), if you look at what we intend to do in the expense side, that's a very big step towards that gap that you referred to on the ROE. And beyond the expenses, maybe still expect to see some improvement on the technical side. I mean, I appreciate it, it becomes more difficult to get as we go on. But given the portfolio action that we have taken and some of the portfolio steps that we'll take next year, we anticipate further improvement technically.

Q - Thomas Seidl {BIO 17755912 <GO>}

Maybe...

A - George Quinn {BIO 15159240 <GO>}

And doing things in combination will be what drives the improvement to more than 12%.

Q - Thomas Seidl {BIO 17755912 <GO>}

Can I follow up, please? As on the expense side, I would assume that this is already part of your 1.5% lower combined ratio guidance. And on the life side, you basically guide for flat operating profit. So, I guess, the expense part is already captured in that.

A - George Quinn {BIO 15159240 <GO>}

So again, I mean, we have an expectation that's through the course of next year we'll achieve maybe about $400 million pre-tax cost reduction. It's not only in one area.

On the rate change and, I mean, the risk that that causes, I mean, the market to react and essentially capital reduction (29:20), I mean, I think, if you look at things from a longer-term perspective, I agree with you that, I mean, ordinarily when some of the pricing factors or the cost reduction factors change, the market eventually competes them away. I think, typically, there's a lag around interest rates, I mean, hard to say precisely how long it would be. But, I think, if we did see rates move up, I'm not convinced that you'd lose that benefit immediately, but I agree that over time, it'd be very, very hard to retain it.

Q - Thomas Seidl {BIO 17755912 <GO>}

So, year-to-date, you don't see that type of activity from competition?

A - George Quinn {BIO 15159240 <GO>}

I'm not aware of that at this stage.

Q - Thomas Seidl {BIO 17755912 <GO>}

All right. Okay. Thank you very much, George.

A - George Quinn {BIO 15159240 <GO>}

Thank you.

Operator

Next question comes from Vinit Malhotra, Mediobanca. Please go ahead.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes. Good afternoon, everybody. I just wanted to understand, George, the divergence sort of between NAC and GC in terms of the loss ratio or the underlying loss ratios. Is it that NAC is doing more effective tiering because of the investments in the data mining tools, or is there something that explains that and this quarter again from an entirely burdening (30:37) previous quarter, but just trying to understand a bit more.

And the second question is just for you to come back on expense ratio, but there's also a comment on commissions going up because of business mix. If you could just elaborate a bit. Is it that you have to pay more commissions so that people can justify volume cuts or what's the story there? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Yeah. Okay. Thanks, Vinit. So, on NAC versus Global Corporate, I mean, they are obviously quite different markets. And they have, I mean, even from an (31:14) perspective, completely different starting points.

NAC, I mean, has some exposure at the top end of its business to things that are similar to the things that Global Corporate has at the bottom end. But, I mean, the nature of why it is quite different, so I mean, and focus on things like worker's comp on the construction side (31:37). Obviously, they have crop in a big way after the acquisition. Global Corporate, I mean, the entire program is for the companies you'd expect.

I think, if you look at what NAC has done, we're very happy with the execution from the team at NAC. I mean, they do invest a lot on data analytics using new technologies to try and create products to help us best select our price more effectively, and they've done a number of things during the course of 2016 that, in fact, Kristof spoke about at the Investor Day.

Global Corporate, I mean, the issue – I mean, partly where we start from is partly the market. So, it's very, very competitive market. It's obviously the one that's most impacted by, for example, cash burn risks and we all know what's happened from a pricing perspective there.

But, again, within the – I mean, if you look at the portfolio, again, Mario talked about this at the Investor Day. I mean, we could look to try and shift the portfolio mix in a way that we think would deliver a more attractive return. We have been a bit too concentrated in areas where I think we've seen more margin erosion over the last few years. So, a more balanced portfolio in Global Corporate will certainly help us. I know that's high on Jim Shea's list of priorities. I mean, the challenge is the extent to which the market will allow us or support that shift over time.

Q - Vinit Malhotra {BIO 16184491 <GO>}

And, George, just where we – in 3Q, there was obviously the European lines which had true-ups in Global Corporate. Was there a similar effect in 4Q, or that only losses that led to this worsening in (33:23)?

A - George Quinn {BIO 15159240 <GO>}

I mean, while I appreciate the question, (33:27) analyze things today, I think the problem with it is that you (33:30) for almost everything if you do that. I mean, at the end, our conclusion is it's just not where we want it to be. This is clearly where we see the biggest opportunity for improvements.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Sure.

