S1 2021 Earnings Call

Company Participants

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

Other Participants

- Andrew Ritchie, Analyst
- Anthony Young, Analyst
- Ashik Musaddi, Analyst
- Louise Miles, Analyst
- Michael Huttner, Analyst
- Peter Eliot, Analyst
- Thomas Fossard, Analyst
- Vinit Malhotra, Analyst
- Will Hardcastle, Analyst
- William Hawkins, Analyst

Presentation

Operator

Ladies and gentlemen, welcome to the Zurich Insurance Group Half Year Results 2021 Conference Call. I'm Sandra, 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. The presentation will be followed by a Q&A session. (Operator Instructions) The conference must not be recorded for publication or broadcast.

At this time, it's my pleasure to hand over to Mr. Richard Burden, Head of Investor Relations and Rating Agency Management. Please go ahead sir.

Richard Burden {BIO 1809244 <GO>}

Thank you. Good morning, good afternoon. Welcome to Zurich Insurance Group's first half 2021 results Q&A call. On the call today is our group CEO, Mario Greco; and our Group CFO, George Quinn. Before I hand over to Mario and George for some introductory remarks, just a reminder for the Q&A, we kindly ask you to keep to a maximum of two questions in the first round [ph], and if we got spare time at the end, we will come back to you.

So with that, Mario, over to you.

Mario Greco {BIO 1754408 <GO>}

Thank you, Richard, and good morning, good afternoon from myself, and let me just have some few remarks as an introduction and then we'll pass to Q&A. This morning, we published one of the strongest ever first half results for Zurich. Our earnings are back to pre-pandemic levels despite the continuing impact of the public health crisis and a very high level of natural catastrophes. This performance reflects the improvements made to the business since 2016 in terms of underwriting, simplifying our business and delivery for our customers. Our focus on customers is leading to higher levels of customer satisfaction and this drove the growth in customer numbers by approximately 600,000 in the first half and supported growth in revenue across all of our businesses. Since 2016, we have reshaped and improved our property and casualty portfolio. This is allowing us to take full advantage of growth opportunities within our commercial insurance business as price increases in terms and conditions for their improvement. Property and casualty gross written premiums grew an excellent 16% in the first half, while combined ratio fell to its lowest level in over 20 years, despite more than 6 points of natural catastrophe losses.

We expect pricing to remain strong through the remainder of 2021 and into 2022, and we are well placed to achieve further strong growth in margin expansion. Our consistent focus on protection and unit-linked life business continues to pays off and we have improved margins within the businesses through continued product development and selective repricing. These actions led to a 44% increase in life business operating profits to an all-time high-level.

Farmers Management Services saw a return to growth in the first half, driven by the improved growth at the Farmers Exchanges where expansion in the agency force and improved productivity supported growth. With the further strengthening of the Exchanges distributions through the completion of the acquisition of the MetLife Property and Casualty business, I'm confident of the growth outlook for the Farmers Business.

This year's extreme weather events, which have touched most parts of the world underscored the risk of climate change and the need for businesses to take immediate actions. Over the first half, we have continued to strengthen our own commitments to reduce CO2 emissions through new intermediate targets for both our own operations and investments. As part of these commitments, we are planning further actions to reduce emissions related to travel, vehicle fleets, foods -- food and real estate over the second half of this year, and we would publish news in the next three weeks about that.

The group simplification and strengthening of the business over recent years, together with our very strong balance sheet positions us well to continue to take advantage of opportunities to grow all of our businesses in earnings as economies emerge from the COVID-19 pandemic. I have great confidence in the strength of our business and the skills of our employees to maintain this momentum and to deliver on our goals. Thank you for listening, and we are now ready to take your Q&A.

Questions And Answers

Operator

We will now begin the question-and-answer session. (Operator Instructions) The first question comes from Louise Miles from Morgan Stanley. Please go ahead.

Q - Louise Miles {BIO 20765435 <GO>}

Hi. Thanks for taking my questions, and I'll stick to two. So my first question is on the P&C business and on the PYD. So for the Group, it was 2.5% in the first half. It's a bit higher than previous years and 4.8% in North America. I mean, can you give us a bit of commentary on the outlook for the second half? I mean, should the trends just continue and just the rationale for starting -- certainly to see it's high level in the first half of 2021?

And then looking at the SST, you just published 206%, just thinking about the SST ratio towards the second half of this year, I mean, presumably, it's going to hit somewhere close to 210% given the net capital generation or net dividend payment is probably going to be positive. So getting very close to that 210%, kind of, upper end of your range. I know you have a range, but that's probably equivalent to 120% on your Z-ECM. And I also note that debt leverage has spiked up a bit this year. I mean, if you have excess capital, are you going to kind of prioritize delevering or there other things that you'd like to see. Thanks.

