Q1 2017 Earnings Call

Company Participants

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

Other Participants

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

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, good morning or good afternoon. Welcome to the Zurich Insurance Group First Quarter 2017 Results Conference Call. I'm Sarah, 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>}

Good morning, good afternoon, everybody, and welcome to our call for the first quarter 2017 results. On the call today we have our Group CFO, George Quinn. And before we start with the actual Q&A, George will make a few introductory remarks to the results.

George Quinn {BIO 15159240 <GO>}

Thanks, Richard, and good morning, good afternoon also from me to everyone on the call, and thank you for joining us for this Q1 discussion. Just before we move to the Q&A, I'll make a few remarks. Our results show a strong performance with BOP up 14%, adjusting for the impact of the change to the Ogden discount rate in the UK, with the business across the board showing progress against the key objectives that we laid out at the time of our Investor Day in November last year. In property and casualty, we continue to focus on disciplined underwriting, and delivery of our cost savings goals. This focus is having a positive impact on our underwriting performance with the accident year loss ratio ex-cat improving by about 2.4 points year-on-year.

On the expense side, we've achieved further absolute cost savings in the quarter. However, the decline in NEP as a result of the underwriting actions from 2016, together with mixed effects means that these are yet to show through in the expense ratio. The stabilization in written premiums in the first quarter, the end pattern of U.S. crop premiums, together with the product cost savings that we have planned make us confident that the expense ratio will decline over the remainder of the year. Elsewhere, our Life business continues to deliver on a long-haul strategy of focusing on capital light protection (03:28) business, but this continue to support good growth on all metrics, while farmers continues to see a steady performance.

The quarter has confirmed a very strong cap position with a Z-ECM ratio of 129%, above our target range, and providing us with significant capital flexibility even after the completion of the recent Cover-More acquisition, and the debt redemptions which, together, will take about 4 points over the ratio over the second quarter. We continue to review the capital levels of our business in light of growth opportunities, and the macro outlook (04:06). However, our near term primary focus remains on delivering on our dividend policy and growing the dividend over the planned period.

We're now happy to take your questions.

Q&A

Operator

The first question is from Farooq Hanif from Credit Suisse. Please go ahead.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi, everybody. Two questions on capital and one on the loss ratio. On the SST methodology change, do you think the 227% now is a fairly good comparative with Solvency II? So should we start looking at that as a comparison with some of your peers, how meaningful do you think that is? And related to that, second question, even after a couple of more transactions, you'll still be at a Z-ECM ratio, which is historically extremely high. So just wondering what implications that has for either dividend or further acquisitions. And the last question, the loss ratio, it's been a great improvement, you've done a lot of work. But when you look at the commercial ratio ex-Ogden it's still unprofitable. So should we expect, as well as an expense program, we're still going to have an attempt to bring that underlying loss ratio down further, and just what does that do to top line, and what's the timing of it? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Thanks, Farooq. So first of all on the 227. If you go back to the Investor Day presentation from last year, I think that there were really, I mean, two key components that we saw were driving the difference in conservatism between SST and Solvency II. I mean, the ones that you're seeing here, I think, the methodology changes. So FINMA has taken out the scenarios that were added in, and it's changed the way that the market value margin or potentially capital charge is reflected in the capital – in the calculation. However, if you go back to the Investor Day, there was also still a significant difference, and we've measured it by reference to what we can see on our European business as subject to Solvency II versus the same number that we can see on an SST basis. So we're still of a view today that the number is certainly more comparable, but it's not comparable yet, because there's still significant differences between what Solvency II requires and what SST requires that still have an unique conservatism in the SST calculation. So we think that if you were to look at the numbers, I mean, a Solvency II equivalent for us would be quite a bit higher than 227%. And I think you've seen from some of the more detail, what one of our neighbors has done that, I mean, that difference will still exist even with these changes from FINMA.

Q - Farooq Hanif {BIO 4780978 <GO>}

Presumably, we will go in SST out from here (07:28) on your Solvency II entities will be able to see some of that.

A - George Quinn {BIO 15159240 <GO>}

So we are subject to the same reporting requirements, and I guess, they are all about to set the wires shortly. So I think, it's partly and mainly in group numbers come a bit later. So (07:41) entities, and you'll see them the same way you see the others. At least with that – I mean, FINMA obviously in the process of what mostly companies on what FCR should look like, I mean, FCR will come for us as a group bank from Swiss entities at some point in I think the not-too distant future. On the second point on capital, I mean, allowing for Cover-More and the impact of, let's call it, the vast financing that we did last year, that means that some of the maturities will not be replaced this year.

I mean, I think the only thing I'd say on that for the time being, is, I mean, we're in a good place on capital. I mean, we're still strongly capitalized. But as I said in the introductory comments, I mean, our focus, and I really mean that, our entire focus is on the operational side for the time being. It's all about improving operating performance, and using that to drive dividend growth. That's our number one priority. On commercial, I know, you guys haven't had much time today given all the other companies that are out there, but I mean, we have the new disclosure, which will take a bit of time to get used to, but we have commercial as a separate business.