A - George Quinn {BIO 15159240 <GO>}

On the expense ratio, commissions, next topic, so. And the one thing we have seen – I mean, it's neutral, actually, to slightly positive for the combined ratio. It may explain a shift in the expense ratio driven through the commission side. I mean, again, we've got a bit more consumer – mass consumer business in the book. We know we have more coming on stream in Latin America over the course of the next 12 months. And of course, the acquisition that we'd like to complete that we currently have underway will also be something that drives potentially the mix or rather the mix within the combined ratio in a different way.

So, I think, on this topic – I mean, we'll try and do more as we come up to Q1 and help people understand how it might develop as we go forward because it'll be a key topic for us, but it's that mass consumer element of the portfolio that tends to drive up the commission component.

Q - Vinit Malhotra {BIO 16184491 <GO>}

All right. Thank you very much.

Operator

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

Q - Michael Igor Huttner {BIO 1556863 <GO>}

Fantastic. Thank you so much. I have two questions. One which is a pure speculative question. You have this German life business where $400 million will be used in ZZR over the next five years. Have you thought of selling it and what numbers are you looking at?

The reason I asked is there was a (35:14) that in December there would be demand from Munich's (35:21) portfolio and he put a price on it on $1 billion. So, clearly, there's a market for this kind of stuff, which is a property market and the buyers are not expecting to be paid to take the business.

And then the second question is, Jim Shea, he's a new guy at Global Corporates, right? What's the type – how is his incentive structured? Because on the one hand, I don't get it, why would I want to start in a business which is effectively kind of being wind down and (35:51) reporting, so I get zero visibility, very difficult target, (35:57)?

But on the other hand, if you might catch the benefits that all these claims, which I imagine, your very large claims decided, yeah, you're branding them against the claim (36:12), let's get their money back early. And you might say, no, it's not like that, I'm thinking maybe it's a little bit like that. But these claims will naturally dry up over the next couple of months or maybe six months, and then you'd – the business might actually look even better than you were hoping. How is the incentive structures relative to these two potential trends? Because I guess it's – I don't really know. Thank you.

A - George Quinn {BIO 15159240 <GO>}

Excellent. So, two traditional Michael Huttner question.

Q - Michael Igor Huttner {BIO 1556863 <GO>}

Thank you.

A - George Quinn {BIO 15159240 <GO>}

You're appreciated. I'm going to ask Mario to answer the second one at the moment.

Q - Michael Igor Huttner {BIO 1556863 <GO>}

Of course.

A - George Quinn {BIO 15159240 <GO>}

On the first one, you'll appreciate it, I'm not going to answer that one.

Q - Michael Igor Huttner {BIO 1556863 <GO>}

Yes.

A - George Quinn {BIO 15159240 <GO>}

I think the thing I would point you to though is, again, one of the comments that Mario made back in November when we had the Investor Day, I mean, we took a decision many, many years ago about what our priority would be when it came to the products that what we thought we could serve clients best. And that's reflected in the product mix today, and it's certainly one of the things that helped our German business from being a much bigger challenge than it would be otherwise.

So, I mean, we don't have a burdening problem in the German life business, we have some capital that's not earning quite what we like it to do, but I think our team there, with the challenges that they have, is actually doing a very good job.

Mario, do you want to comment on Jim – Jim's incentive?

A - Mario Greco {BIO 1754408 <GO>}

How can I say it to you, Michael? The transformation that Jim is bringing is, to start with, it's a different approach. Jim has been an underwriter for a number of years. So, he is bringing street underwriting culture to the organization. And so, we are refocusing everyone to work client by client, account by account, portfolio by portfolio. The other thing that still needs to be appreciated is skills are not infinite, and they're definitely not infinite for us. Between the corporate and commercial, we were replicating skills, that cannot work or cannot work infinitely.

And so by bundling together, under Jim, all these people, we have a unification and a better use of the skills. Also, I think, it's much more clear now the way in which he is operating compared with before, because the people belong to the countries and Jim is responsible for setting target set for giving them underwriting priorities, guidelines, and he runs directly some global businesses which clarifies a lot of the accountability issues that we had before. But that is a huge change for us, and it's something that caught us busy for a number of months last year.

Q - Michael Igor Huttner {BIO 1556863 <GO>}

Absolutely. Brilliant. Thank you very much. Oh, just a question. How much capital is in German life?

A - George Quinn {BIO 15159240 <GO>}

If we go back to our presentation, you'll probably remember very well from three years ago, I mean, within that (39:45) we have an underperforming capital on it, Germany makes up – it's not quite half, but it's not far away from the $10 billion we've identified then.

Q - Michael Igor Huttner {BIO 1556863 <GO>}

Brilliant. Thank you very much.