A - George Quinn {BIO 15159240 <GO>}

Thanks, Louise. So on the PYD first, you're right. We are above the normal range that you'd expect to see from us in the first half of the year, it's driven by the US. And if I -- I mean, if you look across the business, I'd say the pressure in the first half of the year was certainly upwards. I think, given the strength of PYD in the first half, I'd be surprised if we were fully within the range for the full year, but I expect at this point at least for the second half we'll be back in the 1% to 2% range. We do have regular workers' comp review coming up in the third quarter. So I don't yet know what that's going to show us. But certainly at this stage, I'm thinking that one to two in the second half with potentially PYD for the full year slightly above the normal guided range.

On SST, I'm going to resist the temptation to create an upper bound around it, because we tried really hard to get rid of that last year. I think, from a capital perspective, we're obviously in a good place. We've had a significant move up through a combination of the market changes and the impact of operating capital generation in the first half. I think, you're right. You would expect to see that rise in the second half of the year.

So I mean, what would be the priorities? I mean, I think at this stage, I mean, the past is a very good gauge to the future. I think, if you look at the various leverage metrics, I mean, we are pretty green on almost all of them apart from the tangible debt leverage metric. I mean, we're not going to lose sight of that, but it's not the -- I mean, it's not certainly that's causing us any significant concern. So I mean, I think from our perspective, I mean, we remain able to take a look at things that out there. If we think they're advantageous for strategy and would help in financial performance, but as always, the targets and the plans don't depend on this, but it's nice to have the flexibility to be able to explore do come up.

Q - Louise Miles {BIO 20765435 <GO>}

Very helpful. Thanks.

A - George Quinn {BIO 15159240 <GO>}

Thank you.

Operator

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

Q - Peter Eliot {BIO 7556214 <GO>}

Thank you very much. The first one, I mean, after the great results today on an underlying basis, you've basically already reached your 15% ROE that you were hoping for, sort of, thinking indicatively you might not achieve by next year. So I was just wondering if you could tell us what you think if anything is still to come from that ROE walk that you showed us? I mean, I guess, I'd be especially interested in where we are in the buckets of portfolio, quality and capital allocation, which you'd hoped would add 2.5 points combined. So that's the first question.

Second one, the P&C investment income, you were saying 50 million per annum decline. Now you're saying 100 million for '21, just wondering what's happened to make this, sort of, fall faster than expected? And whether we should expect that it to continue falling at that rate? Any clarity there would be great. Thank you very much.

A - George Quinn {BIO 15159240 <GO>}

Peter, thanks. So on the first one. One of the media asked me about that topic this morning and they gave me flashbacks to November 2019, but I don't think anyone in the room was concluding that the targets were easy to achieve. I think you need to look at them all together. So, I mean, the delivery of the ROE target is something that's extremely important. I think, we've made great progress on that. As you point out, I'll come back to this in a second. There are some things we want to do around capital allocation that continues to be important to us, but we also need to take care of the cash target, we need to take care of the earnings target. So I mean, all of these things are priorities for us.

When it comes to management of the capital, obviously, the bank book topic is high on the list of priorities. I mean, I'm probably not going to say too much about it today, because I think it's better to wait until we've actually done something and then we can talk about. I think what that means and the benefits that brings us. But I think in the same way that you've seen us be disciplined around capital allocation in the past. We will do that in the future and we have particular interest on the bank book side of things.

On the investment income guidance, I think, in the past, we certainly indicated a range. I think, I've also talked about the fact that, I mean, you need to take the duration of the book into account. If you look at the gap that we have between book yield and reinvestment yield that would imply something -- I mean, maybe not quite 100%, it's something pretty close to it based on what we see currently. And I guess, I mean, what changes -- I mean that gap between the book and reinvestment yield changes in both directions, I mean, fairly frequently and we update to give you a sense of what it currently looks like. So I can't tell you this is fixed here, because of course it is partly dependent on the future track of interest rates, we've seen from today -- with today's gap, the upper end of that range is the more likely outcome.

Q - Peter Eliot {BIO 7556214 <GO>}

Okay. Thank you very much.

A - George Quinn {BIO 15159240 <GO>}

Thank you.

Operator

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

Q - William Hawkins {BIO 1822411 <GO>}

Hello. Thank you for taking my questions. George, on Slide 20, the Asia-Pacific Life BOP is still bouncing around quite a lot. I'm trying to figure out, kind of, what you consider normal. And then, when we're thinking about the future, what -- any incremental impact of OnePath, may or may not still be taking account, presumably with two integration costs, but still have more to go on the synergies. So if you just help me understand a bit about what's kind of normal and the outlook for the Asia-Pacific Life BOP?

