Q2 2014 Earnings Call

Company Participants

- Antonio Moretti, Director-Investor Relations
- Denis Kessler, Chairman & Chief Executive Officer
- François de Varenne, Chief Executive Officer, SCOR Global Investments SE
- Frieder Knüpling, Chief Risk Officer
- Mark Kociancic, Chief Financial Officer
- Paolo de Martin, Chief Executive Officer, SCOR Global Life SE
- Victor Peignet, Chief Executive Officer of SCOR Global P&C SE

Other Participants

- Andrew J. Ritchie, Analyst
- Daniel Bischof, Analyst
- Frank Kopfinger, Analyst
- Kamran Hossain, Analyst
- Maciej K. Wasilewicz, Analyst
- Michael I. Huttner, Analyst
- Olivia S. Brindle, Analyst
- Thomas Fossard, Analyst
- Thomas Jacquet, Analyst
- Thomas M. Dorner, Analyst
- William Hardcastle, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day, ladies and gentlemen, and welcome to the SCOR Group 2014 First Half Results Conference Call. Today's call is being recorded. At this time, I would now like to hand the call over to Mr. Antonio Moretti, Investor Relations Director. Please go ahead, sir.

Antonio Moretti {BIO 17681290 <GO>}

Good morning, everyone, and thank you for joining the SCOR Group H1 2014 results call. Before starting the presentation, please consider our disclaimer on page two, which indicates that the presented H1 2014 results have been subject to the completion of a limited review by SCOR's independent auditors.

Also note, which is indicated on page three, that in the presentation, two sets of financial data are used. The first set is presented on an unaudited published basis and includes Generali U.S. figures from the acquisition date of October 1, 2013. Obviously, prior year comparatives do not include Generali U.S. The second set of data is presented on an unaudited pro-forma basis and includes Generali U.S. as if the acquisition had taken place on 1st of January 2013.

With this, I would like to give the floor to Mr. Denis Kessler, CEO and Chairman of the SCOR Group, who is joined in this call by the whole COMEX team.

Denis Kessler {BIO 1498477 <GO>}

Thank you, Antonio, and good morning, everyone. With the net income of €256 million and ROE of 10.3%, SCOR has delivered a strong set of results for the first half of 2014 and so that (1:38) confirms the validity of our strategy but also the relevance of the path chosen with the Optimal Dynamics strategic plan.

Without going into all the details, let me give you a few highlights of what has happened over the last six months. First of all, the group has paid €243 million in cash dividends to its investors during the second quarter, once again demonstrating its ability to deliver consistent and strong dividends. Its business engines have been performing in line with Optimal Dynamics strategy plan. For instance, since the beginning of the year, SCOR Global P&C has delivered strong renewals with broadly stable profitability on a net basis. SCOR Global P&C has also strengthened its London market presence with the launch of our Lloyd's Managing Agency and has continued to implement the Optimal Dynamics strategy plan with the creation of a new business unit dedicated to the Alternative Solutions initiative to provide our clients with an even wider range of solutions.

On the Life side, we have completed the integration of Generali U.S., and we paid in advance a $228 million bridge loan, and meanwhile, SCOR Global Life has continued to enlarge its footprint in the longevity and financial solutions markets in line, again, with the Optimal Dynamics plan.

On the asset side, SCOR Global Investment has conducted a prudent rebalancing of the investment portfolio, again, in line with the Optimal Dynamics orientations. As such, through the first six months of 2014, the two targets of Optimal Dynamics, profitability on one side and solvency on the other side, are firmly on track with a return of risk-free rate of over 1,000 basis points and a solvency ratio according to our internal model, which reaches 231%. To give you more color about the 2014 solvency ratio, which confirmed the group's very strong capital position, I will now pass the microphone to Frieder, who will present the next slide.

Frieder?

Frieder Knüpling

Thank you, Denis. Moving on to page five, SCOR's solvency position has developed very favorably during 2013. The required capital is almost unchanged at €3.3 billion, as the business growth has been offset by further improvements to our capital shield and favorable economic developments. The available capital has grown to €7.5 billion, mainly due to the strong value of new business written during 2013, and the rise in interest rates.

This has increased the solvency ratio based on the 2014 group internal model to 231%, that means slightly above the Optimal Dynamics target of a solvency ratio in the range of 185% to 220%. Given the expected fluctuations of any economic capital model, we do not consider this a material deviation from this optimal range.

Our internal model is used extensively for managing risks, solvency, and capital, and we are working closely with our European regulators towards being able to use it also under Solvency II beginning in 2016.

With this, I will hand over to Mark, who will take you through the financial details of the results.

Mark Kociancic {BIO 17852409 <GO>}

Thank you, Frieder. Going to page six, I will you through the financial highlights of our first half results. SCOR wrote more than €5.4 billion of gross written premiums for the first half of 2014, which represents an 8.9% increase at current exchange rates, and 12.5% increase at constant exchange rates. This growth is fueled by healthy SCOR Global P&C renewals since the beginning of the year, by the increased strength of the SGL franchise, thanks to the Generali acquisition, and by major new contracts signed by the SCOR Global Life team.

The net income for the first six months stands at €256 million which generated a 10.3% return on equity. Both SCOR Global P&C and SCOR Global Life delivered an operational performance well in line with our Optimal Dynamics assumptions. The P&C combined ratio stands at an excellent level of 90.9% while the Life technical margin reaches a solid 7.2%.

