Q2 2017 Earnings Call

Company Participants

- Christian Mumenthaler, Group CEO
- David A. Cole, Group CFO
- Edouard Schmid, Group Chief Underwriting Officer
- Philippe Brahin, Head of IR

Other Participants

- Andrew James Ritchie, Analyst
- Edward Morris, Analyst
- Frank Kopfinger, Analyst
- Guilhem Horvath, Analyst
- Jonathan Peter Phillip Urwin, Analyst
- Kamran Hossain, Analyst
- Nadine Adrienne Marion van der Meulen, Analyst
- Olivia Sylvia Brindle, Analyst
- Stefan SchÃ¼rmann, Analyst
- Thomas Fossard, Analyst
- Thomas Seidl, Analyst
- Vikram Gandhi, Analyst
- Vinit Malhotra, Analyst

Presentation

Operator

Ladies and gentlemen. Good morning or good afternoon. And welcome to the Swiss Re's Half Year 2017 Results Conference Call. (Operator Instructions)

At this time, it's my pleasure to turn over to Christian Mumenthaler, Group CEO. Please go ahead.

Christian Mumenthaler {BIO 6479864 <GO>}

Thank you very much. Good morning. Good afternoon, everybody. Welcome to our H1 results conference call. I'm here with David Cole, our Group CFO; Eddie Schmid, our Group Chief Underwriting Officer; and Philippe Brahin, our Head of Investor Relations.

Let me start with a brief overview of the results we published this morning. As you have seen, Swiss Re delivered group net income of $1.2 billion in the first half. If you look at the different BUs, P&C Re achieved a solid result in the current environment with a net income of $546 million. Our underwriting performance remained stable as reduced capacity in line to our prices did not meet our profitability expectations. This is the right thing to do at this stage of the cycle and it paid off in terms of underlying profitability.

Life & Health Re achieved strong results with a net income of $432 million. The business segment remains in good shape with a stable underwriting performance, reflecting the quality of our portfolio across markets and line of business.

Corporate Solutions had a difficult first half as results continue to be affected by the soft markets. Net income was $39 million. As in P&C Re, we also reduced Corporate Solutions top line. However, the underwriting result was impacted by high net cat losses and unfavorable prior year developments. On the strategic side, we continue to invest in Corporate Solutions' capabilities. And we're very pleased with the launch of the JV with Bradesco Seguros in Brazil.

Life Capital reported net income of $143 million, with an underlying performance in line with expectations. The gross cash generation was strong at $532 million in the first half and enabled a significant dividend to the group of $1.1 billion. This demonstrates the value proposition of Life Capital and its ability to deliver on its strategy.

Asset Management provided strong result with ROI of 3.5%. The high quality of our investment portfolio is underlined by our continued very low level of impairments.

All business units have now paid dividends to the group and the capital position of the group remains very strong, making us ideally placed at this point of the cycle.

With that, I'll hand over to our Head of Investor Relations, Philippe Brahin, to introduce the Q&A session.

Philippe Brahin {BIO 19081619 <GO>}

Many thanks, Christian. And good day also to all of you from my side. (Operator Instructions) So with that, operator, could we please take the first question?

Questions And Answers

Operator

The first question is from Olivia Brindle from Bank of America.

Q - Olivia Sylvia Brindle {BIO 17273762 <GO>}

The first 3 questions for me. And the first one just, I guess, generally looking at the combined ratios, particularly in P&C Re. You are still on an underlying basis within your guidance for the year of around 100%. But it does feel like maybe your turn has got a little bit worst on that since you first gave that guidance.

So just interested in your view on whether that's a correct interpretation, whether you have maybe -- could come a little less positive on that and since you first gave your 100% and how you feel about that for the remainder of this year. Then second question actually on Life Capital, the very, very strong cash generation there. Your views on what the underlying capability there is and particularly how Guardian is developing within that compared to your original expectations.

A - David A. Cole {BIO 7251632 <GO>}

Thank you, Olivia. I'll ask Eddie to address the first question and I'll come back on the Life Capital question.

A - Edouard Schmid {BIO 18942809 <GO>}

Yes. In terms of the P&C Re combined ratio, we gave out the estimate of 100% for the financial year 2017. And we're also comfortable with that estimate. As you pointed out, the underlying combined ratio deteriorated a little bit on a normalized basis. On an actual basis, actually almost flat. It's 97.2% versus 97.4%. If you normalize for reserve releases and for nat cat, it deteriorated a little bit but it's still below the 100%. So we're quite comfortable to keep that 100% estimate for 2017.

A - Christian Mumenthaler {BIO 6479864 <GO>}

I think maybe I'll add to that in terms of tonality, I think, Olivia. In our perspective, I think we're completely where we thought we would be a year ago. It's no particular surprise. I think this bottoming out is still happening. There's little signs that things get better. But you still have a negative delta. But I don't think our tone has become more negative. I think it's more very much in line with what we thought a year ago.

Thanks, Christian. As for your second question, Olivia, let me start with Guardian. The Guardian acquisition and integration has very much gone in line with our expectations. In fact, in some respects, I think we're even a little bit ahead of where we thought we'd be, both from a timing point of view but also in terms of realizing value. We actually were able to complete the Part VII already prior to the end of last year. The gross cash generation both for '16 as well as the first half of '17 is indeed quite strong. We're very pleased with that.