And then secondly please, when you're talking about the north of 4 billion cash remittance hoped for on Slide 9. If we're thinking about the incremental increase in that relative to what you achieved last year, the 3.4 billion, should we be assuming pretty much all of the incremental increases coming from non-life or are there material moving parts in Life, Farmers or the group center? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Yeah. Thanks, Will. So on the first one on APAC Life BOP. I mean, I think what you've seen this year is a big rebound in Australia. So that's obviously driven by the acquisition. I wish I could tell you the integration was over, it's not quite over yet. It should be over by the end of this year. And just to bring to mental expectation, I mean, given what the team are telling us, I mean, we're -- we're not quite at the business case that we presented back at the end of 2017 when we announced the transaction. So I think, I'm still optimistic that we see a bit more from where we are today. So I think there is room for Australia to improve further. Obviously big driver of the benefit has been the recent repricing. We think there's also some product redesign to come in the market in Australia which will actually dampen some of that volatility that's been a challenge in the market in the past. And the end of this year should see more or less the end of the integration cost side of it and the full benefit of the synergies that we have planned for the transaction.

On the cash remittance topic, so as all P&C -- short answer is definitely no, because I think if you think of what drives this, I mean, obviously, a big chunk of its earnings for this year, where some of it is going to be catch up for what's happened in the prior year, because of course what we've had at the very start of this year is really still impacted by the -- impact of COVID on earnings, and in some cases, on balance sheets.

And if you look at what we did last year, I mean, even though we had a very significant cash generation, I mean, there were one or two regulators who were still encouraging businesses to wait. And while it wasn't that material for us overall, those tend to be more Life-oriented than P&C. So I think you'll see, we've bounced back from Life as well, but obviously the strength of P&C earnings is going to be a significant driver.

Q - William Hawkins {BIO 1822411 <GO>}

That's very helpful. Thank you, George.

A - George Quinn {BIO 15159240 <GO>}

Thank you.

Operator

The next question comes from Michael Huttner from Berenberg. Please go ahead.

Q - Michael Huttner {BIO 21454754 <GO>}

Fantastic. It sounds like in relation with COVID, the results are good. And I have -- so the -- I have two questions. One is, is there more and here it sounds mysterious, it's not mysterious when you sell insurance policies, the premiums booked over year, so the -- effectively there is a lag benefit to price increases. So I just wondered if you could give us a figure of how much we could add for the lag to the figures you've published today?

And then the other figure -- the figures which would be interesting, I think, it's on Slide 6. So it's -- you sold some mysterious ones [ph] and I was just wondering whether you could give us the numbers effectively the inflation cost which you're seeing? Thank you very much.

A - George Quinn {BIO 15159240 <GO>}

Yeah. Thanks, Michael. So on the first one, I'm trying to avoid to give forecasts because Mario will remember them and hold me. I can't tell you, he will.

Q - Michael Huttner {BIO 21454754 <GO>}

I guess if he is happy with the results he is not listening.

A - Mario Greco {BIO 1754408 <GO>}

I mean, the point that you make there Michael is absolutely valid.

So they clearly as -- I mean, I think, there is two things to bear in mind. So I mean, there is -- I think, we all have an expectation that pricing will continue to benefit earnings from where we are now. There is not only a lag benefit from the price increases that we've seen. If you look at price trends in the market, I mean, it looks as though the trajectory in the commercial market is going to be pretty gentle. I mean, I think in the second half of the year, I'd be surprised if it was strong as it was in the first half. I'm already surprised that it was strong in the first half because it wasn't in the second half of last year, but you will see further benefits from P&C. So all things being equal, which is the claims experience, would expect to see further improvement in the underwriting margin for P&C.

On Slide 6, so there's two ways you can do this, because the IR team actually uses a spreadsheet. So the -- I think the thing is the scale, but that's a bit unhelpful. We are seeing a loss cost inflation around the same level as the end of last year, somewhere -- I mean, around the 5 mark, maybe just slightly above. Some of the drivers to what we've seen before, so no real change. And I mean, there's not a lot of new information in the market. I mean, we've seen some of these larger settlements that have been announced around opioids and the Boy Scouts topic. But on the broader social inflation topic, the courts are just starting to reopen. So it's still too early to get a read on trajectory. But I mean, given, what we've seen in the past, I mean, we feel pretty comfortable with the overall inflation assumption, but somewhere in that 5, 5.5 type range.

Q - Michael Huttner {BIO 21454754 <GO>}

Brilliant. Thank you very much.

Operator

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

Q - Andrew Ritchie {BIO 18731996 <GO>}

Hi there. Two questions please. First of all, George, are you encouraging us on the Life business to basically take the BOP reported adjusted for the 50 million positive one-offs but add back COVID losses and that's new run rate for Life. I mean, the problem is, the Life business has a lot of variables in recent years, acquisitions, a lot of FX noise and COVID. I just wonder if maybe there is noise as well because the underlying is overstated slightly, because the COVID is overstated, because there is allocation issues there. So what -- I guess, can you give us any guidance as to what you think the kind of right run rate is for Life now? And has there been a step up and is that just sort of more normal markets that's driving that?