SCOR Global Investments delivers a return on invested assets of 2.9%, while slightly increasing the duration of the investment portfolio as indicated in Optimal Dynamics.

Moving on to page eight, the shareholders' equity reaches €5.1 billion after the payment of €243 million of cash dividends during the second quarter. The book value per share is now well above €27, standing at €27.39 per share and the financial leverage stands at 20.8%, which is below the 25% ceiling indicated during Optimal Dynamics.

On page nine, the operational cash flow is €2 million for the first six months since it was affected by several non-recurring items, most of which we discussed in Q1 including an anticipated tax payment relating to the restructuring of the acquired Generali block of business: the Mediterráneo Vida financing commission and timing differences on P&C cap payments and their corresponding retrocession recoveries.

On a normalized basis, the net cash flows from operations would be approximately €400 million. Additionally, during the first quarter, SCOR repaid in full, the $228 million bridge loan facility used to help finance the Generali U.S. transaction. Overall, the total liquidity position decreases to approximately €1.8 billion in line with previous indications.

Now, I'll turn it over to Victor for the P&C results.

Victor Peignet {BIO 6287211 <GO>}

Good morning. (7:52 - 8:10) And the answer is that based on the information available to-date, which is yet very preliminary, our estimates of each of these losses on a net basis for us stand at a low-single digit between $10 million and $15 million and between $10 million and $20 million pre-tax, respectively. Therefore, none of these losses is going to have a material impact on our results, which is in line with our voluntary non-positioning on the aviation war business. Again, based on the very preliminary information available, especially for the Tripoli Airport attack, to-date, the total net burden from the suite of those losses seems likely to be in the range of $25 million to $35 million.

Coming back to the slides, the results we are showing are very much in line with the assumption that we've made for Optimal Dynamics across all metrics, whether they be related to growth or technical-expected profitability. With these results, there is not much to say but that we are on track at mid-year to have a full-year €5 billion gross premium income in line with the indication that we have been giving since the publication of the first January renewals results.

As far as the net combined ratio is concerned, SCOR Global P&C delivers an excellent technical profitability with a net combined ratio of 90.9% which, as of today, could be expected to be at the high end of the 93% to 94% Optimal Dynamic assumption on a normalized basis. To be sure that we are all clear, when I talk of a combined ratio on a normalized basis, I mean a combined ratio with a nat cat loss activity of the second half of the year which would make us to catch up with our annual budgeted ratio of 7%, and the management expense ratio trending down towards its normal annual run rate of 6.5%. It's worth mentioning that these results are based on the continuation of our present reserving policy unchanged, and do not include any reserve release, nor any reserve strengthening.

Regarding the June-July renewals, here again they went through without surprises worth being mentioned that it confirmed the high level competition in the markets, as well as the importance of franchise in the negotiations and the lendings of these negotiations in terms of share allocations and signings.

As you can see from the dancing (10:41) boxes that represent the walkthrough from the renewable to the renewed and newly booked premiums, the proportion of cancelled and restructured is increasing up to 15% from the low levels of the recent past, which is reflecting the underwriting discipline that has been applied.

In complement to the detailed information that is provided in this slide, I'd like to mention that on a year-to-date and underwriting basis, not accounting basis, looking at the January to July activity, the Treaty P&C and Specialty Lines gross premium income increases by 6.7% at constant exchange rates and by 8.2% when including Lloyd's business, which is in line with Optimal Dynamic assumptions.

The overall price decrease on the renewed contracts is contained to minus 0.6%, with minus 3.6% price decrease on non-proportional business being partly compensated by 0.5% price increase on proportional business.

The expected profitability deteriorates compared to 2013 by around 1 percentage point in terms of gross underwriting ratio and return on risk adjusted allocated capital, which is planned to be partly compensated by the equivalent of 0.5 percentage point coming from the increased efficiency of the retrocession program.

The ways in which these indicators are moving mean that with a business that is being retained or put in the books, the overall portfolio continues to meet the target profitability criteria. Additionally, as time goes by and the competition remains or intensifies, the terms and conditions are getting closer to the minimum required in a number of markets and lines of business which is when we expect that all the work that we have done to create a company culture of capital and risk management will be a real differentiator in our favor.

On this positive note, I'll let Paolo to comment on presenting the life activity and results.

Paolo de Martin {BIO 15930577 <GO>}

Thank you, Victor. Moving on to page 13 of the presentation, SCOR Global Life delivers a strong set of results in the first half of 2014, continuing the execution of the Optimal Dynamics plan. Gross written premium reached €3 billion, which translated into pro-forma growth of 2.6% at constant exchange rates. As new business profitability continues to meet the group ROE target, the solid premium growth reflects a healthy new business flow globally. This is driven, among others, by Longevity in Europe and Financial Solutions in Europe and Asia, as illustrated earlier in the year by the Longevity transaction signed with Aviva and the value-in-force transaction entered with Mediterráneo Vida.

Looking at our in-force book of business, we continue to enjoy strong performance, both in terms of premium persistency and emergence of results, with mortality trends in line with expectations. This translates into strong technical performance with a technical margin of 7.2%, confirming the ongoing evolution in the underlying mix, and in line with the Optimal Dynamic assumption of 7%.

Moving on to slide 14, as you remember, we closed the acquisition of Generali U.S.A. (sic) [Generali U.S.] (13:56) on October 1, making us the U.S. market leader based on 2012 data. 10 months after, we're happy to communicate that the integration of the acquired business in SCOR is essentially completed, and the market leadership has been securely maintained.