Part of it has to do with our ongoing shaping of our overall capital position and the ongoing discussions that we'll have as we move off of a standard type of approach to a Solvency II capital to internal model, which we would anticipate over the course of the next 12 to 18 months to be able to conclude as well. Obviously, that's subject to agreement of the PRA. The underlying business performs very much in line with our expectations. We, I think, at this point in time, also in terms of looking forward, are ready for potential new transactions, continue to have a good pipeline as well. In terms of forward-looking statements on cash generation, I think for the time being, we'll keep with our earlier communicated guidance of about 1.4 to 1.7 during the period 2016 through 2018, inclusive.

And that's a number that reflects both the cash generation coming off of the close life portfolio under ReAssure and then netted to the extent that we're making investments in our open life business, which we have been doing during the course of both 2016 as well as the first half of 2017. Thank you.

Operator

The next question is from Kamran Hossain from RBC.

Q - Kamran Hossain {BIO 17666412 <GO>}

Just one question for me. Just looking at, I guess, over time the reserve development at P&C Re versus CorSo can you just talk us through whether there are any kind of fundamental differences in reserving approach between the 2 units closely? P&C Re seems to develop better than CorSo. I guess, there's some implication of kind of the good reserves that went with P&C Re when there's a separation. But any ideas of kind of the different philosophies or approach of the 2 units will be really helpful.

A - David A. Cole {BIO 7251632 <GO>}

Excellent. Thank you. I'll ask Eddie to respond.

A - Edouard Schmid {BIO 18942809 <GO>}

Yes. We apply the same reserving methodology for both segments, P&C Re and Corporate Solutions. It's actually the same underlying characteristics. And we follow this best estimate methodology with the same governance around it. So there's no fundamental difference. As you yourself pointed out, there's a bit less favorable development in the Corporate Solutions sector as we have the reserves we left back in P&C Reinsurance when we carved out Corporate Solutions a number of years ago. But in terms of channel reserving approach, it's very much the same philosophy and governance we apply.

A - David A. Cole {BIO 7251632 <GO>}

If I may just add one comment to that. I think there's also a specific difference given the overall business mix. Corporate Solutions, as you know, is more significantly exposed in access layer. Sometimes you're going to have these things that show up in our current year's report as prior year development. But actually, it's just a relatively late reporting of lawsuits. So we had that in Q2 of last year. You may recall the couple of specific items we've had in the first half of this year as well. So I think there's also just that aspect, which impacts what we are reporting, appropriately reporting as PYD. But it's not where our previously established reserves have proven to be insufficient, just to be very clear.

Operator

Your next question is from Andrew Ritchie from Autonomous.

Q - Andrew James Ritchie {BIO 18731996 <GO>}

Thanks for the additional disclosure on Slide 18 around Corporate Solutions. I guess, I'm curious to know what you want us to do with it in the sense that are you trying to show us that if you look at this business on a noise-free basis, which I suppose is the loss ratio, excluding large losses, you're running at 57. It's not changed that much. And you would say your competitors are probably running, let's call it, 60 to 80 or something.

Is that what you're trying to encourage us to do with that data? I guess, linked to that slide, what's the normal level for large man-made for this division? I'm assuming for current year in large man-made and ignoring prior year, I'm assuming you would suggest that H1 is benign in that respect. And the second question is a very simple one. You've dividended up $3.8 billion, I think, for the half year. I mean, the buyback in dividend doesn't cost that much. It's probably about $1 billion less. What was the plan? Are you just going to sit with additional liquidity at group center? Is that how you feel you should at the minute? Or how should we think about it?

A - David A. Cole {BIO 7251632 <GO>}

Thank you, Andrew. So I think I'll direct the first part of that to Eddie. And then I'll come back on the overall capital situation.

A - Edouard Schmid {BIO 18942809 <GO>}

So the main reason for Corporate Solutions' change in the disclosure of the combined ratio of the completion is really to align with the peers. And we feel it much better reflects the nature of this underlying business, the high excess business, which had some large loss volatility. So it's then depicting what really happened in the current accident year in terms of large man-made losses and large nat cat losses. Then separate, you see the prior year development. So it's really the alignment with peers that should improve comparability. That was the driving factor to the change disclosure.

Q - Andrew James Ritchie {BIO 18731996 <GO>}

And sorry, what would be a normal -- I mean, none of your peers don't actually segment out consistently the man-made. What do you think is the normal level of man-made to this unit?

A - David A. Cole {BIO 7251632 <GO>}

Andrew, I don't think we'll be giving that. We haven't given that in the past. I think we'll -- it's hard to talk about a normalized level of man-made with such volatility around.

Q - Andrew James Ritchie {BIO 18731996 <GO>}

I guess, putting it another way. I mean, if we kind of adjust for the negative PYD, you're running below the targeted combined ratio for this unit. We shouldn't extrapolate that? I mean, how would you characterize the man-made experience in the first half?

A - David A. Cole {BIO 7251632 <GO>}

Yes. Indeed. I would say we just stick with the earlier estimate that we gave for the year. We're midway through the year. There's an annual estimate and obvious volatility associated with this business, perhaps even more so than within reinsurance. So I would caution against extrapolation. We just stick with the earlier provided guidance.

Q - Andrew James Ritchie {BIO 18731996 <GO>}

Okay, of 103?

A - David A. Cole {BIO 7251632 <GO>}

Correct. And as to your second question. So first, correct, across the different business units now with the latest dividend up from Life Capital. We've now received $3.8 billion. We're sitting with a, I think, a very comfortable overall capital position. No. It's not our intent to just sit around. We continuously, of course, are looking at the marketplace for opportunities to invest in our businesses when opportunities make sense, as you know, both from a strategic point to be also from a financial point of view.