The second question, Farmers, what tools and what are the protections in place for the surplus ratio in the second half of the year? Becase surplus ratio have ticked down more than I expected. I thought you -- I thought Farmers had bought MetLife below book. So I thought would be a gain there. So are there any remaining tools to use for that surplus ratio and what are the cat protections, remind us about those, should there be active -- an active season in the second half? Thanks.

A - George Quinn {BIO 15159240 <GO>}

Great. So on the first one, so I think the -- if you look at what's changed over the prior year, I think the most obvious standard feature is the topic I covered earlier with Will. So I mean, we've -- we've managed to get the Australian business, and I say we -- I'm talking about our CEO and the team in Australia, because it's (inaudible) do that. I mean, they've managed to get this back more or less on track. So I think in terms of -- I mean, what's sustainable and durable, that changed is not something I expect to see reverse anytime soon.

The issue around COVID mortality versus excess mortality generally, I mean, we've certainly seen that in the Farmers book, which I guess is not really relevant to the Life guidance, but the point is, so for example, if you look at the performance from a mortality perspective, Q1 is really heavy for excess death claims driven by COVID. They still have excess death claims in Q2. But they actually have superior mortality overall. And so, I think, there is some of this that you need to be a wee bit careful in terms of the temporary impacts.

But having said that, I mean, if I was looking at it, I would do this, I will certainly adjust for the topic that was discussed on the call this morning in Europe. I think, if I chat to the Australians, they don't add back everything that we've seen from the Australian improvements in the first half. So they're assuming that some of the claim experience is temporary. But as I mentioned also to Will I think we'll also see further improvement from them through the second half of this year into next. I mean, overall, from a run rate perspective, I think we're probably slightly better than the 10% above guidance that we gave compared to the numbers for last year. But I mean, I agree that we're going to be a wee bit careful around some of the mortality benefit we see in some of the markets more recently.

On the Exchanges, so I'm going to make a caveat to begin with. I'm not the CFO of the Farmers Exchanges. So, I mean, obviously I have a very keen interest of these topics in the same way that you do. But I'm going to be careful about how much information I get into, because that's really a topic for them rather than for us given they're an independent organization.

And on the surplus, so why might the surplus be a bit lower than perhaps an external observer would have expected. They have ended up deciding to place less reinsurance. So if you think if -- I mean, how that transaction has worked for them, I mean, I think what you described in terms of the acquisition of something at a discount is true, but they certainly had intended earlier to increase the core share by more than they have in the end. And I think that's driven by the feeling that they -- maybe they have more reinsurance protection than they feel they need. And I guess, part of that will be driven, if you look at the historical reference points for surplus ratio for Farmers, it's not quite as high as it's been in the last 18 months, but it's been a lot lower and the second, it ended up well.

From a reinsurance structural protection perspective, they still have in place the structure that has protected them very effectively over the course of the last couple of years, in particular, dealing with wildfires, and there is no significant change to how that operates compared to the past. So I know -- I know we're talking to the team at Farmers on the exchange side, and I mean, they feel comfortable with their capital levels and don't feel that it's a topic of particular constraint for them.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Okay. Thanks.

Operator

The next question comes from Will Hardcastle from UBS. Please go ahead.

Q - Will Hardcastle {BIO 16346311 <GO>}

Good afternoon everyone. Looking back to Slide 6, if that's okay, and thinking about commercial in North America specific. If you would carve out North America Commercial standalone, is it possible to give us a broad idea of the extent of underlying improvement year-on-year on margin or half on half? And is this trend accelerating or slowing down, given, I guess, what Michael was saying about the not immediate recognition of the price and the spreads are narrow to few points, presumably we should be expecting a similar level of improvement over the next 12 months given the pricing trajectory discussed?

And then the second one is on expense ratio. I guess, if you can give us an idea of how much of this improvement is sustainable? To what extent is their operational leverage at play and how much is perhaps one-off fee if traveling will start revert back to some form of normality? Thanks.

A - George Quinn {BIO 15159240 <GO>}

Thanks, Will. So maybe if I reverse the order, not the questions, but the point you made on ZNA, I think it would be -- I mean, rather than going back to Michael's point about the lag effect of the price rises that we've seen, I think to assume that pricing continues with the same spread over loss cost inflation that we see in the first half is -- I mean, I think it's a touch too aggressive for me. So I think as we go through planning this summer, I mean, I expect to see -- I don't expect to see a significant drop in what we expect to see in the commercial pricing dynamic, but I don't expect it to be quite the same as we've seen in the past. So we wouldn't be planning for that. So you would anticipate seeing year-on-year improvement, but not quite at the same pace as we've seen in the first half of this year.

In terms of quantum, I mean, if you look at the covered business that that commercial rate indicator, I was talking about it is about half of ZNA's book, maybe slightly less around that type of level. And I think using that and assuming that it can earn then fully over about an 18 month period, that's a pretty good guide, I would model the margin expansion that we see between price and loss cost trend.