The smooth integration of Generali U.S.A. (sic) [Generali U.S.] (14:16) confirms on one side SCOR's discipline and detailed execution framework. And on the other side, the strength of the acquired team, which brings into SCOR Global Life a strong complementarity of skills, technology and market know-how. This has allowed the new combined platform to maintain the market leadership position with no material loss of client.

With this, I turn it over to François for the investment results.

François de Varenne

Thank you, Paolo. Moving on to slide 15, SCOR's total investment portfolio, which is €23 billion at the end of June 2014, with an invested asset portfolio of €14.7 billion compared to €14.1 billion at the end of December 2013. In a slightly improved economic and financial context, SCOR Global Investments continues its policy of progressively reducing its liquidity in the second quarter 2014, while selectively increasing the duration of the fixed income portfolio in line with Optimal Dynamics.

Thus, cash and short-term investments represent 11% of the assets at the end of June 2014 excluding (15:22) down 3 points compared to December 2013. Cash has been mainly reinvested in corporate bonds and loans throughout the first six months. The duration of the fixed income portfolio, which is 3.8 years excluding cash compared to 3.4 years at the end of December 2013. This increase in duration is mainly done on GBP and USD-dominated portfolios. Given the fall in euro rates in the second quarter of 2014, the increase in the duration of the bond portfolio has been temporarily suspended.

The quality of the fixed income portfolio has been maintained with a stable average rating of AA-. At the end of the first semester, expected cash flows on the fixed income portfolio over the next 24 months stands at €5.3 billion including cash and short-term investments, facilitating dynamic management of the reinvestment policy.

In the first six months of 2014, the invested assets portfolio generates a financial contribution of €208 million. The active management policy employed by SCOR Global Investments has enabled the group to record capital gains of €50 million. The return on invested assets is well in line with Optimal Dynamics' expectations and stands at 2.9% for the first six months of 2014.

And now, I will hand over to Antonio Moretti for the conclusion of the presentation.

Antonio Moretti {BIO 17681290 <GO>}

Thank you, François. Before moving on to the Q&A session, please note on page 16, the next scheduled events, which are the Investors Day in London on September 10, and the Q3 2014 results on November 6.

With this, we can start the Q&A and I remind you to please keep it at two questions maximum per person. Thank you.

Q&A

Operator

Thank you. Ladies and gentlemen, we will now move on to the Q&A session. Our first question today comes from Tom Dorner of Citigroup. Please go ahead.

Q - Thomas M. Dorner

Hi there. I've got two questions on the P&C reinsurance business. The first one is something that you mentioned in the slides about sort of elevated management expenses and that there's a timing issue. I just wonder if you could say something more around that. And then second the question I had was on the Optimal Dynamics plan for the P&C reinsurance business more generally the 93% to 94% combined ratio. I think you assumed broadly stable pricing and I can see you've shown in this quarter that you are steering the portfolio to try and offset some of the pricing pressure. But looking forward into next year, are you still sort of comfortable with those base assumptions given what seems to be happening in the market?

A - Denis Kessler {BIO 1498477 <GO>}

Thanks, Tom. Victor, on that questions, please.

A - Victor Peignet {BIO 6287211 <GO>}

Well, you are right that our Optimal Dynamics was assuming stable pricing overall. And you're also right in saying that we've been managing the portfolio in order to contain the impact of the price reductions. I think in a number of areas, we are getting close to the minimum required, and I believe that the technicality and the discipline in the market will contain the further reductions in some areas; in other areas, while recent events may give rise to price revisions. So, overall, I don't think we have reasons to-date to deviate from the plan. I think we still have enough of the franchise and leverage to contain the price reductions for the next year.

A - Mark Kociancic {BIO 17852409 <GO>}

Just regarding the P&C expense ratio, they are slightly elevated at H1. Some minor expenses coming from a variety of areas, a little bit in Lloyds, but we still think that a 6.5% combined ratio for the division is well in sight for the end of the year. So, it's probably more of a timing issue which should trend down a bit, nothing that alarms us on our side.

Q - Thomas M. Dorner

Okay. Thanks.

Operator

Thank you. Our next question today comes from Michael Huttner of JPMorgan. Please go ahead.

Q - Michael I. Huttner {BIO 1556863 <GO>}

Thanks. I've got two questions. One is can you say what's the benefit of this high solvency? If it were me, I'm sorry I'm a little jerk, I would go home and count it at night, but you probably do better things at solvency – yeah, yeah?

A - Denis Kessler {BIO 1498477 <GO>}

Michael, we couldn't hear what you said at the beginning. Can you repeat?

Q - Michael I. Huttner {BIO 1556863 <GO>}

Okay, right. On solvency, what is the benefit for shareholders? Are you going to increase the dividend more, do buybacks, or does it just mean that you're waiting for the S&P upgrade? And the second is now that you've completed Generali, so you've completed it. You've repaid the bridge loan and the leverage is low. Are you now looking for next deal? Thank you.

A - Denis Kessler {BIO 1498477 <GO>}

Next question please. Mark, what are we going to do with the excess solvency?

A - Mark Kociancic {BIO 17852409 <GO>}

Yeah. So first of all, it's a nice position to be and to be approximately 5% above what we outlined as our optimal solvency range, so we're very happy with that. I would caution based upon I think the slide we tried to put forward, tried to balance this risk, but we are in a transitory period for the next 12 months with the ACPR domestic regulator just like other companies would be in Solvency II's framework.

