Q1 2018 Earnings Call

Company Participants

- John Robert Dacey, Group Chief Financial Officer
- Patrick Raaflaub, Group Chief Risk Officer
- Philippe Brahin, Head-Investor Relations

Other Participants

- Andrew J. Ritchie, Analyst
- Frank Kopfinger, Analyst
- Ivan Bokhmat, Analyst
- Jonny Urwin, Analyst
- Kamran Hossain, Analyst
- Stefan Schürmann, Analyst
- Thomas Fossard, Analyst
- Thomas Seidl, Analyst
- Vinit Malhotra, Analyst
- William Hawkins, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning or good afternoon. Welcome to Swiss Re's First Quarter 2018 Results Conference Call. Please note that today's conference call is being recorded. At this time, I would like to turn the conference over to John Dacey, Group CFO. Please go ahead.

John Robert Dacey {BIO 4437051 <GO>}

Thank you very much. Good afternoon, and good morning to those of you in the Americas and welcome to the first quarter 2018 results conference call. I'm here with Patrick Raaflaub, our Group Chief Risk Officer and Philippe Brahin, the Head of Investor Relations.

And if you indulge me, I'd like to start with a brief overview of the key figures which we published this morning. Swiss Re reported a net income of $457 million for the first quarter. This number reflects the negative impact of the change in the U.S. GAAP accounting rules or equity investments held in our investment portfolio. On a pre-tax basis, the impact was $280 million, on a post-tax basis $221 million. And in the press release, we issued today you see that the alternative number estimated with the previous accounting regime was $678 million.

Going through the performance of the individual business segments, we're pleased with the performance of the Reinsurance units, our two largest businesses. P&C, we maintained underwriting discipline, while expanding and improving, but we think still challenging price environment. We delivered $347 million, which translates to an ROE of 13.5%. These numbers are not adjusted in any way for the previous accounting of U.S. GAAP, but instead reflect the 2018 performance. In terms of renewals, treaty premiums has increased 7% year-to-date with the price improvements of 2%, a continuation of what we saw for the January 1, renewals.

Life & Health Re continues on its solid performance track record, delivering a net income of $201 million and an ROE of 11.5%. Corporate Solutions net income was $41 million in the first quarter of 2018. This result continues to reflect the impact of business written in previous underwriting years where soft market environment prevailed. Commercial insurance rates, as well as terms and conditions have started to improve after last year's sizable nat cat losses.

Life Capital delivered an exceptional gross cash generation of $705 million, reflecting proceeds from a minority stake (00:02:52) as well as benefiting from the finalization of the 2017 Solvency II calculation. The net income of the unit was impacted by the negative investment market performance in the UK of Q1.

Though I mentioned the overall Group results, the asset management performance was clearly impacted by the U.S. GAAP guidance from the treatment of equities. The reported ROI of 2.2% was in fact on an adjusted basis estimated to be 3.2% for the quarter if we had applied the counting rules of the last year. The fixed income running yield of 2.8% was stable and in line with the expectations which we had previously communicated.

Finally, and given our strong capital position that we announced at the launch of the share buyback program, without caveats or constraints which was authorized by the AGM two weeks ago. We will begin repurchases on Monday, May 7, as we have received all the necessary approvals.

With that, I hand it back to our Head of Investor Relations, Philippe, to who will introduce the Q&A session.

Philippe Brahin {BIO 19081619 <GO>}

Thanks, John and good day to all of you also from my side. So as we did at Q1 and nine month last year, we were will only comment on the key figures we reported in our press release and provide you with the qualitative assessment on underlying trends. I also wanted to mention that we published our 2017 financial condition report at the end of last week. And we are very pleased to have our group CIO with us today as John mentioned, in case you have questions on the (00:04:33) or on any risk topics. And as usual please, restrict yourself to two questions during the Q&A, register again for follow-up questions.

So with that, operator could you please have the first question?

Q&A

Operator

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

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

Hello. Hi, there. In your opening comments, John and I think in the press conference this morning, you still described the pricing environment as still challenging, I think, were your words. I mean, can you give us any additional color on that, has it become more challenging? It looks like there was a kind of flat evolution with April renewals which I guess is not surprising, so any more color would be useful on that.