On operational leverage, so -- I mean, again it's a good point. So obviously part of what we've benefited from -- over the course of the last 12, 18 months is maybe a slightly lower expense base than you'd anticipate to be sustainable. But Mario did make the point in his intro to the call. I mean, there are some aspects of what we do, I mean, seeing this from -- especially from this week with the IPCC report earlier in the week, there are elements with the operating model change and may get expenses. I mean, just from a sustainability perspective, we want to see change. And in fact, we were communicating that last night to our leadership team.

So I mean, I do expect some of this comes back, but I'm not convinced it's particularly material. And in fact, the concept that we typically discuss with the businesses and planning, we have internal per se for gross credit, and basically to the extent that businesses can present credible plans around growth, we will allow them to grow expenses, not at the same rate as top line, but certainly the level required to make sure that clients are looked after as we would expect them to be looked after. So I think there is a bit of operational leverage. So you will see some bounce back but I don't think it's that significant in the context of the overall group.

Q - Will Hardcastle {BIO 16346311 <GO>}

Brilliant. Thanks.

Operator

The next question comes from Anthony Young from RBC CM. Please go ahead.

Q - Anthony Young {BIO 18948322 <GO>}

Hi, thank you. Just one question actually on the Life book. So I see your plan is to focus more on capital-light and protection businesses. Could you give some color on what's your plan on the corporate savings and savings annuity please in the future, because I think Slide 22 seems that the NBV for these two business lines are low? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Yes. Thanks Anthony. So I mean -- I mean we prefer protection that includes the corporate market. I mean, we are a -- we're a significant player in corporate and we're trying to leverage the relationship we have through the -- I mean, the large commercial P&C business that we have to get good access to organizations and we can for a corporate risk protection. It tends to be a more competitive market, though. I mean the -- I mean the distribution mechanism tends to mean that see the pricing is quite keen, but seen from a Zurich perspective, I mean, these tend to come in at large -- I mean, obviously, large total amounts. We don't have quite the same overhead that you'd have, say, for example, in a retail business, which I guess is pretty obvious.

So for us, the -- I mean, the -- we refer to as corporate life and pensions. It's the protection and the savings component -- point to the year two component or second is something that area of interest for us. So we are looking to grow that, but you are right. The margins are not as strong as we see in other parts of the book, but that's not a key concern for us.

On the annuity topic, annuity is not a preferred risk for us. So the -- the asset risk that comes with annuities and then annuitization auctions is not something that sits well within our capital model. I mean, we tend to either avoid it or look for other ways to offer our clients the ability to seek annuities with third-parties. So the annuity side of the risk profile is not an area of particular focus for us.

Q - Anthony Young {BIO 18948322 <GO>}

Thank you.

Operator

The next question comes from Ashik Musaddi from JP Morgan. Please go ahead.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Yeah. Thank you and good afternoon. George and Mario, just a couple of questions I have. First of all, on cat losses. I mean, yeah, we have been seeing the cat losses for most of the insurers and reinsurers have been pretty high for last three, four years and we are seeing the same again for the first half as well. Since we had one point did mention that companies need to be mindful of increasing cat losses and don't know what it was intended for, was it for primary, was it for themselves, who knows but clearly, there is some evidence about climate change et cetera. So I mean, how do you think about your 3% budget for cat losses. Do you think that needs to be higher and some of the prices increased could basically help support you move that number higher before impacting any profitability? So that's the first one.

And secondly, I mean, I just go back to the previous question around annuities. I mean, yes, you've made it very clear. Annuities is not really a preferred business. I mean -- but how would you think about your UK Life business overall? I mean, is that something you would continue to maintain which would include other parts as well, just not annuity? So how would you flag that? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Great. So on the cat topic first. I think, just one point. So when we updated guidance at the beginning of this year, we raised the cat loads to be 3.5%, just for everyone's benefit. And I mean I think it's a tricky topic, because on one hand, I mean these are clearly annual contracts. So they were not taken long-term bets on the risk that climate continues to drive significant increases in cat claims and cat losses. I think, at the same time though, I mean, obviously, natural catastrophe business is a very hard business to judge on any short-term period. So you need to be careful with the capacity that you deploy.

That's why it's important to try and speak relatively consistent around the proportion of risk that we carry that's related to cat that we don't try and expand into a market that we perceive has been particularly profitable because of the volatility that brings us. So I think consistency is going to be the most important topic for us here. I mean, we do look at it pretty carefully if I -- earlier this week. Kristof, the North American business, his team were talking to me, and Sierra, who is the Head of Commercial about our stance around particularly cat risks over the course of the next couple of years. So I mean, I think, we have views on how we can optimize this into the future, but it is a hard business to take a significant directional bet on it because of the volatility. I mean, I think that's really something best left for the reinsurance.