I am tempted to go back and try and take some of the negative impacts. I mean, commercial has a slightly high cat burden in Q1. There's a few other topics around comparison with the prior year that I think the headline numbers don't fully represent. However, I think, even if I did all of that, I mean, the basic issue remains the same. It's a tough market out there. We still have challenges in the portfolio, and Jim has a number of activities planned for this year to tackle some of the weaker parts of our business, and I mean, one of those continues to be commercial motor. If you look at commercial motor globally, I'd say that we see pretty good rate in the U.S. currently. But commercial motor and other markets, particularly in Europe, is not providing adequate return currently. So there's a lot of work still to do on commercial.

Q - Farooq Hanif {BIO 4780978 <GO>}

Thank you very much.

Operator

The next question is from Peter Eliot from Kepler Cheuvreux. Please go ahead.

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

Thank you very much. The first one was just on your earned premium outlook. Are you still guiding to flat earned premiums in 2017? And just to understand, that presumably means that the Q1 developments were pretty much as you expected. So all of that, for the timing difference, say, fully accounts, fortunately they were basically in line with your expectations. And secondly, I guess, just given the comment on prioritizing profitability over volume in commercial, does that sort of pose any risk to that statement, or help us understand how you think of that. Secondly, can I just understand how much of the Ogden impact is in the Z-ECM ratio at the end of 2016, and also what the outlook is in terms of how much we might sort of expect to come through to the P&L (11:08)? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Okay. Thanks, Peter. So first of all on the earned premium outlook, so no change to our prior guidance. Our expectation is that it'll be flat for the entire year, albeit with some peaks and troughs. In fact, we just had the trough as we go through the quarters. I mean, the main distorting factor is going to be crop. I think, I mean, what we've had in Q1 is, by and large, what we expected because of the lag impact of earning the written resumptions that you saw last year. Q1 is also slightly impacted by the fact that we got a bit more reinsurance in the portfolio, certainly impact commercial more than other parts of the book. So the only thing I'd say is, if you go back to the disclosures we had when we talked about growth in more detail, there is some insights there into the past that you can expect, but I mean, crop is very strong in Q2 and Q3, and it's still significantly present in Q4, but almost not present at all in Q1. So we expect flat premium for the year but with a pattern driven by crop.

On the action that we've taken around commercial, I mean, there's three additional risks. I mean, from an overall volume perspective, we don't see anything that suggest us, I mean, what we need to do in our commercial book is somehow as extraordinary as some of the things that we did at the end of last year or the year before. I mean, if we look at commercial in general, retention is slightly better, new business flows are more in line with expectations. But we have some pockets that need to be tackled. So I mean, at this stage, maybe I have a plan for commercial that would reflect those risks. So I don't expect today that we'll be coming back for further discussion about why is the NEP in a different place. But having said that, I mean, of course, the priority is profit, and we don't control the market. So I mean, if the market was to move in a way that we don't anticipate today, I mean, I guess for us and for others, that would put top line at risk. On Ogden, you can assume that we have Ogden in its entirety in the year-end number.

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

Okay. Great. Thank you. But I got a one very small follow up, just on sort of the timing pattern that you're talking about. The 1.2% on expense ratio that you said was basically due to timing, can we also assume that is all sort of premium-related, and therefore, actually, both in Q2 and Q3 if we're getting sort of higher premium, actually that we should expect maybe, I don't know, 0.6 percentage points sort of tailwind in each of Q2 and Q3.

A - George Quinn {BIO 15159240 <GO>}

So the one thing I got to avoid here, Peter, is give you a forecast. But I think, I mean, the components, just to reiterate, I mean, if you ignore prop (14:09), last year's written performance is a good guide to what you should expect to see through this year. So you could use that and proxy the underlying end. From a crop perspective, I think you've got the original numbers around the time of the acquisition, and you've got a pattern in there, so you could overlay the two. And for expenses, I mean, we have an absolute reduction in expenses, but it's a bit overwhelmed in the quarter by the NEP impact. But from an expense perspective, it's obviously not going to go up, and it will go down. I think you mainly all know, I mean, we have an ambition to take expenses down this year by about $400 million. So we get roughly to the halfway point in the expense program by the end of this year.

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

Okay. Thanks a lot.

Operator

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

Q - Jonny Urwin {BIO 17445508 <GO>}

Hi there. Thanks for taking my questions. Just two from me. So firstly, can you give us some more color on the move on the Farmers' new business count, 19% reduction in Q1, what caused that? How do you expect that to develop for the rest of the year? And secondly, just in the context of the sort of planned actions on the commercial book, there's some news flow out today in the insurance side that you're potentially looking to offload the German (15:27) portfolio. If you've got any comments there, that'd be great. Thanks.