Second question, Life Capital, I mean is there a black box as one – to try and work out sort of the GAAP earnings? Is there any sort of things we should consider that, I think, (00:05:27) press the result or you talked about the effective markets which obviously lowered the linked fee income. Can you give us any flavors of the amount there or the net strain that you're still seeing from the L&G savings business or net strain coming out of the front books which I guess is still negative? Just any color on the median term run rate GAAP earnings for Life Capital would be useful?

A - Operator

Andrew, thank you for that and I appreciate and to some degree of the frustration of trying to model out Life Capital, there are a lot of moving parts there. Let me start with the first question you had on the price environment. I think, the April renewals which were dominated frankly by our business in Japan didn't bring a lot of new information to us. As I said, we continue to be able to get the rates that we saw in the January 1, a net increase of 2% with the LPTA (00:06:39) of 103%.

Our overall sense is we will see more in June and July with the renewals in the U.S. market with the loss affected portfolios and our expectations are that prices should continue to deliver an inflection based on the actual performance and actually the insufficient pricing we saw through 2017. So, I guess, I'd say we would have more to tell you on our half year results in terms of real color there.

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

Where you are referring to the fact that there's just not enough price yet?

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

I think, our expectation and we mentioned this at the full year results was, with the $140 billion of losses in 2017, the market should have reacted a little stronger than it did. Now part of this is both a supply issue as well as demand issue. We are seeing people interested in additional and broader coverage on the reinsurance buying. So the demand, I think is there at the moment. Supply is meeting that demand and I suggest that Swiss Re continues to be one of the leaders in trying to push for adequate pricing across the board. We're comfortable with what the business we're riding and the prices we are achieving, but obviously, it's constraining our growth compared to some of our competitors.

With respect to Life Capital, I'd say that probably, I can give you a little bit of color. The L&G portfolio integration is going to not deliver any material earnings to this business for the next quarters. And in fact, there are some costs, not large, but real cost in bringing this portfolio onboard. I think, as the UK equity markets were down about 8% in the first quarter that has had an impact on the fee income for the unit linked businesses that we have within Reinsurance. So that's been a net negative for the quarter.

I think, thirdly, the open book business (00:09:18) in particular, does have a growth strain and you see that we were able to grow our premiums in that segment strongly in the first quarter. There was one significant transaction with STQ (00:09:32) in Europe which accounts for a substantial part of that, but net-net there was a new business strain and that is there. So, I think, those three factors together dampen the profitability for the quarter and we would expect as markets behave a little better that we can show some improvement in these numbers obviously after a pretty low starting point in the following quarters.

A - Philippe Brahin {BIO 19081619 <GO>}

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

Operator

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

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi, everyone. Just one question from me. Currently P&C Reinsurance has had a pretty good start to the year, and some decent improvement in the combined ratio there. And in Corporate Solutions, I guess things are a little bit flat year-on-year in terms of profitability. Could you give us an indication on rate increases at Corporate Solutions, or if you can't give a number, whether the rates increases for Corporate Solutions are above those seen for Reinsurance? Thank you.

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

Sure. So I think at the Investor Day, Agostino, our CEO of Corporate Solutions, gave an indication that he was expecting a 5% increase on average across the board for his business for the year. I think to-date we've been a little shy of that, but we still see that as a reasonable objective for the full year, and we'll see if we can reach that during the course of the year.

I do think importantly in the Corporate Solutions business, since we don't have a big January 1 renewals but rather the portfolio goes through a normal year cycle, you've not seen much of the post 2017 book actually come on board yet. And so a little different than Reinsurance where the premiums on 1/1 came in. This is going to take a little more time for us to get that combined ratio down as a result of better pricing in the current environment.

A - Philippe Brahin {BIO 19081619 <GO>}

All right. Thanks, Kamran, for your question. Can we have het next question, please?

Operator

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

Q - William Hawkins {BIO 1822411 <GO>}

Hello. Hi, John. Thanks for taking my question. First of all, you have the big gross cash generation in Life Capital. Has that already affected the outlook that you gave us at the Investor Day of $2.3 billion to $2.5 billion over the 2016 to 2018 period? And if so, roughly by how much, I'm trying to get a feel for what's been the scale of this one-off?

And then, secondly, I know that you guys care a lot more about EVM than you do U.S. GAAP and there has been a lot of stuff going on this year with big contracts in volatile capital markets and the rest of it. So I just wonder if you could give us - given that you care more about those numbers, give us any kind of indication of how the EVM performance has gone yesterday, any notable factors?