On the annuity, actually we like the UK Life market. The team there are very focused on protection products. We've had a new product in the market for about 24 months now. They have quite a bit of success in selling it. And the annuitization of -- annuity part of the business in the UK, I mean, we've been pretty successful at reinsuring that en bloc as we go. So the UK team has managed over time to keep any exposure that the business brings from annuity perspective actually quite low. So annuities is not an issue in the UK in Life market. It is the one that we like, and continue looking for further growth there.

Q - Ashik Musaddi {BIO 15847584 <GO>}

That's very clear. Thank you. Thanks a lot.

Operator

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

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes, good afternoon, George and Mario, and everybody else. Just -- so the first topic is from my side on frequency benefits of COVID. So I can see from some of the notes like 1.2 points has benefit -- has been the benefit in 1H giving us 58.3 attritional loss ratio. Would you be doing -- just adding it back in and then trying to work out the whole spread between pricing and claims inflation which you talked about or would you say that in the new COVID, post-COVID world, you're going to continue to have some benefits? Just curious to hear your thoughts on frequency claims and benefits.

Second topic is just a clarification, I seen from media -- I think from a media conference about your comment on German floods, $150 million to $200 million, maybe euros. But what I don't -- I'm trying to understand is that the 5% outlook today for the full year net cat seems to imply that too likely is being perceived as a 3.5% kind of normal (inaudible) or is that the correct reading or are you expecting significant reinsurance recovery from German floods? Any clarification would be helpful. Thank you.

A - George Quinn {BIO 15159240 <GO>}

Yeah, thanks, Vinit. So on the frequency topic, I must say, I don't have a really good answer for you immediately. I need to go and ask someone closer to the underwriting on that topic. So if you allow me, I'll get Richard and the team to come back to you on that. I mean, it feels natural -- it feels reasonable to me that there must be some impact on how we approach it. I don't know off the top of my head on that one. So if you allow us, we will come back.

On German floods, $150 million, $200 million is the number. And you're absolutely right that the guidance we've given around cat for the second half is not that we're indubitably optimistic that we're going to see a very benign second half of the year. But just given the way the reinsurance program is structured, I mean, that does provide us with some measure of protection. And therefore, that's what drives outlook for the second half. I think, if we'd had a quieter first half, we would be giving you a slightly different perspective on the second half of the year.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Thank you, George.

Operator

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

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes, good afternoon. Two questions on the P&C side. The first one would be related to -- maybe to complement the question from Michael and Will, can you talk a bit of your economic combined ratio? I mean, actually, you reported this morning quite nice improvement in the reported combined ratio, but what about the economic combined ratio? And also because you're pointing in your comments to a higher reserving situation -- a better reserving situation at the end of H1. So looks like potentially you may have moved again the loss pick. So any information on this will be of interest.

The second element would be on the 8% P&C growth in retail, it looks like, I mean, pricing is still around zero. So I mean, could you be a bit a clear on where the growth is coming from and what is driving this? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Yeah. Thanks, Thomas. So on the first point, the economic combined ratio, I guess, we all have to agree on what economic combined ratio meant, but I mean, I assume it's on the time value of money mainly rather than the capital challenges. And I guess, the key issue being -- I mean, given the comments earlier about the impact of interest rates, some of that movement and the combined ratio is actually required to maintain earnings. But I guess, you can see the impact of the improvement in technical underwriting profit completely overwhelms the impact of interest rates even if you model it forward for the entire duration and the entire turnover of the portfolio. So I mean, I don't have a number I can give you for the economic combined ratio. I guess, the good news is, when interest rates are this low, there won't be that much difference between an economic combined ratio and the actual one that we're currently printing.

You mentioned within that, I mean, some -- you raised the issue of loss picks. So I mean, I don't think we've changed the philosophy in the first half of the year. So I mean, we've tried to be pretty consistent. So the loss cost trend I mentioned earlier is pretty much in the same area that we had for last year. So that means we're carrying the same assumptions through -- into these loss picks for inflation as we start 2021.

I think if anything the -- I mean, the very recent experience on the more recent years is probably slightly better as we ended 2021 than we would have assumed a year earlier. Good liability from that given that that takes some time to develop, but at least the early signs around the reserving at the end of 2020 would give immediate impression that things are actually stronger than we would have assumed a year earlier.

On the retail side of things, so -- I mean, we do have pretty strong growth in retail. I think that's probably the most surprising things for me. I think we -- well, certainly I had anticipated that retail might be under more pressure than it has transpired. I think because of the way the particular market positions that we have that we're not -- we're not so concentrated in some of the ultra-competitive parts of the market where maybe some of the frequency change.

And the point that Vinit mentioned earlier have started to feedback into pricing. If you look at our retail markets, I mean, we've seen pretty good growth, everywhere perhaps with the exception of the Zurich business in Latin America where because of the -- I guess, the later incidents of COVID, they've had more restrictions. So for example, the mass consumer business in Brazil has had a pretty tough first half 2021. But the retail business has gone well and it's going well pretty much across the board.