A - George Quinn {BIO 15159240 <GO>}

Okay. So the answer to the second question is the easiest. So the answer to that one is no. On the first one, on the Farmers' new business count, I guess, as everyone, as we've discussed several times in this forum before, if you look at the exchanges by the biggest issues that they face, and in fact, the U.S. social market in general is the proved profitability. So I think you see Farmers, and in fact, I mean, in general you see almost all markets pushing rate significantly. And in fact, if I look at some of the peers to the exchanges, and their new business count, so their new business changes quarter-over-quarter, I mean, are in the same place, and in some cases even more significant than you see from Farmers.

Farmers actually has an improvement in auto in the quarter, but not yet enough to get to the level that would, for the overall portfolio, achieve the level of profitability of the exchange we're looking for. So that topic around rate, I expect from Farmers, and in fact, I think, I see from others that it continues to be a theme, and I think will be for the remainder of this year. So we still expect to see Farmers drove premiums, but it's going to be driven by rates. And to the extent that that has an implication for the exchanges around new business, I think, the exchanges have decided, and that they're happy to accept that for the time being to bring profitability to where it used to be.

Q - Jonny Urwin {BIO 17445508 <GO>}

Thanks George.

Operator

The next question is from Paul De'Ath, Royal Bank of Canada. Please go ahead.

Q - Paul De'Ath

Yeah. Hi there. Just looking at the, I guess, the combination of the loss ratio, and also the commission expenses. And obviously, you talked about the change in mix is kind of the driver of the commission expenses going up. But presumably at the same time, that is also a driver of the loss ratio moving down the (17:35) loss ratio. So is it better to look at those things combined, so at the loss ratio and the commission ratio together? It looks to me that the underlying improvement is more like 1 percentage point rather than the 2.4 percentage points on the pure loss ratio. Just any thought on whether that's a better way of looking at things. And then, second point was just on the crop business, again obviously, you've highlighted there is some seasonality, I guess, in the net earned premiums, and is there a significant seasonality in the claims in that business as well that we need to look out for? Thanks.

A - George Quinn {BIO 15159240 <GO>}

Yeah. Thanks, Paul. So I mean, so the first one is a good point, in fact, I should have mentioned it in response to one of the earlier questions around what do we expect in terms of, I mean, future impact on expense ratio. I think it's not unreasonable to look at the combination. So I think if you combine commission and loss, I mean, as we grew the mass consumer business, the commission ratio is going to tick up. Overall, we'd expect that to contribute profitably overall to the group. But I mean, you may see some tradeoff between loss ratio and commission, but selling to the extended commission ratio moved in the remainder of the year, I think, I mean, I would assume, and I'd ask you to see most of the time being that that's offset, but excess loss ratio improvement beyond the existing target as we have for improvement. On seasonality, I mean, the short answer is, yes. So I mean, as you'd appreciate, I mean, given the risks that we've run in the crop business, there's a combination of topics around the commodity price, hail and based on (19:28) other natural perils that would drive the outcome, I mean, more or less, I mean, I would assume that, what I would ask you to assume, the seasonality around premium is a reasonable indication of the seasonality around claims.

Q - Paul De'Ath

Okay. Thanks.

Operator

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

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

Hi there. Just looking at the underlying loss ratio improvement year-on-year, you mentioned in your commentary that you had lower attritional and lower large losses. I guess, I'm just trying to judge, and maybe you could give me your view as to how much of it was a bit of good luck on (20:12) large losses, how much of it really reflects the portfolio effects, and/or how much of it reflects the benefits of the changed reinsurance program? Just a bit more flavor, just to sort of understand the sustainability of the current level and the improvement, and maybe linked to that, what were you seeing in terms of underlying loss trends, particularly in the U.S.? And I guess, the other question, George, you talked – in your opening comments, you were keen to talk about dividend growth. Now, clearly, there's no balance sheet constraint, what is it, what the metric we should care about by thinking about the point where you're comfortable to grow the dividend? Is it BOP ex-Ogden, which you kind of make a highlight of in the presentation, is it where you get the combined ratio where you get an ROE? What was the metric that you care about the most before you switch on dividend growth?

A - George Quinn {BIO 15159240 <GO>}

Excellent. Thank you for that question. So on the underlying loss ratio, I think, the changed reinsurance program, and from what I can see in Q1, I don't think that will be a net benefit, it will probably be a small net cost. But I don't believe that's had a significant impact. I think, if you look at the – I mean, the two big drivers you mentioned already, so the improvement is roughly 50%. The lower side of attritional, and the other being the large side of attritional. I mean, the large is going to come and go. It's very hard to reach any conclusions based on this quarter. But I could tell you that you can expect that improvement to stick throughout the year or be smaller or larger. I think, the reduction in the smaller end of attritional rate is more meaningful, and that gave us more confidence around the progress that we think we're making around the improvement. But (22:08) with the fact that it's three months. We need a bit more behind us before I think we can start to draw deep conclusions about the extent to which the changes that we have made, I know finally showing up in the performance. But I think we feel good about where we are, but maybe there's clearly some luck.