But obviously, we'll continue to watch the profit developments during the course of the year. Everyone knows we're coming up into the windstorm season now in North America. And toward the latter part of the year, we'll come back and come to conclusions as to how our profit generation, capital generation versus our investment opportunities have developed and we'll say something about overall capital management at that point in time.

Operator

The next question is from Thomas Seidl from Sanford C. Bernstein.

Q - Thomas Seidl {BIO 17755912 <GO>}

First question on Life Capital. I'm just wondering if you also look at the U.S. cat [ph] income. But on that basis, of course, the segment runs now at $75 million, quarterly income of 4%. Our EBIT is quite away from your 6% to 8% target. Now you do not disclose a lot of fundamental drivers. But when I look at Page 11 of your slides in the income statement, it seems like it all depends on how much of the investment income you allocate to policyholders. Last year, you gave basically 90% of the $3.4 billion investment income to policyholders.

But this year, it's the opposite. You've generated $2.3 billion. But you gave $2.5 billion in either of the 2 ways to policyholders and I wonder what's going on there and how we should think about the outlook of this investment spread? And the second question on CorSo. Now you target here a 10% to 15% ROE. We are now down to 3.6%. We had a quarterly loss in Q2. And as such, I wonder if you could provide us with the journey to the 10% to 15%. What are you going to do? And over which time frame do you expect to achieve the 10% to 15%?

A - David A. Cole {BIO 7251632 <GO>}

Thank you, Thomas. Maybe I'll pick up the first and then ask Christian to come back to the second, if you don't mind. So indeed, ROE for the first half of the year, 4%, correct. There are a couple of things that are influencing that. I'll just start with an obvious one with $2 billion of unrealized gains. We're not complaining about that. It is what it is but, of course, the nature of that is that it drives down the reported ROE. If you wanted to, you can adjust for that and come up with an ROE of about 5.7$ or something in that order of magnitude.

But that's not what we want to do. We want to focus on the medium term. Our target remains 6% to 8%. We've got a relatively low ROE existing business that we are going to continue to manage well. And we will average that ROE up as we continue to conclude successful acquisitions of portfolios in a similar vein to what we did with Guardian. Of course, somewhat dragging that report is ROE down or the investments that we're making in our open book businesses. It's going to take some time for that business to mature and to be more positive contributor to the ROE figure.

But we remain very positive about that business. As to the second part of your question about the relative disposition of investment income, that has to do with the underlying nature of the policies and whether or not their participating policies are not, Thomas. We're just -- the policyholder there are following the portions of the financial markets, which clearly are going to be different year-over-year.

Q - Thomas Seidl {BIO 17755912 <GO>}

Sure. But except normally, how you can -- how can it happen. And in a half year, you pay more, $200 million more to policyholders than yourself earned? I mean, I combined with the unit linked and the risk profits. But we can also take it individually, right? I just don't get how you have to pay more than 100% as a creditor as a benefit to policyholders in a half year.

A - David A. Cole {BIO 7251632 <GO>}

Yes. Well I'm happy to take a stand-alone discussion, walk through that and go back to the history and what now. I think anything really unique to our business in that regard is a feature of the U.K. market. But basically, it just boils down to the policyholders. They're following the portion of the investments in the financial markets, which are moving up and down. And that, of course, creates some volatility in our various reporting periods. But there's nothing really special about the first half of 2017 versus what you would have seen in previous halves or previous years for that matter. Chris, do you want to come back to the question about --

A - Christian Mumenthaler {BIO 6479864 <GO>}

Yes. Actually, maybe very quickly also on the first one, right? I think the -- this Admin Re type business is low ROE business to start with and then only because of these huge unrealized gains, it made it harder. And in the financial crisis, a lot of the high-yielding bonds were sold. And so that's all the old history. But it's clearly locked into a low ROE at this stage. The target you mentioned, 6% to 8%, has always been our medium-term target. Something we want to aspire to. But nobody has ever said we would achieve that at this stage.

And the only way you can achieve that is either interest rates go up, obviously, or you add good profitable business as we've done with Guardian. But it will need several transactions to move it up. So just to manage expectations there, I think the results you see now are completely expected, in my view. There's no possible magic except the 2 I just referred to. In CorSo yes, I think over the cycle, 10% to 15%, absolutely possible. We look back 17 years of our history. And clearly, I think it's possible. The 2 difficult phases in these 17 years, the first one of those at the very beginning, '99, 2000, 2001, there was a soft cycle. Then, actually, we made the profits nearly every year.

I think Katrina was one exception, 2005. Usually earn it back within two years. And obviously, the last two years because, of course, it's back into a rather nasty soft cycle, in my view. What can you do about that over there? I think what we do is in a soft cycle, the only thing you can do is basically cut the worst business and they're doing that. I mean, we did a few acquisitions, which is why there's not that much done, as you would see, without the acquisitions. But even with the acquisitions, we're down. So the team is now in the second or third year of pruning this portfolio to try to get the best out.

In addition, as you know, when I compare it to peers, I have to look at the total financial contribution. This is not something we disclose. But we gave you a few hints here and there. So if I look at the last six years of performance versus peers and I look at the underwriting margin, I look at the cost ratio, I look at the investments ratio. So when I look at that, on the underwriting side, of course, that's done a very good job. It's actually better than peers on average over the six years, pretty much every year, which means that the basis and hypothesis that we can use our knowledge to underwrite is intact. On the cost ratio, it's significantly higher, which is the question of scale and obviously ratably high investments into these primer leads, which will yield fruits only later.