We're trying to get our model approved, and so if there is potential for model adjustments to be made and until that is secured, we're going to stand still with this solvency and excess capital level as we see it at the current time. I think in 12 months, once this thing is finalized, we can start entertaining questions like that.

A - Denis Kessler {BIO 1498477 <GO>}

On the second question, now that we have integrated Generali that we have paid back the loan. We spent the time to define, let's say, what we're going to do for the Life activities of the group. And I'm going to give the floor to Paolo to say what's the strategic reviews that he has been doing over the last six months. So, Paolo?

A - Paolo de Martin {BIO 15930577 <GO>}

Yeah. I think we're going to give a wider update when we meet for the Investor Day. I think we reviewed that all markets, and I think at this point we can really confirm that the Optimal Dynamic targets are in sight and reachable in the period of 2016. I think, at this point, on the Life side, we don't foresee any need for further acquisitions. I think that we have a very good global footprint, and I think we now need to leverage it.

A - Denis Kessler {BIO 1498477 <GO>}

Thank you, Paolo. So, anyway, we will come back on those issues at the IR day to be held early September, the 8th if my memory is right.

Q - Michael I. Huttner {BIO 1556863 <GO>}

Thank you.

A - Denis Kessler {BIO 1498477 <GO>}

10th. The 10th. Sorry. Look at it on the agenda, Michael.

Q - Michael I. Huttner {BIO 1556863 <GO>}

Thank you.

A - Denis Kessler {BIO 1498477 <GO>}

Next question, please.

Operator

Our next question today comes from Daniel Bischof of Helvea. Please go ahead.

Q - Daniel Bischof {BIO 17407166 <GO>}

Thank you and good morning. Two questions. Firstly, on the casualty initiative, which has been bleak given the market conditions, could you give an update what you're seeing in the marketplace and how you look at casualty in the short term?

And then, secondly, again, on solvency, thanks for slide five. Could you talk about the potential effects of the model changes? I mean, first of all, in which direction you would expect it to move, and secondly, what kind of magnitude you're talking about.

A - Denis Kessler {BIO 1498477 <GO>}

Thank you very much, Daniel. Victor, on the casualty initiative and how we see the casualty market.

A - Victor Peignet {BIO 6287211 <GO>}

I think the casualty initiative is on track in the sense that it is very client focused, it was driven by basically our E&S clients focused in the U.S. On that, I think there are movements in that particular market regarding the reinsurance purchase that allows us to continue with the initiative. Well, we are progressing. I think to-date on this year, the total premium income from that initiative stands at about $30 million. I remind you that we have an objective of $150 million over three years. So, I think we are on target for the first year.

We see tensions in the market. But within that particular segment, I believe that while our pricing levels will stand very much in line with what we expected. And, again, as we are taking a global view of those clients across all lines, Treaty P&C, Specialty Lines, while we believe that on an overall basis this is still very relevant for us to strengthen our position with that particular client base which is in between 25 and 40 clients in the U.S. market.

A - Denis Kessler {BIO 1498477 <GO>}

Frieder Knüpling on the model changes?

A - Frieder Knüpling

Yeah. We are just now finalizing the pre-application process with European regulators, that is, I mean, the first review of our internal model which they have conducted over the course of the past two years, and this is now coming to an end. And we are now going into a phase where we are discussing the high level observations and recommendations which come out of this review and this is going to take place in the next six months really. So, it's a little early to comment on the likely outcome of this and, really, I don't want to speculate about individual outcomes there. So, I hope that by the end of this year, we'll have more clarity and then we'll obviously prepare everything which needs to be done for filing the internal model for approval next year. That's going to be possible only starting in April, and we'll do it soon afterwards once all the Solvency II literature and the draft text have been transposed into national law. That's something which still needs to happen, so there's still a considerable amount of uncertainty around the details of the process, but our target is to get through this process by the end of next year, in time, before Solvency II comes in in 2016.

Q - Daniel Bischof {BIO 17407166 <GO>}

Excellent. Thank you very much.

Operator

Thank you. Our next question today comes from Kamran Hossain of RBC. Please go ahead.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi. Good morning. A couple of questions. Just coming perhaps to the capital position. Could you give us an update on where you stand versus the S&P AA range? And I guess kind of second one on that. To what extent is achieving a AA rating an aim score at the moment? And what's S&P's view? How do they accept your internal model at the moment? Do they look to that and give you more credit for that? So, if you could give some of your comments around that. That'll be helpful. Thanks.

A - Denis Kessler {BIO 1498477 <GO>}

Okay. So, maybe, Mark on this issue.

A - Mark Kociancic {BIO 17852409 <GO>}

Yeah. So first of all, with the level of excess capital on S&P's model, we've updated that just recently, so we're significantly above the AA level of capitalization that's required in their model, won't get into more precise figures other than to say that it's significant. I think last year, we gave you some comments that it was right around that level or marginally above. So, there has been an uptick. The risk credit provided for the model, they did spend extensive time with us as did a couple of the other rating agencies. It's not strictly S&P that's interested in it. So, that's reflected.

And then with respect to the AA- aim or ambition, this is more of a nice-to-have, not a target of the group. For us, the internal model is paramount with what we do and how we run the company. The rating agencies and some of the regulatory measures that we have globally serve as additional constraints, but the company is firmly run by the internal model.

Q - Kamran Hossain {BIO 17666412 <GO>}

Perfect. Thanks very much.

