Q2 2016 Earnings Call

Company Participants

- George Quinn
- Mario Greco
- Richard Burden

Other Participants

- Andrew J. Ritchie
- Andy Hughes
- Dhruv Gahlaut
- James A. Shuck
- Michael Igor Huttner
- Nadine van der Meulen
- Niccolo C. Dalla Palma
- Nick Holmes
- Paul De'Ath
- Peter D. Eliot
- Sami Taipalus
- Stefan Schürmann
- Thomas Seidl
- Vinit Malhotra

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, good morning or good afternoon. Welcome to the Zurich Insurance Group Half Year Results 2016 Analyst Conference Call. I'm Sara, the Chorus Call operator. I would like to remind you that all participants would be in listen-only mode and the conference is being recorded. After the presentation, there will be a Q&A session. The conference must not be recorded for publication or broadcast.

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

Richard Burden {BIO 1809244 <GO>}

Thank you. Good morning and good afternoon, everybody, and welcome to Zurich Insurance Group's second quarter results call. On the call are our CEO, Mario Greco, and our Group CFO, George Quinn. Before we move to questions, we just wanted to highlight a supplement disclosure that we provided this morning on our reserves.

We kindly ask you to keep questions relating to this disclosure for tomorrow's additional call, which is dedicated to the topic. Mario will now make a few comments and then we will take your questions. As usual, please keep to two questions.

I'll now hand over to Mario.

Mario Greco {BIO 1754408 <GO>}

Thank you, Richard, and hello to everybody from myself, and thank you for joining us. Allow me to make a few comments on the results and on the state of the company today before I open up to questions that George and I will address.

First of all, I'm very pleased to report these results. I think they're good results and they show that there is traction. They show that we're walking the talk and we are delivering on what was announced that we will do.

In GI, the underlying accident year loss ratio in the expense ratio has both improved and we stay committed to the 2-percentage point to 3-percentage point improvement in the underlying combined ratio for the year.

In Global Life and Farmers, management services continued to demonstrate solid growth and very stable earnings. Capital is resilient and the Zurich economic capital ratio is well within our target range at an estimated 107% at the end of June.

Cash remittances, they are still coming above the targets and were still targeted to be over $10 billion at the end of 2016. So this looks like as a good start of the year. We acknowledge that there is more work to be done and we're ready to do this work in the remaining part of the year and then in the next years. However, this start gives us a lot of confidence that the actions taken are the right one in that we can really fix the business and restore the profitability back as we thought we would.

We expect, of course, a further improvement in the second half of year, and then we will continue over the next years improving the business. Also, let me reconfirm to you that at the end of this semester, I still see the group as fundamentally sound. I still see our reserves position as strong one. I still see the capital as strong and the brand as a very strong and effective one.

These are all very important characteristics that we need to build upon and again, I'm not forgetting all the things that we need to fix. The loss ratio is to improve the cost, have to further come down, but this is very solid organization with lots of skills, lot of professionalism and this results show that I think in a tangible way.

I'm – also let me quickly spend a word on transparency and communication. And I think the transparency and the data that we provided for tomorrow of reserves give a lot of transparency also on this issue. And you can (04:33) continuing to build a very open dialogue and deliver all the necessary information in a very transparent way.

We are also working very hard to position Zurich for the future and to shape a very clear and simple strategy for the next years. However, the organization is already changing and is already getting simplified. We are progressing with the head office restructuring, and we are extending that same stream of actions to the countries where we are piloting the impact of a simplified current (05:12) organization into three European countries to draw then conclusions for considering for all others.

We are looking forward to meeting all of you on 17th of November for the Investors Day, where we will update you on the financial targets and on our strategy. But in the meantime, we remain committed to continue improving the business and to have a strong second half of year and showing you that the improvements will continue.

Thank you very much for listening. And now, George and I will be happy to take your questions.

Q&A

Operator

We will now begin the question-and-answer session. The first question is from Peter Eliot, Kepler Cheuvreux. Please go ahead.

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

Thank you very much. I guess the first question was, there's a lot of references to the impact of large losses based on the presentation and commentary. You have given us some numbers and comparatives there, but I guess you used to give us an aggregate figure. And I am just wondering if you could quantify the overall impact the large losses had in the quarter and how that compares to historic averages?