And there, we disclosed 3% to 4% combined ratio points are in investments. Some peers will also invest, of course. But maybe not as much. Then this is a reserve that were left behind in reinsurance, as you say, as somebody said before in 2012. And there's, of course, a sort of a 2012 start-up. And these reserves have consistently yielded 4% to 5% combined ratio points equivalent if they were disclosing CorSo. And that's the same for this first half year. So if you look everything together, we feel that in a difficult market where everybody is struggling, of course, it's actually well positioned. There's nothing exceptional. That's certainly not an execution problem in our view.

And last factor, as you know. And we already disclosed, we don't buy much reinsurance for that segment, which would also practically mean that in the good years, it's probably outperforming. And if they have more claims, as you have now, it's performing less. So when it comes back, I don't know. But I think it very much depends on the cycle basically. So if the cycle is like those of the past times, you will see over time an improvement back up to performance. And over the cycle, it's earning its 10% to 15%.

Q - Thomas Seidl {BIO 17755912 <GO>}

Okay. That means we don't have like a time frame in mind like for next three years, it's going to happen. You just need to wait for the cycling?

A - Christian Mumenthaler {BIO 6479864 <GO>}

I have no crystal ball, unfortunately. I wish I had. I think the hypothesis clearly of management is it will come back up, right? Otherwise, it will make no sense. But we have a 150-year history. We have seen many, many cycles in that time and there's no reason to believe that cycles have stopped. So we know it's going to come back. And we know that over the cycle, you earn money with it.

Operator

The next question is from Vinit Malhotra from Mediobanca.

Q - Vinit Malhotra {BIO 16184491 <GO>}

So my first 2 questions. First, on the Corporate Solutions again, sorry. Just that because this is the second time that at least we are discussing a prior year development on a loss, which has come into the focus at $200 million, obviously, a very large number, how should we -- I mean, is there a risk that this is the nature of the beast, it's going to happen or could happen again in the future? Or you could say to us that no, no, we are doing XY and set things to ensure or reserve for that. We don't have these issues again.

Could you please comment on that to help us understand? And second thing on the P&C reserve release in the 1H of 2%. It does feel a little lighter than history, which I know was always mentioned by you in the (inaudible) maybe two years ago. But the point I was trying to get to is that there is some motor frequency-related issues in the U.K. and the U.S. also in 1H that you have done. Could you help us understand what this would have been without this motor thing? And is it now all reserved for? And how should we look at this reserving pattern going forward?

A - David A. Cole {BIO 7251632 <GO>}

Okay. Thanks. Maybe I'll ask Eddie to address the first question on the large loss PYD at Corporate Solutions and I'll come back to the reserve question.

A - Edouard Schmid {BIO 18942809 <GO>}

Yes. So we don't see any fundamental issue. It's right we have now 2 first half years that we're impacted by significant prior year development to a large extent, as you pointed out, by large man-made losses that deteriorated. So they happened in '15, '16. But it took some time for them to be, let's say, reserved at a more corporate level. Again, that's related to the nature of the business. We like high excess business so it takes some time after the losses come up. And also, it's particularly liability claims in the U.S. It takes often quite a while to allocate responsibility, who is really in charge of what.

So that tends to explain why sometimes we have this kind of late development. But it's not a fundamental issue. On the other hand, we actually have positive reserve development on the smaller claims and on the IBNR. Then again to complete the picture, you would again have to bring in the reserves less back in reinsurance. So if you look at the total picture, I think that the story is much more reasonable. But it's a fact that we have now two years where we had this pattern of large man-made losses developing a bit further. But it's not to do with an underlying fundamental issue.

A - Christian Mumenthaler {BIO 6479864 <GO>}

This is from a strategy point of view. All the communication, I think, has always been transparent. We run this business against the whole balance sheet of Swiss Re. So that means we do not apply any smoothing mechanism. We don't buy reinsurance. And we allow them to write relatively big lines. They are small in the context of Swiss Re Group. But this is not a business we try to make look good every quarter, every half year, right? And that's the philosophy. We can argue about the philosophy.

But I think the philosophy has been very clear and sort of makes sense. But with a long run not to lose money on reinsurance and things like that. So that's -- I think that's why half year like that can absolutely happen in the current environment. If you have huge margins, then maybe that -- you will have -- it lifts everything up. But in an environment like that which is, I would say, very stressed in the Corporate Solutions business, this can happen. It's not extraordinary.

A - David A. Cole {BIO 7251632 <GO>}

That's a great segue into the second question about reserve releases. So our philosophy is best estimate at all time across all portfolios across the globe. And we -- we've said on many, many occasions that we don't budget for our reserve developments, positive or negative. The fact of the matter is we know that we will have some developments from on our reserves more likely than not because we position ourselves toward the upper end of the best estimate range. We would anticipate that in most periods, we'd probably have some sort of small positive development but we recognize it from time to time. We can have negative development.

If you just look at the last 4, five years, you'll see there have been a couple of quarters where we'd have negative development as much as a couple of hundred million. Now if I look at first half of this year, we have positive development. We're positive in both quarters, relatively modest, as you indicated, 2 bps. But I think it's important to note that it was positive across all the major lines of business. Specific to motor, yes, we've seen the duration in both the U.S. as well as in the U.K. And that's something that obviously has impacted -- impacting us, clearly. But impacting the industry at large and measures are underway to address that.