A - Denis Kessler {BIO 1498477 <GO>}

Of course, if S&P is on line, may I add that it's not only nice to have, but it's certainly very nice to have. So, we hope that the message has been sent through.

Q - Kamran Hossain {BIO 17666412 <GO>}

Perfect. Thanks very much.

Operator

Thank you. Our next question today comes from Will Hardcastle of Bank of America. Please go ahead.

Q - William Hardcastle {BIO 16346311 <GO>}

Good morning, guys. I was just trying to understand (28:52).

A - Antonio Moretti {BIO 17681290 <GO>}

Will, Will, we can't hear you anymore.

Q - William Hardcastle {BIO 16346311 <GO>}

Is that clearer?

A - Antonio Moretti {BIO 17681290 <GO>}

No, it's not.

Q - William Hardcastle {BIO 16346311 <GO>}

Hello? Hello?

A - Antonio Moretti {BIO 17681290 <GO>}

Try now.

Q - William Hardcastle {BIO 16346311 <GO>}

(29:10) combined ratio, versus a 2.5 points on return on capital. And also, I just - I'm not sure I caught - you mentioned the retro impact on that. Was that - reduces the impact by 0.5 point on the combined ratio?

A - Antonio Moretti {BIO 17681290 <GO>}

Will, would you mind saying that again? We missed the first part again.

Q - William Hardcastle {BIO 16346311 <GO>}

Okay. Let's try that one more time. I was just hoping to understand the math, really, behind the 1 point combined ratio deterioration from the June-July business versus the 2.5 points on the return on capital. Is it just the required capital amount is going up significantly because of the deteriorating margin? And then the second part was just - I actually misheard, ironically, regarding the retro impact. Was that half-a-point on the combined ratio?

A - Denis Kessler {BIO 1498477 <GO>}

Victor?

A - Victor Peignet {BIO 6287211 <GO>}

Okay. So, the second part, what we are saying is that basically, on a year-to-date basis, we have a deterioration of the gross underwriting ratio, as well as the return on allocated capital of about 1 percentage point on each. And what we are saying is that, because of the efficiency that is of the retro program, that has been improved at its renewal (30:27) end of last year. We believe that half of the deterioration of the combined ratio of the gross combined ratio is going to be compensated by the impact, or the effect, of the retro session program.

Q - William Hardcastle {BIO 16346311 <GO>}

Right. So just to be clear, Victor, 1 point is the gross impact?

A - Victor Peignet {BIO 6287211 <GO>}

That's it. Yeah, we measure the gross impact, which is basically what you measure with your underwriting and pricing tools. We work on gross and then you add to that the effect of your retro session.

Q - William Hardcastle {BIO 16346311 <GO>}

Sure.

A - Victor Peignet {BIO 6287211 <GO>}

As far as the first point, well, the relationship between the deterioration on the return on capital and the combined ratio is basically that your return on capital takes into account, as you rightly say, the variation of capital intensity by line of business which reflects, first of all, your loss models, and if you strengthen your loss models, which is what we have done in certain areas and in particular in nat cat, well then you've got capital intensity increases that is reflected in your return if the prices are not following.

Q - William Hardcastle {BIO 16346311 <GO>}

Okay. Thanks.

Operator

Thank you. Our next question today comes from Thomas Fossard of HSBC. Please go ahead.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes. Good morning. I've got two questions. The first one will be on your newly Alternative Solution initiatives. Could you tell us what is the aim? What you're willing to achieve? How you want to position yourself compared to the competition which has been, I would say, very lively and innovative over the past two years? What SCOR is bringing to the table on that side of the business?

Second question will be on the financial assets. Could you just update on the expected return investments for the full year, now you achieved already six months? And maybe also, could you give a bit of more granularity around the €30 million of gains extraction on the fixed income book in Q2? Thanks.

A - Denis Kessler {BIO 1498477 <GO>}

Victor, on the initiative.

A - Victor Peignet {BIO 6287211 <GO>}

Well, the initiative consists in basically regrouping activities that were done within the business units in a specialist unit dedicated to what we call Alternative Solution and that, that will encompass both clients from the insurance world as well as from the large corporate. This goes with the fact that reinsurance purchase is more and more driven by Wealth Capital Management. And we have been providing ourselves, through our various business unit solutions, to help our clients to manage their capital. And we want really to capitalize on that and by adding a dedicated unit, we believe that we can develop more specialist resources and more efficiencies in addressing the problems.

This unit will work like a specialty line. It means that the relationship, the prime relationship, will stay with the underwriters, with the P&C treaty underwriters for instance, as far as insurers are concerned, with business solution as far as large corporate is concerned, but the specialist team will come and back them up in order to strengthen the offer to the clients.

A - Denis Kessler {BIO 1498477 <GO>}

Correct.

A - Victor Peignet {BIO 6287211 <GO>}

Today, I think, to give you an idea, probably today I would say that, depending on the definition of alternative solution, that varies from one market to the other, or one reinsurer to the other, probably around 10% of our total premium can be assimilated today to Alternative Solutions. So, we are not starting from scratch. We are starting from an existing base, which is already sizeable, but we want to further specialize that and regroup it into a dedicated unit.

A - Denis Kessler {BIO 1498477 <GO>}

Let's segue to (34:56) François, do you expect a return for the full year?

A - François de Varenne

So, Thomas, we indicated at the beginning of the year the expected retail invested assets for the full year, so which mean, including income, dividends, (35:12) income, and realize capital gains in the range of 2.4% to 2.9%. We run the portfolio today for the first six months of 2014.