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

(22:27) on the reinsurance comment then, do you still have quite – you have untouched the additional large losses cover you brought there.

A - George Quinn {BIO 15159240 <GO>}

So the changes in the program at the year-end, I mean, probably the principal one was to see a bit more of the U.S. property risk. I mean, we need a relatively active claim environment for that to really show up as a positive impact. And just given the return paid around those risks, I mean, (22:57) in any given three months period. I mean, that's more of a broader view of the market from us, kind of need to make sure that we can serve our clients. So just to recap, I think on that, I think we feel good about the half of the improvement that comes from lower attritional. The other half, very hard to judge. And that general comment, the three months makes the whole thing pretty hard to judge, albeit good start for the year.

Underlying loss trends in the U.S. I mean, in general, with the exceptions that the commercial auto still runs, I mean, reasonably hard, I would say. I mean, rate has come up to a level that certainly makes it slightly more attractive. But I think, we would still want to see the market. We still want to see more improvement in commercial auto in the U.S. before we become enthusiastic. There's not enough in it yet about re-improvement to feel happy about underlying profitability on that book.

On the remainder, I mean in general loss trends are, I'd say, relatively benign. I mean, workers' comp is in good shape. I mean GL, we don't see anything that causes any concern. I mean, if you look at rates and you look at loss cost trends, I mean rate we see in the U.S. is up at 1% and we would judge loss costs slightly higher. So albeit loss trends in the U.S. are not particularly negative, rate is currently being absorbed by all of the market rate change.

On what's the benchmark for dividend growth, I mean, I'm going to answer it in two parts. I mean, the key driver is going to be the dividend policy (24:44) in November. Now, what do we feed into that in terms of the number, I don't think we will want to tweak or play around. But if I guess, we did say at the time that there's clearly a forward-looking element to it, so it shouldn't just be based on what we see in the past. We'll take into account what we believe is coming. I think, in terms of Ogden in the first quarter, I think all we see around Ogden is that – I mean, the approach we've taken to Ogden in Q1 is to really say to the UK, it's a UK issue, so you manage it. And the group's willingness to use reserve strength as you've seen in Q1 is relatively lower in that topic, and that's really about putting pressure on the market. Having said that, over the course of the year, we now still expect today, that our PYD in total for the full 12 months including Ogden will be in that target range. So even though Ogden is a relatively big topic, given the scale of it in Q1, I think it will be a much smaller topic by the time we get to the end of the year.

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

Okay. Thanks very much.

Operator

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

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah. Thanks. Good afternoon. Three questions from my side, please. First, on pricing, I mean, I look at the page 11 of the presentation, in the U.S., you grew net of (26:12) underlying 1% basis, but increased prices 1% was the figures we get from the market, CIAB saying minus 3% Marsh, minus 3% all other peers reporting a negative price change in the U.S. commercial lending. We don't have any exposure to credit line. So my question is, how is it possible that you defy the pricing gravity there? Secondly, when it comes to the cost expense ratio, of course, we hear your story about the mixed change driving up the commission ratios. And I also saw your comment that the one-off effect from NEP was 1.2%. So if you strip that out from the 33.5% expense ratio, we get to still above up 32% level. So how confident are you that you get below 32% expense ratio all-in by end of the year? And the third quarter is on the derisking you announced at the Investor Day. I read with interest that you stopped basically the derisking of equities because of the rising stock market, I assume. And when I look at the waterfall chart you presented at the Investor Day, you assumed that this derisking would add equity, and hence be dilutive to our ease by 1 percentage point. So with basically equity $1.5 billion lower year-on-year, shouldn't that mean that you should see a much higher ROE coming out of all those work your doing?

A - George Quinn {BIO 15159240 <GO>}

Thank you, Thomas. So why don't I start with pricing? So if you look at the U.S. business, in particular, I mean there is growth but not in the commercial. Commercial is actually strong. In fact, the growth is going to be driven by a combination of, I guess, what we typically refer to as alternative or direct market. So that tends to be crop, this newly acquired business, and the F&I business that we have. And we think that from a pricing dynamic, that market today is quite different from the rest of commercial. So that explains how we have managed to defy the rate change. On expenses, I mean, we've said over the program, I mean, you know from us what we intend to do. You know what the ambition that we have for this year is. I mean, if we campaign that with what we expect from a top line perspective, as I explained to the guys earlier, I mean, it's not so difficult to work out where we expect it to go, and we'd expect it to go down.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yes. But how much, I mean, below 32%, you're confident?

A - George Quinn {BIO 15159240 <GO>}

So I mean, take the 400 (28:55) to make a reasonable estimate of how much that falls into GI, and superimpose it on the impact (29:01) you can work the number out. On the de-risking, I mean, de-risking was still – because essentially, we've done the de-risking that we have planned to do. I think, the issue around equity is, I mean, less equity impacts, but I mean, we do have some interest rate impact in the quarter. And that would vary over the course of the next two years as we move towards the end of the planning period. So I think, for the time being, I would stick to the guidance that we gave you back in November. I mean, there will be some volatility because of interest rates between now and then.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah. But clearly, with $1.5 billion lower equity than assumed at this point in time, this makes the achievement of the 12% or 13%, whatever the number is, much easier now.