In terms of the final part of your question, we feel that we're very adequately reserved, even prudently reserved. We're not managing our quarterly P&L by adjusting our reserve like some people may think it makes sense to do. We clearly don't think that makes sense to do. So we really follow the reserves and development of the portfolio as closely as possible and always on the best estimate basis.

Operator

The next question is from Frank Kopfinger from Deutsche Bank.

Q - Frank Kopfinger {BIO 16342277 <GO>}

I have 2 questions. My first question is on your currency development FX impact. Can you shed some more light on the trials behind just the currencies and ideally also provide some sensitivities on how we should track this going forward? And my second question is on your 102% price quality level, I think you call it now. This improved from your last reporting from 101%. Does this suggest or imply that there's a chance that the combined ratio could improve from now?

A - David A. Cole {BIO 7251632 <GO>}

First, on FX, I think it's worthwhile to note that from time to time we have some segmental drivers here. But across the group, as you know, we really try to maintain a relatively fully maxed portfolio, both from a duration point of view as well as from a currency point of view. So actually, although from time to time, individual segments will have pluses and minuses on the FX side. By the time you back it out across the group where we're doing cost of group hedging, it actually is rather modest, for instance, in the first half of 2017. The overall net impact of foreign exchange on us was order of magnitude of $1 million, I think, just to indicating what I was suggesting. Let me go to Eddie for the second.

A - Edouard Schmid {BIO 18942809 <GO>}

Yes. So the long-term price adequacy, as we call it, indeed improved a little bit. You can compare it, at this point, versus what we showed for the Jan renewal. Actually, if you compare to the same period last year, we would say we could maintain the quality of the portfolio at 102% of this long-term price. Adequacy, as you know, 100% would be calibrated to 700 basis points above risk-free.

What we actually did, we cut quite a bit of business. You can see that from the written premium, down some 15%. And actually, we stick to very strict underwriting discipline and cut the worst-priced business and that obviously will improve the quality of the business. It's the effect that in quite some markets and lines that is pressured downwards. But by shedding the worst-priced business, we could actually maintain the quality. So if you then link that to future combined ratio, you could say we do not expect a deterioration. So we could maintain the quality of the portfolio. That's how I would describe this 102% price adequacy level.

Operator

The next question is from Jon Urwin from UBS.

Q - Jonathan Peter Phillip Urwin {BIO 6126952 <GO>}

Just a couple of strategic questions. So firstly, I wanted to get your latest thoughts on how you plan to manage the cycle, mainly in P&C Re from here, assuming pricing doesn't really change, we get a bit more stability. But no major swings in the market outlook. I mean, obviously, in recent years, you shifted the mix towards casualty, very more private placements. But from here, what levers do you have? I mean, is this going for any further mix change? Would you use more retro? Or is it just about pulling back, as you just mentioned, cutting that sort of least attractive business to improve the pricing adequacy?

So just big picture thoughts there would be appreciated. And secondly, large and tailored transactions, the private placements. They're not coming through anywhere near the level of last year. I mean, has appetite changed there? Or is it just the function of the lower pricing adequacy? Are you not getting the same levels of differentiation versus the more traditional markets that you're getting last year? Or is it indeed just more lumpy business and it hasn't come up as much year-to-date?

A - David A. Cole {BIO 7251632 <GO>}

Excellent. Thanks, Jon. So I'll go to Eddie for the first and then switch to Christian for the second.

A - Edouard Schmid {BIO 18942809 <GO>}

Yes. So I think we already called it the main kind of tools we have to manage this P&C soft cycle. And we'll speak to that exactly also over the next coming years when the cycle will turn. As Christian said earlier, we don't have the crystal ball but we'll be very much focused on the differentiation. I think there will be opportunities for large transactions where we can extract better margins. On the more opportunistic commodity-type business, we'll stick to this underwriting discipline. We'll keep pruning the worst-priced business and we'll keep focusing on the differentiation with traditional services and solutions we apply to clients.

We can also achieve some, let's say, differential terms. So with these elements, we can, let's say, limit the impact of the soft cycle but we're still, in the end, part of the bigger picture. So there's no fundamental new tools to manage that. But we'll stick to that underwriting discipline and continue with the differentiation. And that will help us through the next 1, 2, 3, four years, however long it takes for this cycle to turn.

A - Christian Mumenthaler {BIO 6479864 <GO>}

Maybe I'll take the large transactions matter. I don't think we see a difference in terms of amounts, pipeline, all of that. I mean, we do dozens of these transactions. But obviously, if you look at premium as an indicator, you tend to see only the big quarter shares. And obviously, last year, there was one very big one that came into the limelight. You wouldn't probably see the structured cap transactions and things like that or the portfolio transfers or things like that because they don't show up there. So we continue to see large transactions. The pipeline is actually quite good. We see shifts over time from -- first, it was P&C, most P&C.

And now I think there's clear overweight of Life & Health transactions in the pipeline, which I think reflects the current environment we're in. Because even if people offer us P&C transaction, if the whole market is suffering, there's just the high risk that we can't make it work number-wise. Even if it's -- because if the client doesn't have much margin, how could we get a lot of margin out. So at this stage, short term, medium term, I think it's more likely we do Life & Health large transactions that are visible. But in the P&C side, it's -- they still exist but it's underweight in the overall pipeline. But fundamentally, we have a whole team around that in the pipeline and I don't see huge differences from year-to-year. It's volatile depending on what you write. But I don't see any reason that this has stopped, it hasn't.