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

So I think on the second question, I can give you an answer, which you may not be looking forward, but won't be surprised. We really don't release any quarterly indications on EVM. And I don't expect that we'll start doing that any time soon. But as you rightly point out, there is a little bit of noise in these U.S. GAAP numbers. It's frustrating to us. I'm hoping that in future quarters, this impact of the - having a ride through the unrealized losses or in some cases gains, equity portfolio won't have this kind of an impact.

On the gross cash generation, you're right. $705 million brings us awful close to the finalized in the three-year target after two years and one quarter. I'd say we would expect later this year to be able to provide you with more guidance on future years delivery of cash, but we're not at this point in time changing what we got (00:13:58) that's out there currently.

A - Philippe Brahin {BIO 19081619 <GO>}

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

Operator

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

Q - Jonny Urwin {BIO 17445508 <GO>}

Hi, guys. Thanks for taking my questions. So, firstly, how big do you think the premium base in Corporate Solutions needs to get to, to give you the sort of desired scale that you're looking for? That's first question just in the context of the 30% growth we've seen today.

And secondly, there were small positive reserve releases in P&C Re in the first quarter. Can you give us some color on how that develops in property versus casualty (00:14:41) or California wildfires? Thank you.

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

So let me take the second question first. We have, in P&C Re, had a, as we said, a modest positive prior year development. I can say that it was also modestly positive in our casualty book of business. And so, that was one of the areas where people seemed very concerned in the Investor Relations Day and I was pleased to say that the reserves there continue to demonstrate their resilience.

No specifics on HIM or California wildfires. I think we're probably able to say more about that development later this year. On how big this (00:15:37) have to be, we're obviously continuing the growth you see year-on-year. There is actually a fairly strong growth in Corporate Solutions. I can attribute that to three specific areas. One, the U.S. accident and health business where we've acquired a company two years ago has continued the strong source of growth. Similarly, some specialty lines in our European markets have delivered a nice premium uptick in 2018. And third, the joint venture with Bradesco in Brazil has come online. And for those three, plus a little bit of a tailwind from foreign exchange are responsible for this growth here in the first quarter. We have not done a material expansion either of our property book or casualty book, and I think as we (00:16:41) some verticals with the price environment is probably put some constraints on our ability to grow strongly there.

The overall size, I'd say we're keen to be over time a major player in the commercial insurance space. How big we have to be? It's a little bit of a moving target as some people continue to consolidate, but I think the expectation is we would continue our bolt-on acquisitions, continue the investments in primarily – expect at some point of time to be materially larger than we are today.

A - Philippe Brahin {BIO 19081619 <GO>}

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

Operator

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

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes, good afternoon. Two questions on my side. One for John and one for Patrick. Question for John is on the P&C Re, you site 92% combined ratio, Q1. Can you put that in the context of the full-year guidance of 99%? I mean any (00:17:50) deviation from the full-year guidance you have provided with full-year number. And the question for Patrick is looking at the FCR report (00:18:01), I'm assuming that I have been quite surprised to see how high was the SST ratio of the Reinsurance division 252%. How should we take this number or read this number as actually you mentioned in the past that a significant amount of the excess capital should be upstream at the HoldCo and not be holding in the entity or operating entity level. So I mean, is 250%, 230% that was a level in 2017 about the right level of comfort you need to keep at the Reinsurance level? Thank you.

A - Philippe Brahin {BIO 19081619 <GO>}

Thanks, Thomas. And maybe we will start with John.

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

Sure. So in relating to the combined ratio, I think we were in a fairly benign quarter with respect to large losses. In Reinsurance, we consider a large loss something in excess of $20 million and we had neither – and in that cat more, any manmade loss coming into the category of large losses for Q1 for Reinsurance. But further, there were a whole lot of small and medium losses that accumulated which kept the combined ratio at 92%. There's nothing we see that would lead us to change our full-year guidance of 99% and so we're comfortable with – sorry, that estimate is a good estimate to hold on to. Maybe Patrick?