Operator

The next question comes from Andy Hughes, Macquarie Group. Please go ahead.

Q - Andy Hughes {BIO 15036395 <GO>}

Hi. Thank you so much. Couple of questions, if I could. First one, sorry to over analyze it, but Global Corporate. So, I was just a bit confused because when we went through the kind of tiering exercise, I know you should not, updating on the tiering in the slide today, so are you basically saying that the tiering exercise didn't really work in the way you anticipated? Because I remember when we talked about probably in the Q4 last year, we talked about how, under the new underwriting strategy, the loss would have been lower and clearly you've got large claims now. Are these large claims from Tier 4, or are they large claims from a different tier that was previously categorized?

And the second question is on NAC and it's a very simple one. What would the combined ratio being ex- the crop business in Q4, like I guess, that earns over Q3 and Q4 and therefore when we get to Q1, obviously, it'll revert back to close to a normal year (41:05)? Thanks.

A - George Quinn {BIO 15159240 <GO>}

So, on the Global Corporate topic, I'm going to repeat an answer that I gave a few moments ago. I mean, you can certainly pick out things that you – I could claim if it wasn't for this and be better. But I mean in the end, it is what it is. I mean, we have an expectation of a higher return from this business. We've taken steps through the course of last year, we continue to tier and we haven't shown the tiering, I mean, not because (41:35) same picture. But in the end, it's the outcomes that matter rather than the inputs here.

I think we're still confident that the steps that we've undertaken through the course of 2016 will have a positive impact. As I said, we're not yet to the level that we'd like to see. And that will be part of what we address again through the course of 2017. As I mentioned earlier, Jim has been through the portfolio. He has identified from his perspective the changes that he would like to make and hasn't (42:06) maybe taking capital away from some areas and moving them to others. I don't expect the same significant top line change that we saw in 2016, but we clearly have more work to do on Global Corporate.

Q - Andy Hughes {BIO 15036395 <GO>}

Can I ask (42:22) very big things, Global Corporate, I mean...

A - George Quinn {BIO 15159240 <GO>}

Global Corporate, I mean with the exception of a couple of European, a (42:30) continuous business throughout the year. So I mean, it's not like Reinsurance, who has a big Jan 1. It's a pretty continuous profile.

Q - Andy Hughes {BIO 15036395 <GO>}

Okay.

A - Mario Greco {BIO 1754408 <GO>}

Can I also make a comment? So I think in reality what we appreciate and like is the fact that the trend is visible (42:52) at Global Corporate. You can't really linearize this trend by quarters. It doesn't work that way. I mean I'm sorry to say so, but the improvements for us are there. The improvements will continue to come. You have lots of different things impacting one quarter or the other. The trend is there and the trend will continue to generate improvement over time. I have a sense that you're kind of reading a little bit too much in one quarter only.

Q - Andy Hughes {BIO 15036395 <GO>}

I was looking more at the half year, actually. I was just thinking about 3Q and the 4Q this year versus 3Q and 4Q last year. I mean, it's basically higher than it was last year in terms of the loss ratio.

A - George Quinn {BIO 15159240 <GO>}

So I think if you look at the year today (43:50) I think we've had a better performance on the attrition on the first half. I think we actually had some luck from the launch. Also, (43:57) second half has been weaker. There's not much I can add to what I said earlier. I mean, we're aware we are focused on it, and Jim and the team have a plan at base where (44:09) they expect to drive significant improvements through the course of 2017.

Q - Andy Hughes {BIO 15036395 <GO>}

Okay.

A - George Quinn {BIO 15159240 <GO>}

On the crop topic, I think there's actually a slide in the deck, Andy. So if you have the deck, Andy, on slides, you can (44:25) see there the impacts on NAC of RCIS.

Q - Andy Hughes {BIO 15036395 <GO>}

Thank you.

A - George Quinn {BIO 15159240 <GO>}

Thank you.

Operator

[Operator Instruction] The next question comes from Nick Holmes, Société Générale. Please go ahead.

Q - Nick Holmes {BIO 3387435 <GO>}

Hi, there. Thank you very much. I wanted to revisit the expense control question. And the real question is, why is the $300 million not visible in the expense ratio? And can you tell us what are the factors that offset it basically? And can you explain how should we really think about the $1.5 billion? I mean, it isn't, I guess, giving us great confidence that – we can't see the $300 million in the actual ratio.

And then second question is just quickly on U.S. Commercial. Wondered if you could give us a flavor of where you think rates will end up this year for yourself. I mean, the market is soft, but you've done rather well in 2016. Do you think you can continue that performance? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Thank you, Nick. So on the first one, apologies for this, but I'm going to try and take it back to what we had said earlier in the year. We'd indicated that we anticipated the expense ratio would be fairly flat. Having said that, we had a goal to reduce absolute expense levels. If you look at the full year, we've done both of those things during the course of the year.