A - David A. Cole {BIO 7251632 <GO>}

No. Indeed, the word we use internally is indeed, as you just adjusted, Jon, these are chunky. So they fall in 1 quarter, then they don't. But as Christian suggested, the pipeline remains quite healthy.

Operator

The next question is from Stefan SchÃ¼rmann from Bank Vontobel.

Q - Stefan SchÃ¼rmann

I had 2 questions, the first one relating to the renewal year-to-date. Could you just give an indication on basically the $13.7 billion estimated outcome? Is this now related to nonproportional business? And the second one, ALM operation gap. I haven't found any information in that regard. Is there any change here? Or could you maybe provide some update on where you stand in terms of DV01 operational gap overall for the balance sheet?

A - David A. Cole {BIO 7251632 <GO>}

Stefan, would you mind repeating your first question? It wasn't 100% clear to us here.

Q - Stefan SchÃ¼rmann

Sorry, sorry. For the renewals, just very simply, I mean, how much business you wrote, let's say, relating to nonproportional now year-to-date and then the $13.7 billion outcome for split between proportional and nonproportional, if you may.

A - David A. Cole {BIO 7251632 <GO>}

Okay. Eddie, you want to pick that one up?

A - Edouard Schmid {BIO 18942809 <GO>}

Yes. So the 13% you referred to, Stefan, is the reduction in premium report for what we wrote for the first six months. And actually, the reduction is pretty similar on proportional and nonproportional. So it means we have reduced our writings pretty much across the board. There's variation in the region. But I think the split would not change dramatically in terms of proportional versus nonproportional for the first six months.

A - David A. Cole {BIO 7251632 <GO>}

And as to the second question, we do manage to, more or less, match the ALM position. That's not changed. Overall duration at the end of first half was 6.2. Net-net, right now, we're basically sitting at 0 DV01. We have a little bit of a DV01 in Life Capital. As you know, that's also been brought down, continues to move downward, offset elsewhere in the group. So we continue to maintain a relatively flat or fully maxed position with an average duration of just over six years.

Operator

The next question is from Vikram Gandhi from Societe Generale.

Q - Vikram Gandhi {BIO 18019785 <GO>}

My first question is around the renewals and your pricing. And I guess, you partially covered it in one of the previous questions. I guess, I'm a bit surprised that the proportion of nat cat component has not come down at all on a relative basis. It's still at 17% if I look on Slide 16.

And yet, the group has been able to maintain the price quality at 102%. Plus, it appears from the press release and the presentation that more emphasis is being placed on pricing pressure around costs rather than P&C Re, which I find a bit surprising. So any color around that would be helpful. And the second question is, would you be willing to draw a line and say this is the maximum level of capital that we are ready to deploy towards Life Capital transactions to give some comfort to the market in terms of the flexibility around capital allocation? That will be all for my side.

A - David A. Cole {BIO 7251632 <GO>}

Thank you, Vikram. Eddie, you take the first and I'll pick up the second.

A - Edouard Schmid {BIO 18942809 <GO>}

Yes. So I think in the first question, refer to the Slide 16 where we show the portfolio split and how it changed where, yes, you're correct, that the nat cat proportion is still a similar level there, which refers to my earlier comment that actually we see price pressure picking up across the board. And we have taken some, let's say, pruning actions in many parts of the portfolio. But you're still correct, that we have a very careful look these days at our nat cat deployment, which is the business that was extremely attractively priced a few years ago and has been under significant pressure for a number of years.

And since about two years, we started to reduce capacity deployment significantly. And again, if you compare, let's say, middle of 2016 with the middle of 2017 for our peak cat scenarios, we again reduced our capacity deployment quite significantly, about 10% when it comes to hurricane in the North Atlantic and even a bit more when it comes to storm Europe, which is proof that they continue to take away capacity if prices do not meet our hurdle rates. But it's also true that nat cat exposure, which you've seen that number, is also part of some proportional basis of some transactions. So it doesn't speak out too much. But clearly, we apply this disciplined pruning approach continuously also on the nat cat side.

A - David A. Cole {BIO 7251632 <GO>}

Thank you, Eddie. I said I'll answer the second. Sometimes, I hear from colleagues that I give long and winding answers. Here, I can give a very short one. The question was, I think, if I paraphrase this, absolute capital and the size of transaction we'd be willing to do with Life Capital. And the short answer to that is no. Obviously, the transactions need to meet our financial hurdles and we've indicated it for large allocations of capital for an ROE of above 11%. It also ties in with our earlier comments about how we over time bring the overall ROE of this business up. One of the leverage we have, of course, is acquiring portfolios at attractive rates.

As we said in the past, we do have, obviously, some issues that we need to manage, including operating under SST, the ramifications of larger balance sheet depositions here. We've also said in the past. And that continues to be true, that we're hoping to the prospect of third-party capital also participating with us. And particularly, in the context of very significant transactions, I would say that would be one of the tools that we'd look to, to manage the overall balance sheet position. But if we find attractive portfolios and there are a number of significant transactions now potentially in the marketplace, I think it makes eminent sense for us to deploy the shareholders' equity in a fashion that delivers a very attractive return.