A - George Quinn {BIO 15159240 <GO>}

So I mean, if everything ended today, and we've achieved all the targets and equity what I stated, you're absolutely right. We would exceed the targets that we laid out in November.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah. All right. Thanks, George.

Operator

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

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

Good afternoon. Question from me on the Life side. So a large part of the Z-ECM capital required is attributed through the regional Life businesses. And quite a few of them have quite low ROEs in the past, that was talked about around 6% or below. Could you talk about what actions you're planning to take on the Life side, and whether you're potentially interested to exit certain regional Life businesses? And then second question is on the capitalization, just referring to the first question on the call. If I understand it well, so you would be quite happy to remain overcapitalized for a longer period of time, is that right, or could you maybe comment on the excess capital and your potential plans for that? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Thanks, Nadine. So you're absolutely right. The impact of the capital that's allocated, or in fact the capital requirement or the capital required by some of the more traditional, and particularly European Life businesses and the return, I mean we have talked in the past that that's not an outcome that we're particularly happy with. The challenge is really to do something significant about it. I mean, we've all talked about, I mean, certainly one of the key markets that drives this. And unfortunately today the availability of a market solution is not obvious. I think, if the market did offer us ways to reallocate capital within the existing business, and maybe take capital away from some of the bad books (31:56) which are typically the areas where most of the challenge comes from Life, then we would certainly be prepared to explore it. And in fact, I mean, you remember a couple years ago we did the transaction in the UK around the annuities. So we certainly have a appetite to do that.

Having said that though, I mean, we're not looking for a retail exit of any of our key markets in Europe. I mean, as you know, from the reorganization that we did last year, we've reorganized in a more customer-oriented fashion. And we are hoping that from a new business perspective that starts to pay dividends as that organization starts to take hold. So I don't want to leave anyway with the impression that capital management around the bad book (32:37) has any necessary implications for the our new business flow. On the overcapitalized point, I mean, I wasn't trying to give any indication that there (32:51) for several quarters. I was simply saying that, I mean, as of today, I mean, we are obviously well-capitalized, and the priority remains improving the operating earnings and using that to drive the ordinary dividend. I mean, where we stand on capital policy before, I mean, we'll act accordingly, as you would expect us to. But, I mean this is Q1, we have a long way to go through the year before we make any judgments. But again, the focus is operating earnings and ordinary dividend.

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

All right. And just when you talk about where it's heading out, where you stand on capital before, do you mean the 100% to 120% optimal rent?

A - George Quinn {BIO 15159240 <GO>}

Correct. So we have no change on our target capital rent.

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

Right. And then maybe a quick follow-up question. Sorry.

A - George Quinn {BIO 15159240 <GO>}

It's okay.

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

The overall combined ratio, we've talked a lot about expense ratio and loss ratio on this call, but just (33:57) on the overall combined ratio. Can you give some kind of guidance there, where you expect that to go over time?

A - George Quinn {BIO 15159240 <GO>}

Yes. Thanks. So there, I mean, given what I said to Andrew earlier, I don't repeat what I said at the year-end, except, at this stage, our view and in fact, our plan is to achieve an outcome consistent with what I said then, which was we judged the underlying last year to be around the 99% mark, and we were looking for somewhere around a 1.5-point improvement in the combined ratio, and that's still the goal for this year.

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

Excellent. Thank you very much.

Operator

The next question is from Ralph Hebgen from KBW. Please go ahead.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Yeah. Hi, guys. Ralph Hebgen from KBW. Just one question on the loss ratio development. If I look at the regional split, you have now got a new segment called North America. And in there, the accident year loss ratio improved very nicely from 71% or so in 1Q 2016 to now much lower 67.5%. Now, my question is, would you be able to comment on the underlying dynamics to split it up a little bit into the dynamics in commercial and in corporate?

Because if I understand this rightly, then the North America region now combined, were used to be North America commercial and global corporate. And to the extent that this interpretation is correct, will be interesting if you could make some observations of how the loss ratio improvement relates to the dynamics in commercial business and in corporate business.

A - George Quinn {BIO 15159240 <GO>}

So I'm going to apologize in advance, Ralph. I'm not really able to do that.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Okay.

A - George Quinn {BIO 15159240 <GO>}

I mean, what we're trying to do with Gem (35:58) is to refocus the way we look at – I mean, because we have a new organization, I mean, to look at commercial has a different way to do. I mean, I don't think the dynamics today would be vastly different from the ones you've seen recently. So I mean, the issues that I referred to at the top of the call, I mean, it still exist and still need to be managed. I think if you look at North America overall, and what you do see is that, I mean, commercial still clearly has challenges in what's a pretty tough market. I mean, the other markets in which we operate in the U.S., I mean, they're in pretty good condition and are pretty strong. So I mean, the combination overall is actually doing reasonably well for us. And if we can do more to improve what we see on the commercial side, I mean, that would be a good outcome for the firm overall, and that's what we're aiming to try and do.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Okay. That's fair. Thank you.