And the reason that we thought the expense ratio would be flat is because we anticipated that to improve profitability, which we've done. That would require us to give up some volume. And so, I mean, I don't see an expense control issue. I mean, if I look inside the Group, we have a much tighter expense regime that we've had for some time. There's a focus on further efficiencies that we need to drive over the next two to three years to achieve the goals that we had. But in the offset, (46:43) that's what drives this difference that we have achieved the goal that we set on expenses, and I'd refer you to the answer I gave to Andrew Ritchie earlier on the call.

On the U.S. Commercial market, well, I think the team has done pretty well. I mean, as we look forward and we look at planning, I mean, we would expect in the U.S. market along the lines of the (47:10) from earlier that rate and loss cost in the U.S. market it 2017 will be fairly in balance (47:17). So of all the markets that's one of the most competitive ones out there currently.

Q - Nick Holmes {BIO 3387435 <GO>}

All right. Thanks very much for that, George. Just coming back on the expense ratio. What sort of expense ratio in P&C should we expect for 2017?

A - George Quinn {BIO 15159240 <GO>}

So I mean, I'm really tempted to give you the plan in great detail. I mean, we have a goal for return on capital. And so, both the ROE goal is the primary one that we have. I think we all appreciate that we cannot get there without improving the overall combined ratio. I mean, our expectation is that we'll see us more from what's around in 99% (47:58) down by about 1.5 points. And we'll see contributions from both expense and from loss improvement (48:06).

Q - Nick Holmes {BIO 3387435 <GO>}

Okay. Thank you very much.

Operator

The last question comes from Ralph Hebgen, KBW. Please go ahead.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Yeah. Hi, guys. Ralph Hebgen from KBW. Three things, if I may. The first one goes back to Global Corporate, I'm afraid. Just one point. In the fourth quarter, I noticed that there was a reserve increase again in Global Corporate, and I thought that was a little disappointing, because it came after three quarters where we had a net release run rate in the region of 4 percentage points.

So it will be interesting to just hear some commentary on what generated the need to have a reserve increase (48:57) in the fourth quarter. Was there a little bit of true-up at the year-end involved and where are we going to go from here? That's question number one.

Question number two is relating to cash, specifically in the Life segment. I noticed there you reported $0.4 billion. That's like $100 million or so below the run rate, which we've seen in the recent years. And I think looking at the numbers that might have been generated by Spain, which had a higher acquisition strain. So perhaps on that one also some commentary what generated that lower run rate in the Life segment, and are you happy to confirm your guidance going forward that cash generation in the Life segment is going to increase from here onwards?

And the final one, it's just the factual check on the excess of (49:56) loss attachment point in the large loss reinsurance treaty. What are your plans going forward into 2017? Are you going to lower the attachment point there? And that's it. That's question number three.

A - George Quinn {BIO 15159240 <GO>}

Thank you. Thank you, Ralph. And, so on Global Corporate, I mean, you're absolutely right. There is a reserving increase that was in the book in Q4. I mean, as we told here before, we're looking to try and manage the overall portfolio. And I mean, at all times, we have pockets of strengths and there'll be some pockets of vulnerability. And we addressed one of those pockets of vulnerability in Global Corporate in Q4. I mean, the overall Group outcome was actually, I mean, towards the top end of our guidance on PYD. And, I mean, we've reiterated in the written material (50:49) and I'll reiterate it now that for 2017, we anticipate and you'll see PYD continuing that positive 1% to 2% range.

On the cash thing, I mean, you're absolutely spot on. So you've picked exactly the thing that drives it. I mean, we had to develop a decision together with one of our partners during the course of the year. I mean, it's actually a bit more cash and a bit more capital behind a particular product and we thought that's not (51:21) longer term perspective. That's an interest of shareholders. It doesn't change our expectations on what Life can generate, but, I mean, we had an option or something in front of us that we thought was beneficial for the organization overall, and we therefore made the decision.

And on the excess of (51:41) loss attachment point, I'm going to be slightly more coy than I normally am. So I think I was ultra satisfied a year ago on everything around that contract. We just have renewed a slightly lower attachment point. So we have tried together with our reinsurance partners. I mean, given the improved performance that we've seen even on the large loss basis in 2016, we've had discussions then to try and work (52:10) reinsurers to reflect that. That contract is structured. So I mean, that means the propensity to attach is slightly higher assuming the same level of large losses.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Okay. Great. Thanks, George.