A - Christian Mumenthaler {BIO 6479864 <GO>}

In the sub-question, Vikram, as I understand it correctly on the -- whether we sound more negative on Corporate Solutions than P&C Re and why. I think on a high level, that is not based on the numbers. But just what I see in the market, I think the excess layer business is under a lot of pressure the most, I would say, whereas retail P&C is -- which we don't write directly but that's over the -- in a better position. And when you reinsure, obviously, you access some of both but you have somewhat it's proportional, which means you get some of the retail business. But you also have some nonproportional where you price yourself what you want to have.

And I just think that within reinsurance, we have more levers to differentiate ourselves from the competition. So we can differentiate from others if they're large transactions and all of that. So I think you're right, I would -- that's more intuition than something where we fix, outrate the excess layer business currently under even more pressure than P&C Re at the market overall.

Operator

The next question is from Guilhem Horvath from Exane BNP Paribas.

Q - Guilhem Horvath {BIO 18460437 <GO>}

So I have 2 questions. The first one is on something you mentioned earlier, which is the U.S. casualty. But also on specialty for which lines you had deteriorations this half year. I'd like to better understand what happened there. And maybe if you can also give us a little bit of an outlook on what you expect to have, particularly on U.S. casualty as profitability in the coming years. And maybe an update on claims inflation there as well. And the second question is a higher-level question is that -- to me, you seem a bit more cautious than competitors on the cycle. When you say you don't have a crystal ball to know where -- when the cycle is going to turn, did you see today stabilization in terms of pricing? Or do you still see a very strong pressure on the P&C Reinsurance market? And yes, I'd like to know where you stand on that.

A - David A. Cole {BIO 7251632 <GO>}

Thank you. I think I'll first turn to Eddie for actually both questions.

A - Edouard Schmid {BIO 18942809 <GO>}

Yes. So in terms of casualty, actually, we're quite comfortable with our casualty book overall. As we report, that combined ratio has deteriorated a little bit but it's still healthy if you look at it on an economic basis. There was some, let's say, adverse development, as you pointed out, related to motor. That's actually U.S. based but also U.K. based. But that's not specific to us. These are really market issues and the U.S. motor market has started direct [ph] quite a bit for some time. And we're part of that story and are addressing it and improving these products off the business. You, I think, mentioned inflation as well, which obviously is an important risk factor to be considered when you underwrite longer-dated casualty business.

I think inflation outlook's maybe a little bit higher than a couple of years ago. But we do not expect a huge spike in inflation. And we regularly review our inflation assumptions with our economic research and development department. It's a key consideration into our costing model and it's updated on a regular basis. And as you know, it's less linked to CPI inflation. It's more the medical cost inflation and the wage inflation. And these are continuously updated to reflect the most recent update. I think specialized was also mentioned and it's correct. We had some adverse developments on parts of the portfolio. I think we had an aviation loss, which we mentioned. But overall, it's still a positive reserve development also on specialty. So nothing really unusual.

A - David A. Cole {BIO 7251632 <GO>}

Eddie, the second question about are we, relative to some of our peers, more cautious regarding the pricing environment and outlook?

A - Edouard Schmid {BIO 18942809 <GO>}

I think the only thing we say, we don't know when the cycle is going to turn. I think we, under reinsurance side, we have seen a bit of a silver lining. So we have seen deals that were flattish. And obviously, we see markets reacting upwards when there are claims. So there are signals that are reaching the bottom of the cycle. But how much longer it will take to see significant corrections upwards, that's really impossible to forecast. But it's pretty clear that all the players in the market see that the profitability is lacking. So it's return on equity below the cost of capital if you look at the P&C Reinsurance industry overall. So you would say we cannot take many more years for the market to correct down. But to make any kind of prediction in 1, 2, 3, four years, it's really not possible.

Operator

The next question is from Nadine van der Meulen from Morgan Stanley.

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

I was just wondering on costs. How much cost do you see for cost reductions? Perhaps you could talk a little bit about that, perhaps give an indication in what areas of the group we could see improvements on cost. I realized you've been quite heavily investing in R&D in certain areas. But what could we expect going forward?

A - Christian Mumenthaler {BIO 6479864 <GO>}

Very relevant questions. You know and I said in Investor Day that since a few years, we have installed a philosophy within the group that everybody needs to save 3% per annum. Then we use these proceeds to invest in high-growth markets, to expand in certain lines and all of that. So there's a certain discipline in here but it was so far put into close initiatives. We have significant initiatives in the tech side, on the corporate ledger side, in finance, in different areas. So the -- I don't make any prediction but it's clear one of the levers we have is to do -- to reinvest less, right, to continue the philosophy and reinvest less.

But I think if the P&C side continues, that might be something we need to consider. So I think the good thing is that this type of cost discipline is widely in the culture now or in the DNA. And if necessary, we can use that.

Operator

The next question is from Thomas Fossard from HSBC.

Q - Thomas Fossard {BIO 1941215 <GO>}

One question for me on the P&C Re side and probably more for Christian. In several Investor Days, you've presented a slide on P&C Re to show how much or how better Q3 [ph] were doing -- was doing compared to the industry. And you were, I would say, consistently outperforming underwriting margin and taking, I would say, disproportionate share of the underwriting profit of the industry. What's your view at the present time? I'm not asking for a quantitative. But for more -- more for qualitative answer from your side. Do you think that the gap of the outperformance of Q3 versus the market can be maintained in the current environment? Or are you seeing your current position slipping a bit from what you presented to us in the past?