Operator

The next question is from Andy Hughes from Macquarie. Please go ahead.

Q - Andy Hughes {BIO 15036395 <GO>}

Hi, guys. Sorry about the cold. Can I come back to slide 11 for quick question, again. I think Thomas asked you, why is the 1% so high. It's a bit right. These numbers have been re-sorted to include the global corporate business. Basically, that global corporate business, obviously, have much higher price rises because of the fact that you're bringing down that book. Has that now stopped? Because these numbers look pretty much the same as they did without global corporate before. And I'm also a bit confused as to how the commercial kind of combined ratio, other than the expense, may get much better from here, because your kind of 1% price rise on North America doesn't seem to really get me to a dramatic improvement in the commercial business. And on the retail business, obviously, the combined ratio at Ogden is very low. Is that the kind of level you would expect, going forward, 91%? Do you think that's a sustainable retail margin? Thanks.

A - George Quinn {BIO 15159240 <GO>}

Sorry about your cold, Andy.

Q - Andy Hughes {BIO 15036395 <GO>}

It's all right.

A - George Quinn {BIO 15159240 <GO>}

You sounded a bit miserable. On the rate increase, I mean, if you look at the individual regions, I think – well, I mean, I don't think, I know from what we can see come through. I mean, the North American market is the toughest. I mean, if you look at the dynamics, I mean, even if we've seen an improvement around, for example, commercial auto, the trends that we saw, for example, on workers' comp last year continue, and we still see, I mean, a negative rate around that market. So I mean, in North America overall, there's still more work to be done. The team are completely focused on it. If you look at the portfolio combination, I think we can always be happier, but the overall outcome for North America, I think, is a decent one for the quarter, and the aim is to look at how we allocate capital within commercial, and try and adjust that so we can take a bit more (38:56) stronger.

I think you also know from us that there's a broader topic as well around some of the risk factors in the North American business, and that's also something that we continue to focus on and target as a key activity for this year, which is to reduce some of the exposure that we have to some of the longer-tail lines of business. As far as, I mean, what would we expect from retail, I mean, I want to avoid, say, differentiated targets for different businesses, and I'd only refer you to the guidance I gave earlier. I mean, the overall goal here would be to achieve that 1.5 points of improvement over the underlying 99% that we saw for last year.

Q - Andy Hughes {BIO 15036395 <GO>}

I guess, a bit I'm struggling with is, if the price rises aren't coming through in commercial, especially compared to North America, and you're aiming to move away from long-term lines towards short-term lines, which you've talked about before, that would suggest a decline in the commercial premiums, but you're guiding to flat premiums overall. So basically, what's happening the commercial business is shrinking, and retail business is growing. Is that where the key driver of the improvement this year?

A - George Quinn {BIO 15159240 <GO>}

So the key driver of improvement last year, and part of what flows into this year is exactly that. So of course, we've reduced the capital we allocate to commercial, particularly in some markets where the performance has been weak. And you've seen us emphasize some of the things we've done more recently, things like mass consumer because it provides a bit more stability to the overall book. I mean, the extent in which we can do that depends on the opportunity that the market offers overall. Maybe just one thing on commercial versus corporate, I mean, Richard was just pointing out to me that, I mean, if you look at historical pattern, those two businesses have been moving about the same rate, recently. So I mean, I'm not sure that's an issue in the overall. So in the overall question, where do we expect to see it come from, I mean, we expect to see some improvement in commercial. I mean, where we are at the moment is not a level that we're happy with. I mean, Jim conducted his review of the business when he came on board last year. I mean, he has views of how he will shift the capital allocation, and now expect as we go through the year to see improvements in commercial.

Q - Andy Hughes {BIO 15036395 <GO>}

Can I ask you a quick follow up on the capital, because, obviously, the ratings position is driven by the operating performance of the group. And the operating performance is still not where you want it to be really, is what you're saying. Is that one of the reasons why you potentially have a more conservative capital policy or you're kind of waiting for things to improve on the operating performance level before you look at the capital?

A - George Quinn {BIO 15159240 <GO>}

I would say, that must be the most creative way to ask the capital question, guys do we have too much. I mean, you can see the numbers that we have externally. If I look at all the key capital metrics, I mean, we are not constrained on any of them currently. So there's nothing in this – the emphasis that I'm trying to give, that the capital number we're reporting is at the end of Q1, we can't buy it later in the year, we can reevaluate it. I mean, it's just not a key theme for us to do, and it's not because of some of the weakness elsewhere in the portfolio, I mean, we're in a strong capital position, it's a good place to be. But the priority remains operating earnings and what that can do for the dividend.

Q - Andy Hughes {BIO 15036395 <GO>}

Okay. Thanks so much.