We then annualize return on invested assets of 2.9%. I confirm the assumption of 2.4%, 2.9%, probably, let's say, given current market levels, we should be in the mid part of the range indicated previously.

In terms of granularity on the types of gains we took on the fixed income portfolio recently, as you know, we have an active management of the portfolio and especially on the fixed income part, so which means it's not only a pure biannual strategy, it could be the case for some assets like loans. But on the fixed income portfolio, we like to detect collective values on names and securities, so which mean we trade those names or those securities when we think - or assumption, initial assumption on relative value is reached, so it could be on rates on spread. So, it's spread between the risk covered bonds, agency MBS and corporate bonds.

Q - Thomas Fossard {BIO 1941215 <GO>}

Okay. Thank you.

Operator

Thank you. Our next question now comes from Andrew Ritchie of Autonomous Research. Please go ahead.

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

Hi there. Two questions. Firstly, for Victor, I just wanted to clarify, because there's quite a lot of different metrics you're looking at the evolution of the P&C profitability. I think you're saying that you still are maintaining confidence on the Optimal Dynamics 93%-94% combined ratio. But is it fair to say after a lower expected volume than maybe you'd hoped for, because you're having to possibly restructure more of your book given price declines and the opportunities for deploying capacity are reducing as well, so is it the case that you're reiterating confidence in the margin, but you'd be more cautious on the volume?

And the second question on the investment side, François, more on the reinvestment rate. In Q1 you reiterated – well you said that you felt that the average expected reinvestment rate for 2014 I think was 2.6%. You lowered that slightly to 2.5% in Q1. Where is it now? I mean, I'm guessing if you're no longer extending duration and given benchmark yields have fallen, the 2.5% has fallen again. Just give us an update on that. That would be helpful. Thanks.

A - Denis Kessler {BIO 1498477 <GO>}

Victor, please.

A - Victor Peignet {BIO 6287211 <GO>}

We'll address that in details at the Investor Day in September, but I think the first thing and the most important thing as regard to Optimal Dynamics on the top-line side is the foreign exchange impact. And I think the way Optimal Dynamics was planned, at which exchange rates, and where are we today on the exchange rates and where are we going forward. We will do an update on that at the Investor Day.

Besides the exchange rate impact, your dollar and pounds and other currencies versus euro, well I think our growth business-wise at constant exchange rate is today more or less in line with what we thought it would be. So, we have no reason to believe that for this particular year we are very much outside of the Optimal Dynamics assumptions.

For next year, well for us, it's very simple, we'll do whatever we can to maintain the portfolio. Obviously, we already see that in certain areas we have to let business go. As I have said, our cancelled and restructured is increasing again. If it's necessary, well, we will do what we need to do. But, again, no particular reason to warn on the possible deviation today.

A - Denis Kessler {BIO 1498477 <GO>}

François, on the reinvestment rate?

A - François de Varenne

So, on the reinvestment rates, indeed, I mentioned in Q4, in the presentation of Q4 result and Q1, reinvestment rate of 2.5%, 2.6% for the full year 2014. I just remind the definition of the reinvestment rate. So, that's the average reinvestment rate on the entire portfolio, so not only on the fixed income. So, that's all asset classes. We could include loans, real estate and other investments on top of the fixed income portfolio. And of course it excludes cash and short-term investments since here the remuneration is at almost zero.

So, as of today, despite, let's say, the recent movements on rates and especially on the euro ones what we see is that our reinvestment policy is targeted today on asset classes that are less sensitive to interest rate movements. That's clearly the case of loans and some corporate bonds we select on the portfolio.

So, at this stage, despite the recent movement on the euro rate, we still have an assumption for the full year 2014 of, let's say, an average rate – a reinvestment rate of 2.5%, 2.6%. I'll just draw your attention on slide 39 and the evolution of the income yield on the portfolio. It was for the fourth quarter 2013, 2%. 2.1% in Q1 2014 and 2.4% in Q2 2014. So, even if there is a part of seasonality due to dividend in Q2, that we estimate around 8 basis points to 10 basis points, you see that – hopefully see and the fact that we reinvest today at a higher average rate, it start to be visible in the income.

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

And the reason it's not fallen much is that there's a bigger weighting of the reinvestment to pound and dollar versus euro. Is that the main reason why it hasn't fallen?

A - François de Varenne

Yeah, because if you remember, I mean, the split for currencies in our portfolio, you know that we are very strict on currency policy. But especially after the Transamerica Re and the Generali U.S. acquisition, the invested asset portfolio is nominated for 44% today in USD and for 11% on British pounds, so which mean more than 50% of the portfolio is denominated in currencies where we start to see since, what, last summer, one year ago, a nice increase of interest rate. And we expect this increase to continue especially after the publication of the GDP in the U.S. yesterday. And the euro, it's just one-third of our portfolio. So, we have a huge diversification in terms of currency, and we take benefit of course of this diversification per currency bucket.

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

And you could start lengthening duration again in those currencies in Eurozone where you're not going to be lengthening at this point?

A - François de Varenne

So, you're right and that's what I mentioned in my speech and you'll have the full update also during the Investor Day early September. We started to increase the duration. And you see just here the aggregate number on the total fixed income portfolio. And as I mentioned it, we started to increase the duration at the end of 2013, so after the summer, mainly on the USD and GBP portfolio. And we wait a little bit given, let's say, the current mess in the Eurozone.

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

Okay. Thank you.

Operator

Thank you. Our next question today comes from Maciej Wasilewicz of Morgan Stanley. Please go ahead.