A - Christian Mumenthaler {BIO 6479864 <GO>}

Thank you. Fascinating question. I think there are 3 sources of outperformance. The first one is sort of the SAA equivalent. So where -- in which line of business, in proportion, non-proportion, you put your capital in. The second one is if you have pricing tools that give you better risk assessments, you can better choose which risk to take and which not to take. And the third one is the differentiation, right, the price differentiation at the client level. So where you don't pay brokerage or you get a better price or you get actually private transaction at higher margins.

So if you look at these 3, I think the first one has clearly been a big part of our differentiation over the past. In other words, there was a slide many years ago, I remember, in Investor Day or in the yearly presentation where we showed the long-term price adequacy of proportional business versus nonproportional business. And in these good times, the long-term price adequacy of the nonproportional was something like 150% or something like that and proportional was maybe more, 110%. And so since we have this relatively brutal approach to put the capital where we think the best of these are, we shifted away from proportional, more into nonproportional.

We're overweight in proportional, which has a lot of cat. Cat performed extremely well in the past and that was a big source of outperformance. And I think if you look at today, it's much more even, right? The profit has been sucked out of most of these segments and there's no way the same level of different long-term price adequacy. And therefore, through this SAA-type process, the strategic liability allocation, if you want, I think it's harder. There's still a little bit there but it's harder at this point in time to outperform. On the pricing tool, I think that's equal.

Nothing has changed there. And I think because of our name and importance, clients allow us to pick and choose layers and which one we want to participate and which one not to a certain degree, which I think is a competitive advantage and should yield some outperformance. Then the third one is what we clearly measure year-on-year in great detail is, really, do we have a source of outperformance compared to what the market can achieve? So do we achieve a different price or do we achieve the same deal but without brokerage or do we achieve some private transactions, which have higher margin? And that one is what we have expanded in the last few years.

I think that was very small five years ago because that's a lot of work we have to do with the senior leadership of our clients because I think we have different models and it's justifiable. But it takes a lot of time. So very hard to see overall but I think since the number one was a big source of outperformance, absolutely a probability that the delta shrinks. I think we should have a delta and continue to have a delta. But I think that's a plausible hypothesis.

A - Edouard Schmid {BIO 18942809 <GO>}

I would just add that as we alluded to earlier, it's very important to outperform by actually avoiding the worst business in the market. And that's what we've already shown by really taking away the top line for business where we don't see the hurdle rates being met. In the past, we outperformed by allocating a lot of capital on the best-priced business. I think now it's also a lot about avoiding to deploy capital to the clearly underperforming portfolios but also individual deals. And I think there, based on our disciplined approach, we will see outperformance by our approach.

Operator

The next question is from Edward Morris from JPMorgan.

Q - Edward Morris {BIO 16274236 <GO>}

Two questions, please. The first, just coming quickly back to CorSo. I was just hoping you could clarify the guidance on that, please, for full year. My understanding in full is that the 103 was normalized. We don't have that normalization approached in the same way now. So are you guiding to 103 actual reported combined ratio for the rest of this year? If could you just clarify that, that will be great.

And the second question is on Life Capital and gross cash generation versus dividends. So I see the $1.1 billion dividend that's come up to the group. It looks like there's a $252 million capital contribution, which I think maybe is to fund the open. But can you just talk about how gross cash generation and the dividends that you would expect from Life Capital relate to each other? And presumably, this is a very high figure for this year. What is the sort of normal level of dividend you would expect from Life Capital going forward?

A - David A. Cole {BIO 7251632 <GO>}

Thanks, Edward. Eddie, do you want to pick up the first one?

A - Edouard Schmid {BIO 18942809 <GO>}

Yes. So the CorSo combined ratio estimate to date earlier in the year, 103, was hoping that's a reasonable number. And we don't update it before later in the year.

A - David A. Cole {BIO 7251632 <GO>}

Yes. And I think the change in our reporting, Edward, is not to suggest that we should -- and how -- a different way of thinking about this number as was originally constructed. And so we don't change anything in regard to the previous estimate that we've given. The reason we've changed our reporting, as Eddie indicated earlier, to bring it more in line with development peers on the primary side as opposed to reporting our combined ratio of developments more in line with reinsurance peers, which, of course, we continue to do on the P&C Re side.

As to your second question. So you're right. We envision to extracting excess cash from our Life Capital business reflecting ongoing management of that business and our previously communicated approach, which is to pay out excess capital. We also are investing in that business. And in the course of 2016. But also first half of this year, we have made some investments. There are 2 places these investments are going. The first place, as you properly referred to, is where we are investing in the development of our open book business in both Europe as well as in the U.S. And the second place is a little bit more of a one-off. We've created, at the beginning of this year, a reinsurance vehicle within the Life Capital business unit that allows us to optimize the utilization of capital within the business units.

So it's very similar to what we have previously established for both our Reinsurance unit as well as with our Corporate Solutions unit. Up until the beginning of this year, there really wasn't that much of a need or a purpose use to have that type of vehicle within Life Capital. But with the extension into the open book business and particularly also extension into different markets. So not only operating in the U.K., it makes sense to set up that type of vehicle. So that's part of the capital contribution that you see is related to that.

FINAL

Bloomberg Transcript

A - Philippe Brahin {BIO 19081619 <GO>}

All right, David. Thank you very much. This is Philippe again. I think we have come to the end of our Q&A session. So thank you very much for joining. And please don't hesitate to contact the IR and the team if you have any follow-up questions. Thank you, again for your participation today.

Operator

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