A - Patrick Raaflaub {BIO 16381419 <GO>}

Yeah. So we are – and as you know, we are not giving specific target for the business unit or the subsidiary company. We only communicate the internal respectability target of 220% SST for the entire group. That is for the first time -within the FCR (00:20:23), you see a little bit more details of how the group – the components of the group and how they look under the SST format. And that you could expect that that might fluctuate a little bit in the future, but there's not really much I can say about or more detail I can give you on the Swiss Re Zurich (00:20:56) or the business unit Reinsurance SST ratio.

So, maybe also important to see also from the group perspective that why the SST target is a very important target from a risk policy standpoint. It's not the only indicator, not the only measure that we use to see the group's capitalization. So it's a significant one, but it's not the only one. And it also depends obviously at any given point in time how much capital is deployed, for example, in financial risk, whether the ratio is above and – or how significantly it may be above that target or even, as the case may be, slightly below that target.

A - Philippe Brahin {BIO 19081619 <GO>}

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

Operator

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

Q - Frank Kopfinger {BIO 16342277 <GO>}

Yes. Good afternoon, everybody. I have two questions. My first question is on the buyback. If you change the conditionality, could you also comment on how you are going to execute it while it will be on a steady basis or you might become more opportunistic on this? And then secondly also a question on Financial Condition Report, I realize that on one side the target, the risk capital for P&C increased by around about 10%. As on the other side, mainly all peak risks, they declined. So could you bridge this development for us?

A - Philippe Brahin {BIO 19081619 <GO>}

Sure. I'll take the first question on the buyback. We'll delegate the operational activities of buying the shares to a bank here in Switzerland, but we have the responsibility of the target. Finish date would be in February of next year, and absent any additional insights, we would expect that they would spread this out reasonably evenly over the course of the year (00:23:15) the opportunity in a particular week or month to do a little more because of softness in our share price, that's up to them, not directed by us.

Q - Frank Kopfinger {BIO 16342277 <GO>}

All right, Patrick...

A - Patrick Raaflaub {BIO 16381419 <GO>}

On your second question, really the major reason for this seeming discrepancy is that reserve risk went up because of the nat cat events of the last year. And that increased the target capital because obviously there's some reserve uncertainty for which we have to hold capital according to our model.

A - Philippe Brahin {BIO 19081619 <GO>}

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

Operator

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

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah. Good afternoon. First one on Cor So, there I was quite surprised to see the strong growth given your comment on rather low price increase. You now explained this is from three segments; U.S. A&H, specialty in Europe, and the joint venture. Could you explain a little bit more what exactly you are writing, especially the U.S. accident and health? I think it's about $200 million in total.

And the second question on the P&C Re business. If I strip out the price increase, premium is flat year-on-year despite your price signals pointing to 103%, adequacies are not too bad in historic terms. Does it mean basically you need to maintain this topline just to keep this price level and hence if prices do not change at the mid-year, we should expect a flat topline for Swiss Re in the P&C Re business? Thank you.

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

So, on the first one with – Cor So, as I said, the growth came in these three areas. I'm sorry. I apologize. I missed the...

A - Philippe Brahin {BIO 19081619 <GO>}

U.S. accident and health.

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

Sorry. Within the accident and health, remember, two years ago, we bought a business – a smallish business in the U.S. called IHC. This is employee stop loss. So employers or companies which are clients of Cor So run their own accident and health programs for their employees. We come in on the back end of that and assume where is (00:25:52) risk for these programs and that's a business which has been profitable and which we've been able to grow our market share in the U.S. market year-on-year, the first quarter was actually a very nice and strong growth.

On the P&C Re, we will continue to hold the line on we think are appropriate price levels and if that provides the opportunity for growth on our (00:26:24) book through the year, we're up 7%. We'll take that. And if for some reason, the prices are being undercut by other providers that are (00:26:40) prepared to work with them, we don't feel the need to grow this business at unreasonable price levels.

A - Philippe Brahin {BIO 19081619 <GO>}

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

Operator

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

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes. Good afternoon. So one question on Life Re please one on Corporate Solutions. On the Life Re, I noted with interest that there's not much mention of U.S. mortality pickup. We have seen some very sharp increases from flu-related deaths, for example, and from one of your peers a lot of comments on that. And could you just comment a bit about what you are seeing in your book, maybe it didn't bother you, maybe the frequency was not enough to be a problem, but just a comment would help, please.