Q - Maciej K. Wasilewicz {BIO 16462204 <GO>}

Hi. It's Maciej from Morgan Stanley. Two questions if I may. Number one is on the movement in yields year-to-date. I would have thought that given that you've got a short asset duration portfolio, the downward movement in yields would have a negative impact on your economic capital and perhaps also on your available capital under your economic capital model. I'm wondering if you could outline what impact, if any, the movement in yields year-to-date might have had of that kind of nature.

And the second question I'd have is, I think if I remember correctly and correct me if I'm wrong, that you were looking to increase the cat business over time to balance out your portfolio. Can you tell me whether or not your P&C PMLs have moved up or down year-to-date because you might also have pulled back from some treaties that were unprofitable? So, I just wanted to know whether there's been any major movement in the last renewals, upwards or downwards, in the PMLs. Thank you.

A - Denis Kessler {BIO 1498477 <GO>}

Victor, maybe you could start by...

A - Victor Peignet {BIO 6287211 <GO>}

Well, we had in the plan a strengthening of our U.S. cat underwriting. And this is being processed as planned with a bit probably of slowing down considering the market conditions. But overall, the plan is developed normally. So, yes, we have an increase of P&L in the U.S., but well within the plan and totally within the risk management limitation that we had defined in Optimal Dynamics, and at returns that are well within our targets.

A - Denis Kessler {BIO 1498477 <GO>}

Frieder, on the part of interest rates on the available capital?

A - Frieder Knüpling

Yeah. Our asset portfolio is slightly shorter than our liabilities. I think we disclosed the matching position last year at the IR day. So, increase in interest rates are beneficial for our economic capital. They also slightly reduce our required capital. And that's what we've seen last year, that the increase in interest rates up until the end of the year has added to the improvement in the solvency ratio. And then, as far as FX is concerned, it's relatively neutral because we've got a fairly good match between required and available capital as far as currencies are concerned. It's not perfect, but movements in the U.S. dollar-euro exchange rates broadly have a comparable effect on available capital and required capital. So they don't move the solvency ratio significantly. And we'll provide more detailed sensitivities on that at the IR day in early September.

Q - Maciej K. Wasilewicz {BIO 16462204 <GO>}

So, would it be fair to say then, because yields have come down this year, year-to-date, that there'll be some negative impact on that solvency ratio on the available capital from that decline? Would that be fair to say? Maybe offset by other factors, but nevertheless.

A - Frieder Knüpling

Yeah. If you look at this effect alone directionally that would be the case. I mean you would see broadly an opposite effect of what we saw last year. It's not going to be very material, but in principle, that's true.

Q - Maciej K. Wasilewicz {BIO 16462204 <GO>}

Thank you.

Operator

Thank you. Our next question now comes from Thomas Jacquet of Exane. Please go ahead.

Q - Thomas Jacquet {BIO 4110153 <GO>}

Hi. Good morning, everyone. So, my first question is on the slide 34. Apparently, you had a pretty good performance across the board regarding inflows. Is it something that we should extrapolate, and can you make an update on this part of your business? And my second question is, I think for Victor, on the aviation market, this recent accumulation of losses in a market that was already – that was in a situation where prices were very low, do you expect it to create some opportunities for you and, in particular, can you comment on your potential appetite for the war part of this aviation business, and more generally, how can you leverage this? Thank you.

A - Denis Kessler {BIO 1498477 <GO>}

Thanks, Thomas. François, on third-party asset management?

A - François de Varenne

Yes. So, if you come back to slide 34, so indeed, I'm pretty proud of those numbers, including commitments on some club deals we did recently. Today we manage a little bit more than $1 billion, which is a nice achievement after 18 months. I maintain a target of (48:57) an assumption of managing €1.5 billion at the end of the plan, so by the end of 2016. So, the idea is really here is, given the platform at the marginal cost to really develop and set up a fee business without putting any capital at risk in the group.

A - Denis Kessler {BIO 1498477 <GO>}

You're absolutely right to be proud, François. One side, (49:28) you could precise. It's not open to the general public, maybe not.

A - François de Varenne

And we will also give a full update on the strategy and the types of plans in the Investor Day presentation.

A - Denis Kessler {BIO 1498477 <GO>}

With select investors, which is quite rare. On the airline, Victor, or do we have the time for war coverage?

A - Victor Peignet {BIO 6287211 <GO>}

Well, the series of losses that we have seen in the past weeks, I think has got an impact on the two sides of the market, from the war market definitely and the non-war market as well, since some of – part of that risk, especially the passenger liability, stays within the all-risk excluding war market. So, if we take the all-risk excluding war market, well, we have been hoping for a turn in that market for quite some time now. So, I think that has the loss activity intensified. But there should be greater hopes that the market is going to turn. So, yeah, let's hope and see.

On the war risk itself, the market is very small. Like aviation is no different from marine in absence of war or war-like situations. This market tend to go to very distressed type of conditions whether they are pricings or brokerages. I think the market had gone through that sort of bad direction for quite some time. So now the market is hit by a series of losses. This market will probably react hopefully, pretty strongly, and time will tell.

As far as we are concerned, we are not a war-risk player through our aviation underwriting units. And I don't think we – well, we don't intend to become a war-risk player, even if the market turns. I think this is a market that, in our opinion, is too small and too unbalance. So, we are not going to change our underwriting policy on this. And I said that we had no position in this market in Re and GAUM, which are our two main aviation underwriting contracts. Well, do not have much appetite for that either. So, I think that would stay – continuity of the current policy.