A - George Quinn {BIO 15159240 <GO>}

Thank you. Hope you get better.

Q - Andy Hughes {BIO 15036395 <GO>}

(42:27).

Operator

The next question is from Nick Holmes from Société Générale. Please go ahead.

Q - Nick Holmes {BIO 3387435 <GO>}

Hi there. Thanks. Just one question. Sorry, coming back yet again to U.S. commercial, wondered what's your view of where we are in the cycle. We seem to be getting some mixed signals from the markets. I'm thinking market scout seems to be saying pricing is better than expected. What's your view? Thanks very much.

A - George Quinn {BIO 15159240 <GO>}

Thanks, Nick. I mean, look at the numbers, I mean, how have things changed from what we saw last year. I mean, property is more stable. And if you look at the numbers, maybe even has a very small increase in property, which is a trend that we hadn't anticipated. I think, I'd like to see more of that before you really concluded at something radical taking place there. And the broader liability book, commercial auto, again, as I said earlier, is the one that's showing the most strong improvement, but again off of a very weak base. And workers' comp is the one that has some weakness, albeit off of what we would perceive as a very strong base. So I mean, again, difficult to draw conclusions based on the impact-adjusted quarter. But there are some changes in the general trend, albeit, when you add them up, I think, we end up back where we started.

Q - Nick Holmes {BIO 3387435 <GO>}

Right. Okay. That's very interesting. Thank you.

Operator

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

Q - Vinit Malhotra {BIO 16184491 <GO>}

Hey. Good afternoon. So I got a different topic now. So on Life, obviously we saw some very strong technical margins. And I'm just also looking at market expectation. I think there's definitely would have delivered in 1Q seem to be much stronger than the run rate we had in mind, or what consensus has in mind. Is there anything one-offish or – because I remember back in January or February, there was a bit of more caution on Life because of German ZZR. So if you could just guide a bit about this beat and what it means for the outlook. And second question, please, on the reserve comment, which was very interesting because what you implied, George, is that the rest of the year, we see obviously north of the 2%, say 2.2%, 2.3%, that kind of a level of one-off. And this is obviously a different position for Zurich from the past. Is this coming from workers' comp, as you mentioned in the statement, is there anything else to note is coming more from the corporate center reserves, and if this also meaning that, going forward, we could have more stronger or more reliable reserve releases? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Thanks, Vinit. So on Life, I mean, Life, as a business, not only for us, but I think for most – always has some impact of management action. I mean, our judgment of the quality of the performance in Q1 is the – I mean, the underlying quality has improved. I mean, there is some management or one-off impacts in the quarter. I mean, it's relatively modest, but I wouldn't change the prior gains that we've given around Life if we adjust for the move of Farmers New World Life. I mean, we'll see whether we can continue to the level we're seeing the strong performance through the year, but it was only some management action and the overall result. And if I adjust it back to the old structure we were familiar with, we'd end up around slightly above the guidance levels that we've given before for Life.

On the PYD, so the PYD comment I made earlier in reference to the Ogden's OpEx, I mean, it wasn't intended to be a comment. I'm going to prove it from here or there. It's simply a recognition that over the course of a 12-month period rather than a three-month period, and given the ratings that we have around PYD, I mean, we have a great ability to absorb items that impacts the year. So I mean, if I look at our reserving position, I mean we continue to be, on our opinion, well reserved. If you look at the first quarter, I mean, you see again something that you saw some times last year, but we've added to reserve strength in the corporate center. As that combination of factors gives me the confidence that over the course of the year, Ogden, as I said earlier, should be much less of a theme on the full year than it is in the result today. And in fact, I expect PYD including Ogden to be in that 1% to 2% range.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Thank you very much.

Operator

The next question is from Michael Huttner from JPMorgan. Please go ahead.

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

Fantastic. I just wanted to say that they're great numbers, but the disclosure is fantastic. Long may it last. I'm struggling for questions because you've been so good in the answers. But I think the 97.5% kind of implicit guidance, I assume now from what you've said that this includes Ogden. So this will be the published number. And on the UK, I know that the reserves for (47:00) have come down quite a bit. I was a bit surprised by that because I thought that the Ogden charge would actually affect that number. But, hey, I have no idea. And so I just wonder if you can talk a bit about that and (48:13) reserving risk. And then the last point you've made again on reserves, you said you added reserves strengthen the corporate centers. Your colleague, very, very kindly IR, for the full year helped me out, and I managed to work out the number was somewhere around $200 million or $250 million for last year. I just wondered if you could do the math for me for Q1. Thank you.

A - George Quinn {BIO 15159240 <GO>}

Okay. I never thought I'd hear Michael Huttner introduce a call saying he was stuck for a question.

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

Well, you're so good, I promise, compared to the standard of disclosures of the other groups, you're outstanding, and you continue to be loving, and it's wonderful. Thank you.