Operator

We have a follow-up question from Mr. Andrew Ritchie. Please go ahead.

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

Hi, there. Sorry to come back. Just very quick ones. Tax rates, you guide to 29% in 2017. I think that's similar to what you said at the Investor Day. When do the tax rates start to drift down, because obviously the non-life (52:51) business pays a lower tax rate? I would have thought we'd start to see some benefit of that in 2017, but maybe just clarified instructor (52:58) there?

Second question, you point in the commentary to benefits you're getting from in-force management in the Life business, at least in IFRS earnings. I guess what slightly concerns me is when I look at the EV disclosure, there are actually quite large negative variances to do with poor in-force experience on things like consistency, and I'm not sure what else. So I just wanted to have some lead indicator that we've kind of exhausted the in-force benefits in IFRS terms, because the EV commentary is reflecting there are some in-force issues. Maybe just clarify the disconnect there. Thanks.

A - George Quinn {BIO 15159240 <GO>}

So on the first one, tax rate, I mean, the biggest challenge in the tax rate is actually the ongoing restructuring and lower that cost ends up at Home (53:51), and that's not a very efficient place, but it's the carrier. Maybe we don't have much choice around that. So I mean, what it really means is that I anticipate the tax rate will be elevated both this year and next. It will start to trend down, but I'm still expecting for this year that you'll see something in that 28%, 29% range and something similar, maybe slightly lower in the following year. And then, we'll start to come back to the longer term tax rate that you're more familiar with.

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

Sorry, George. What's the tax rate on a bulk basis then?

A - George Quinn {BIO 15159240 <GO>}

Well, I don't have that one. So I mean, it's slightly different from NIAS, because, of course, there are elements in NIAS. There are tax at different rates. But I don't have it in my head with me right now.

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

But it would be lower, because obviously – and the restructuring is a NIAS item, not a BOP item?

A - George Quinn {BIO 15159240 <GO>}

So, yes, the restructuring is not always the same answer for realized gains. I mean, they can vary depending on which jurisdiction and what the taxable basis is of the realized gain component.

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

And the long-term tax rate, you think should be what?

A - George Quinn {BIO 15159240 <GO>}

So I mean, I think before you've seen somewhere around the 25% rate, so I think somewhere in that 25% to 27% range is where we should be targeting given the mix of businesses that we've got. There's one wild card in all of those. Of course, so quite a large part of our profit is generated in the U.S.

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

Sure.

A - George Quinn {BIO 15159240 <GO>}

And if we saw tax reform there, I mean, that would potentially have a very positive impact on rate terms (55:21).

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

Sure.

A - George Quinn {BIO 15159240 <GO>}

On the in-force management versus the EV topic, so I mean, timing is obviously different and I guess that what's behind your question and the EV tends to anticipate, I mean, the entire life of (55:38) cash flows and extrapolates experience along all those years to expiry. I mean, I don't believe though that we've completely exhausted what can be done in in-force management. And I know from the plans that we have that, I mean, some of the things that we intend to do through the course of this year and the next, I think can improve, well, the profitability and the cash those signatures (56:05) from the book. But I mean, again, in my head, I couldn't draw that over EV versus both comparison. I mean, let me take it away and think about it then.

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

Okay. Thanks. Thanks.

Operator

We have a follow-up question from Mr. Thomas Seidl. Please go ahead.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah. Thank you. Maybe two quick questions on page 17 on the profit as well as profit disclosure on Life, if I may. I noted a very strong drop in the technical margin by 10% and also quite a significant drop in the unit-linked fee-based margin. Maybe you could comment on what does it drive and (56:46) what is the outlook on those two items, please?

A - George Quinn {BIO 15159240 <GO>}

So first of all, on the technical margin, adverse claims experienced. So two of our regions have had higher claims than grow low for pricing (57:01). I mean that can happen and it is driven by some of the incidents, some of the larger cases that we cover. On the unit-linked, I don't recall issues. I need to look at it and the team can come back to you, Tom.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah. Sure. Now the technically margin, is the run rate $1 billion then, or what is sort of the run rate you would expect here?

A - George Quinn {BIO 15159240 <GO>}

So I think if you look at the drop that we've had this year and you treat most of that as volatility, you would see the run rate.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah. Okay. Thanks, George.

A - George Quinn {BIO 15159240 <GO>}

Okay.

Okay. Thanks very much, everybody, for dialing in today. We're aware there's a couple of people still with outstanding questions, and the team will come back to you during the course of the afternoon as we unfortunately don't have any further time today. If you do have any further questions, obviously, the whole IR team stands ready to take them. So with that, wish you a good afternoon.

Operator

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