Second thing is, just on Corporate Solutions profitability, there is a 100-odd combined ratio without any TYD (00:27:43) problems, which we have seen in recent data from Corporate Solutions. It means – and as you've written in your press release that some business from previous underwriting years was harming. What is the deal here? I mean do you think this previous year business would continue beyond maybe this year to affect number on a current year basis? Thanks.

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

Sure. So on the first one, yeah, we did (00:28:12) know there is a little bit of a seasonal impact on the U.S. mortality, and also a few severe claims for our Life portfolio. But we don't extrapolate either those to any particular trend issues and as you see that we were able to endure those bumps in part because of the size of the portfolio and strong performance in other places. So we don't feel that – there was some issue. It wasn't material enough for us to spend a lot of time talking about it. With respect to the Cor So, we believe the reserves are at the correct levels, as you said correctly, either there was no negative prior year development. It was effectively flat for the quarter. And our expectation is that the new business that comes on during 2018 will start to trend this number down, not dramatically and not quickly, but 2017 business will continue to be influencing that performance through this year and by this time a year from now we expect that the better pricing that we are achieving should help us with a more sustainable combined ratio that starts with the 9.

A - Philippe Brahin {BIO 19081619 <GO>}

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

Operator

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

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Hi, thank you for asking my question. I have a question regarding the earnings volatility from the equity mark-to-market. I appreciate there was a new accounting policy adopted, but I suppose it will become a recurring feature in your results going forward. I was just wondering how you think about managing this volatility in future?

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

We would like to see equity markets go up and so the volatility we manage is a volatility on the upside. But look, I think, we've got about $6.6 billion (00:30:39) of investments that are in the bucket, which is going to show this kind of volatility. That's a little about 5.5% or maybe 5% of the total investment portfolio. I don't think we want the accounting rules to change our strategic asset allocation. And therefore, the best we can probably do is just be transparent. And so, with every quarter we're going to provide this comparison that you see here in Q1, which says what the 2018 result for the half year, for three quarters, for the full-year would have been under the previous accounting standards, so you can do your comparison back to 2017.

In 2019 my expectation is that we'll simply provide the movement in the quarter for unrealized gains or losses out of this portfolio. So unfortunately, in the first quarter that we applied this, it is negative and it's substantial. What the slide we included in the Investor Day presentation where we flagged that this was coming, I think, demonstrated that for many quarters, at least historically over the last three years, the impact tended to be much smaller. And so, we hope that it will be a little less of a distraction in those quarters. But we've invested in these equity shares because we think it's an intelligent place for us to allocate the funds that we get from writing our business and I don't expect that we'll materially reduce that portfolio for the reasons of volatility.

A - Philippe Brahin {BIO 19081619 <GO>}

All right. Thanks Ivan for your question. Can we have the next question please.

Operator

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

Q - Stefan Schürmann

Yes. Good afternoon. I had just two small questions, the first one on the cash generation on the $705 million in the Life Capital. Can you maybe give us some qualitative split of that, how much stems from the Solvency II adjustment, how much from margin and how much from the 5% stake of Mitsui? And then, the second one on growth in Life & Health, just can you give me some insight here how much is coming from the Life side and what from the Health side if possible?

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

So on first one, the gross cash generation, I think, as we said the two major single pieces are the Solvency II finalization for ReAssure and secondly the investment from NS Navy (00:33:26), I can suggest that the latter of those was approximate - will be more than $200 million and actually, I think, you probably do the math to get to $240 million for that number. The Solvency II amount was also substantial in the quarter and, but I don't know that if (00:33:53) released the absolute amount, but it's the only other major piece worth noting, I think. The important piece for us is that gross cash generation eventually will allow us to consider important dividends coming up from (00:34:14) capital into the group and we look forward as the group CFO to that flow for Swiss Re Group.

A - Philippe Brahin {BIO 19081619 <GO>}

Regarding the second question, Stefan, I think, you should expect that Q1 to reflect a bit what we have seen in terms of split between Life and Health, Life being 60% of the book and Health 40%, though we don't provide more detail, you'll have more at H1.

All right, so actually this is the last question, so thanks, Stefan again for your question. And we come to the end of the Q&A review, John and Patrick Raaflaub for joining and all of you for joining today. Maybe you can take to reach out to any member of the IR team if you have follow-up questions. And with that, thank you again for your participation.

Operator

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