A - George Quinn {BIO 15159240 <GO>}

Thank you, Michael. So on the reserve basis, I don't know whether we made any significant moves. We need to come back to you on that. I mean, that sits within the team. It's been my responsibility. I mean, we haven't deliberately moved anything there. And if I mean, you're absolutely right. There's an impact from Ogden as a number. So I mean, let us come back to you on that topic. On the question around, I mean, what does the PYD comment mean for the combined ratio gains for the full year. So I'm not going to add anything to what I said earlier other than to say, I mean, you know what, improvement we're targeting, I mean, you have guidance around PYD, and again, I expect over the course of the full year that Ogden will be much less of an issue than it's been.

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

But given that you've given somewhat of a focus on Ogden now, is it right to kind of jump to the full year? I mean, is it right to understand that your comments on the full year on a reported basis, excluding the current, this kind of noisy focus on Ogden here?

A - George Quinn {BIO 15159240 <GO>}

I mean, to be completely blunt, I'm trying to avoid being very precise.

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

Okay.

A - George Quinn {BIO 15159240 <GO>}

That will get me in a great deal of trouble.

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

No worries. No worries. That's fine. Okay. I get that. No worries.

A - George Quinn {BIO 15159240 <GO>}

(50:08) means directionally.

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

Okay.

A - George Quinn {BIO 15159240 <GO>}

On the impact for group Re and the corporate center, I mean, it's a much smaller number than the total we took last year. I don't have the number on my head at the moment. We'll come back to you, Michael.

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

Okay. Perfect. Thank you very much.

Operator

The next question is on Dhruv Gahlaut from HSBC. Please go ahead.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Good afternoon, guys. Just two questions. Firstly, sticking with slide 11, it seems the rate increase stays around 2% or has stayed around 2% for the last couple of quarters, and the guidance around claim inflation was it's always been below. Are you still seeing improvement or help on the underlying loss ratio? Does that still hold true as in whereas claim inflation lie at this point? Secondly, on reinsurance, last year you had – you took a cover for large loss 300x300 (51:02). Has that changed much this year, and if so, what has actually happened there? Have you changed the retention there or anything? Thanks.

A - George Quinn {BIO 15159240 <GO>}

Thanks, Dhruv. So the claims inflation would be slightly more negative today. So I think I might have said in response to one of the earlier questions that we would see around 2%.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Right.

A - George Quinn {BIO 15159240 <GO>}

On the reinsurance, on the volatility protection that we've (51:29), there are some very small changes. So the attachment is very slightly lower but otherwise the cover remains unchanged.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Right. But it's still 300 x 300 (51:38)? Does it still remain?

A - George Quinn {BIO 15159240 <GO>}

That's a good assumption.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Yeah. All right. Perfect. Thanks.

Operator

The next question is from Johnny Vo from Goldman Sachs. Please go ahead. Mr. Vo, your line is open.

Q - Johnny Vo {BIO 5509843 <GO>}

All right. Thanks very much for taking questions. Just two quick questions. Just a clarification on what you said regarding the dividend and that you have a policy. But if you see something positive in the future, then you would potentially act on the dividend sooner. So can you just confirm that was the case. And then the second question was just on M&A. Zurich has been linked with numerous targets across the world from Australia. It's a very softer targets. I mean, is there particular target or part of business that you are looking for given the capital strength that you have?

A - George Quinn {BIO 15159240 <GO>}

Okay. So I think the easy classification to the first one is it's correct. So the policy is designed to take into account a forward-looking view and not simply a bi-polar (52:43) looking view of what's taking place. Although, of course, I mean, I think it's important to look at what we're doing in the moment, and I think the best evidence that we're on the right track is the results we just delivered.

Q - Johnny Vo {BIO 5509843 <GO>}

Yeah.

A - George Quinn {BIO 15159240 <GO>}

So I think for the combination that we currently have, both are very important. But the lowest gain element is forward-looking decision-making in the dividends that we see.

Q - Johnny Vo {BIO 5509843 <GO>}

Okay.

A - George Quinn {BIO 15159240 <GO>}

On the M&A topic, I mean, not much to add there to what we said before. So I mean, first of all the plan that we laid out from the Investor Day, it doesn't depend on M&A. So I mean, it's not the number one priority for us. It's the operating performance. And to the extent the M&A is relevant, I mean, Mario laid out at the presentation in November what the priorities would be, and that's around – I mean, if we do do it, we will look to strengthening existing market positions and avoid that broader mass market transformational-type transaction. So I mean, probably what it means is, to the extent we do do it, more of what you've seen from us already.

Q - Johnny Vo {BIO 5509843 <GO>}

Okay. Brilliant. Thanks.

Operator

There are no further questions at the moment.

A - George Quinn {BIO 15159240 <GO>}

Okay. Given that this is a busy day, the number of results, we'll wrap it up there with no other questions. Thank you very much, everybody, for dialing in today. If you do have any further questions, obviously please do not hesitate to contact the Investor Relations team. We thank you for your attention, and we'll speak to you in due course.

Operator

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