Q - Thomas Jacquet {BIO 4110153 <GO>}

Okay. Thank you very much.

Operator

Thank you. Our next question now comes from Frank Kopfinger of Commerzbank. Please go ahead.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Yes. Good morning, everybody. I have two questions. My first question is on your renewals. Could you elaborate a little bit? And a comment on the lines of business; where you cancel a restructured business, but also on the lines of business within your treaty book of business, which grew as well by 5%. We have to split by geographies, but could you also comment on the lines of business that grew there? And the second question is on the life book of your business, there had been some significant longevity deals in the first half of this year. So, could you comment a little bit on how you see the competition there, and whether there is pressure on pricing right now?

A - Denis Kessler {BIO 1498477 <GO>}

Thanks. Victor, on the cancellation of some lines.

A - Victor Peignet {BIO 6287211 <GO>}

If we segment the market, I think our projections were that, if you make the distinction between local insurers, regional, global, monoliners, I think our projections was that our portfolio of local insurers would suffer from increased competitions, whether it is in the U.S., on the regional market, or in certain other regions of the world. That is what is going on. So, most of the cancel and restructure is within that segment of local insurers.

And again, in the IR Day, we will show you the trends by segment. And this will really appear very clearly. It's not a surprise for us. We know that this is an area that is getting very competitive when the market is softening. That is what is going on, and we have to selectively and strategically increase our selections of client, and let some business go, to protect the overall margin.

A - Denis Kessler {BIO 1498477 <GO>}

On Longevity, Paolo?

A - Paolo de Martin {BIO 15930577 <GO>}

On Longevity, we are, as you know, strong participants in the market. We participate one of the biggest deals, the Aviva deal, in the first quarter. We are right now pricing deals, both in the UK and outside the UK, as we think the Longevity line is slowly developing towards a global product line. Whether it would be more competitive than the rest of the market, I think it's a healthy competition. It is competitive. Some of the business is brokered or somehow intermediated by banks. So, it does tend to be competitive.

On the other side, some of the deals requires extensive capacity, so that counterbalances some of the push towards a very competitive price. But we think it's still very attractively priced. It is a very good diversification for us given our mortality focus. So, we are a strong participant in the market.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Okay. Thank you. Can I come back on the renewals? Could you also shed some light on your growth of the treaty book, which lines of business were the driver there?

A - Victor Peignet {BIO 6287211 <GO>}

Well, the line that hasn't increased overall is motor. So, anyway, the treaty book, Treaty P&C means what it means, property, casualty and motor. While most of the increase that we see at this renewal, because we are talking of this renewal and this June-July renewal is basically Latin American, Caribbean, Australia and U.S. cat. So, obviously, the increase is driven by property line because of the structure of the renewal. I mean, that's definite.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Okay. Thanks.

Operator

Thank you. Our final question today comes from Olivia Brindle of Deutsche Bank. Please go ahead.

Q - Olivia S. Brindle {BIO 17273762 <GO>}

Hi there. I just wanted to clarify something on the attritional loss ratios. And I'm sorry if I've misunderstood your previous comments but it seems like you're saying, on a net basis, the deterioration and underwriting margins is 0.5 percentage point. So, the one of growth and taking half of that adjusting through retrocession. So, the number that we should be applying that to is the attritional loss ratio from last year because that was at 58.5% if you take out reserve releases. So, that would point towards about 59% of attritional for this year which, given you're at 57% so far at the half year and the plan within Optimal Dynamics is also around 57%, just wondering if you could explain how those reconcile.

And also, I guess depending on your answer to that, what sort of trend should we expect for that 57% of attritional? Is it a case of that you've achieved Optimal Dynamics more quickly than you thought and maybe there's a bit more there as you continue to rebalance the portfolio, continue to buy retro more effectively, or is it just a number now that we should expect to be broadly flat going forward? Thank you.

A - Victor Peignet {BIO 6287211 <GO>}

I think we said last year that we were a bit ahead of Optimal Dynamics in the sense that our attritional was improving faster than expected. We are now around 57%, and I think we are stabilized there. What I meant is when I looked at the projection from the pricing tool, if I project a deterioration of 1 point, first of all, this deterioration is not going to come immediately. It's going to come with the earning of the premium which is over time. So, it has got delayed impact and half of it being taken away by the efficiency of the retrocession.

You can say that we are within a margin of negative evolution, and that's what I wanted to say that there is no real threat of ourselves deviating from the 93%, 94% today because the variation is within 0.5 point, which I think is something that is marginal. So you can consider that our portfolio on the run rate today is, yes, around 57% of attritional, which is in the metrics of Optimal Dynamics. Whether we can further improve it, depends on the opportunities in the markets. As it is extremely fragmented, it's difficult to see general trends, and we are really managing renewals as they go. So, I can't really predict. If we can, we would be happy to. I think we will definitely, and I think we are in a position to maintain it at least where it is.

Q - Olivia S. Brindle {BIO 17273762 <GO>}

Okay. Thank you.

Operator

Thank you. That will now conclude today's question-and-answer session. I would now like to hand the call back to Mr. Denis Kessler for any additional or closing remarks.

A - Denis Kessler {BIO 1498477 <GO>}

Just to thank you for attending this conference call on the half-year 2014 results. I wish to see you at the IR day on the 10th of September in London. And in between, enjoy the summer time. Bye-bye.

Operator

That will now conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.