Operator

(Operator Instructions) The next question is a follow-up question from Mr. Andrew Ritchie from Autonomous. Please go ahead.

Q - Andrew Ritchie {BIO 18731996 <GO>}

So, hi there. Sorry to return to topic of reserves. I can see there has been some holding back of the divisional PYD Group center, but I'm more interested in just sort of in North America, I remember, George last year, you strengthened some of the casualty years, including recent years, against sort of reinvesting some of the work comp releases. Has that continued in the first half? I'm just trying to understand if you're still -- you're still holding loss picked up in some of those casualty classes given there's really a lack of data on claims for the last 12 to 18 months. So that's the first question.

Second question, you acquired a financial advisor business in Italy recently. This is your first, sort of, forum to -- that was a slightly surprising acquisition. Maybe just outline what the rationale was behind that deal? Thanks.

A - George Quinn {BIO 15159240 <GO>}

Yeah. Thanks, Andrew. At least, we have your name the right way, right. On the reserves, so what to say on those. So the -- for the current year, I mean, they are no particularly different from what you've seen in the prior year, but we did go back and address some older year issues that you can associate with some of the public changes, some of the mass topics. So I think that's why you may see the picture that you see from North America. And it's quite important to point out that's ahead of the workers' comp review that will take place in Q3. So I mean, I think from a reserving position, I thought we were in a good place. And the last year, as seen from today, I'd say that we are in an even stronger position overall.

And on the financial adviser business, so...

A - Mario Greco {BIO 1754408 <GO>}

Can I add a point to this, Andrew. Also remember that we are in the hardening market and this is something that always happens in the hardening market where one of the benefit is that you negotiate better terms and conditions with the clients, but actuaries and claims people continue to reserve for the past conditions, right. I mean, because they don't -- they don't base their assessments and future assessment on what they've seen already. So the knowledge there is the past and the past is different and worse than what we have today in the books, and that creates a difficult situation in the hard market that reserves are better -- are better quality in a sense than ever before. That happens every time, and we're seeing this happening even this time.

A - George Quinn {BIO 15159240 <GO>}

On the -- on the acquisition that we made very recently or we've announced recently, I mean, this wasn't something what we said during [ph] the year. So you know what, we need to go ahead and acquire some financial advisors. I mean, this is -- this is something that is -- I mean, it's clearly connected to the relationship we have with Deutsche and already this is a group who sells Zurich product. And I mean, for us to take the step will benefit the business in Italy from a longer-term perspective, but it doesn't change the Group stance on how we expect to run the business in the future.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Okay. Thanks.

A - Mario Greco {BIO 1754408 <GO>}

And Andrew, remember that we've been working with this network for almost 15 years successfully for us and successfully for them. So for us, it was a natural thoughts when we heard that Deutsche Bank was selling them to consider the acquisition, and now this gives us the opportunity to connect them to the insurance agents and use the customer bases of the insurance agents to foster the sales results of the life side. This network is quite good at selling unit-linked products, which is also our priority in Italy. And so, it was just grabbing a nice opportunity in the market.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Okay. Thank you.

Operator

The next question is a follow-up from Mr. Vinit Malhotra from Mediobanca. Please go ahead.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes. Thank you for the opportunity. Just trying to follow-up again on the combined ratio elements. Just on the pricing, George, I mean, if I look at the Europe and North American commercial team, the European commercial pricing in 2Q is roughly 13%, and almost very close to the 14% of North America. Could you just comment on where this is coming from, because 1Q was 11%. So while everybody in the world talks about moderation, here we have European commercial actually adding 2 points versus even 1Q so, any comments on that would be very interesting.

And second question is just on Slide 18. I think, we -- where we show the retail SME (inaudible) or ex-cat, ex COVID. And it's nice to see an 80 basis point improvement. I thought for a while this segment was kind of flattish. Could you say where this could be coming from, because I presume COVID frequency and everything is cleaned out here? Any comments, also interesting? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Okay. So on the first one, UK, that's UK commercial market is driving this. I think I talked already at the end of the year, but -- I mean the UK was cashing out pretty rapidly than the US. I mean, that's why you see the outcomes that you see here. I think, if you look at the retail business generally and look at where the improvement is coming from, I mean, it's a wide range of markets. And it is easier for us to exclude some of them than to list all of them. I mean, I think the -- a market where traditionally you don't see a lot of price movement and we tend to be a much bigger motor player, which is a market that has challenges as Switzerland. So I mean, here it is not a big driver of what you've seen in terms of the improvement.

But if you look at all of the others, I mean, most of them tend to contribute in some way. I mean, overall, the picture is still fairly flattish. So the business benefits from the fact that some of the things that, in fact, I mean the point that you made earlier about frequency, maybe some of the change in behavior, I mean, we benefit more from that we do from pure price.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Thank you. Appreciate it.

Operator

We have a follow-up question from Michael Huttner from Berenberg. Please go ahead.

Q - Michael Huttner {BIO 21454754 <GO>}

Thank you. And you probably said this already, so apologies, but -- and how much of the aggregate cover have you used up and how much is still left before you hit the -- not the cover but the retention before you benefit from the cover?

And then the second, this is very cheeky. Is there anything you can say about dividends. So I was trying -- if I phrase the question lightly, it would be to say, well, if I pretended to be a Board member, I'm not, then I would look at the excellent solvency, the wonderful cash and the clear -- the strong trend in net profit and I'd be -- I'd be ready to put a big increase number, but I'm not sure if the Board thinks like that or do they think more in terms of what's sustainable? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Thanks, Mike. I thought the first question was quite cheeky already. So the -- I mean, all I can say on the first topic is that, we weren't in the aggregates at the end of the first half. So as I mentioned earlier, I mean, just given the cat load assumption that we have, and I mean, any reasonable modeling for the franchise requirements on the cat which suggests that we will attach it at some point in the second half of the year. But I can't give you a current update, while can't is not the right one. I won't to give you current updates is probably the more accurate statement. So sorry for that.

On the dividend topic, I mean, I think all the things that you listed in consideration is correct. The only thing that's -- we bought officers time. So typically the Board does this starting in December. So I mean, it won't be until the end of the year. This is a topic that we give it directly [ph] for the Board.

Q - Michael Huttner {BIO 21454754 <GO>}

Okay. Thank you very much.

Operator

The last question for today's call is from Peter Eliot from Kepler Cheuvreux. Please go ahead.

Q - Peter Eliot {BIO 7556214 <GO>}

Thank you very much for the opportunity to add some. The first one, I mean, I guess, you've given us very clear guidance on what the pricing and loss cost inflation is doing, so we can model the outlook. I mean, you've also mentioned the tighter terms and conditions. I'm just wondering if qualitatively, George, you could sort of give us a feel for how you'd be building that into our model as well and the sort of materiality of that on the margin outlook? That was the first one.

And the second one, just returning to your guidance, I guess, you've -- you've upped a little bit the outlook for the Group functions and operations in terms of drag there. Just wondering if there's anything in particular that surprised you in that segment? Yeah, those were the two. Thank you.

A - George Quinn {BIO 15159240 <GO>}

Yeah. Thanks, Peter. So I'll do the GF&O change first. I mean, not really. I think the -- I mean, there is a series of drivers of it. So we've got a bit of adverse FX in the first half. We got some financing cost related to the Met deal. We've given up some investment income. And I'm currently charging the businesses less for services than we were at this point last year. And I think probably the only change that I have decided to make is that, I'm not planning to go back and charge them more and take it back to where it was say, at the half point last year. That puts more pressure on the corporate center to adapt and adjust. And I think, generally, that's a good pressure to have in the first place.

On the -- on the terms and conditions, it's a really tricky one. I think, the -- I mean, I guess, if we went back to prior hard market, you have to go back quite a long time to find the last one. I mean, the way that I remember it -- it is the way I remember it rather than I can prove it, that tends to be the aspect that has more longevity. It tends to be the thing that eliminate some of the -- the frequency the deductibles have gone up, some of the soft markets, options that you give to customers to put claims to you, they're removed.

In terms of quantum, I don't -- I honestly don't know today. And if I -- I think if we could -- if we put quantum to it, I think the Chief Actuary would have a another reserved strength addition to offset it for the time being until it was approved. So I think it's something that will benefit us not just this year, but actually even more as we move into the future, but I can't give you any sense of size and not even a materiality. But I think it's extremely important for us, and it's -- I mean, it's one of the things that Sierra and the entire commercial team actually focus on most, because it's a thing that will still be here when the rates not quite as high as today.

Q - Peter Eliot {BIO 7556214 <GO>}

That's great. Thank you very much.

A - Richard Burden {BIO 1809244 <GO>}

Well, thank you everybody for dialing in today. If you do have any further questions, the IR team is ready to take them offline. And with that, thank you and goodbye.

A - George Quinn {BIO 15159240 <GO>}

Can I interrupt you just for a second? So I guess, you guys are all aware. This is Richard's last outing as our Head of IR. Well, I think, he hope it's the last as Head of HR. On behalf of Mario and the entire team, I just want say thanks for the fantastic job you have done Richard. I'm sorry to see you leave this role, but I'm looking forward to seeing you in the Europe job.

A - Richard Burden {BIO 1809244 <GO>}

I'm looking forward to it too.

A - Mario Greco {BIO 1754408 <GO>}

Thank you, Richard.

A - Richard Burden {BIO 1809244 <GO>}

Thank you everybody.

Operator

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