And then secondly, I am just wondering if you can help me understand at a very high level the sort of the interaction – the timing of the actions you are implementing. I guess, you attribute quite a lot of the improvement to actions you have taken. But I guess rate increases take time to earn their way through, and although you said (07:09) rate increase's overall 2%, I guess not a huge amount. And then on expense savings, restructuring charges very much weighted towards the second half of the year. So I am just wondering if you could say at a high level – help us sort of guide through the timing of the improvements and say perhaps why we are seeing quite a lot this early? Thanks.

A - George Quinn {BIO 15159240 <GO>}

Let me start. So on the last topic, I am not going (07:34) isolating large losses from the overall because the goal for the sem (07:40) is to focus on the entire loss ratio, and that's being the entire thing and whether it's attritional large losses. I mean to try and help around I think what we have in the quarter versus what we expect which may answer a question that a number of you may have. And if you look at the result we have for the quarter, we have combined ratio of 99. We are I think about 98.3 for the half year. I think the half year is a pretty good indication to where we think we are today on an underlying basis, it's somewhere in that mid-98 range and that compares to the ambition that we have to bring ourselves to about two points to three points as Mario mentioned from a level that was around 100 points underlying for last year. If you look at the quarter, I mean the main deviations would be that on the large loss side – and I think if you take this number of face value, it would make more progress at this point than we expected.

I think in reality when we dig into it, this almost sound like some randomness in the large loss performance. And we would assume that that's resulted (08:47) favor in Q2. So I would assume a slightly higher level than we've seen, maybe a point higher than the combined ratio than we reported today.

On the expense side, we also have a number of one-offs. I mean, we – you've seen we have a very strong figure, 30.3% on the expense ratio. If you allow for the impact of some of the one-offs and the impact of RCIS, which causes a bit of a flip between loss ratio and expense ratio, I mean, we would see the expense ratio for the year, I mean, being somewhere, I mean, close to a point higher. And so if you allow for all of that and you allow for some continued earnings (09:34) attritions. Coming on to your second question maintaining (09:34), I mean, you've seen us report positive rates in Q1, it's slightly less in Q2. I mean, in general, what we see at the beginning of the year, we're earning I mean roughly a half, but slightly more than half this year, remainder of next year and that pattern will continue.

So there will be a bit of a lag, but I mean, we would certainly expect to see that come through as – I mean, around half a point on the attrition as we go through the remainder of the year. I mean, overall, we think we're well on track. And large losses notwithstanding cat, notwithstanding to achieve that targeted combined ratio.

On the broader topic of timing, there's been actions (10:16) around restructuring, so you've seen that – I mean, so far in the year we've incurred about $227 million of restructuring costs. I mean, Mario announced several weeks ago a restructuring to improve and simplify the organization and increase the focus that we have on the customer. We're running through that process now. That would generate some more costs and likely (10:40) mainly in Q3.

I expect the total cost for this year to come within the overall guidance that we've given on restructuring, so within that $500 million guidance that I gave earlier in the year. As far as the benefits are concerned, I mean, there's no update I'll give you today on the benefits other than we still expect and anticipate we'll deliver that $300 million improvement this year with an overall goal to deliver $1 billion by 2018. That will be a topic that we'll update you on more when we get to the Investor Day.

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

Okay. Thanks a lot.

Operator

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

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Good afternoon. Thanks for taking my questions. First question is in regard to the cash remittance target of more than $10 billion. Could you give us an indication in terms of where you are with the remittance since the start of the year? Secondly, also on a underlying basis, on the GI book, could you say how price versus claim inflation is running at this point, and what are you expecting for the next – in the second half, basically?

A - Mario Greco {BIO 1754408 <GO>}

So, on the cash remittance, so – I mean just to reiterate, I mean, we still – there's no change in our view of what will happen this year. We still expect that we'll deliver more than $10 billion compared to that target of $9 billion. That would imply a minimum of $2.4 billion. But we've also said that – I mean, assuming an unchanged dividend, we expect the dividend to be cash covered this year.

I mean, the way the pattern works is that – I mean, the flows are split I mean, roughly evenly believe or not and the summer is a quiet period, towards the end of Q1 beginning of Q2 the first major flow and then – and Q4 is the second one. So currently we exactly want to try before (12:41) we expected to be. We don't see anything that would cause us to change our view. So we are confident that we will achieve (12:48) guidance that we've given you.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Right.

A - Mario Greco {BIO 1754408 <GO>}

On rate versus loss (12:52) costs, I mean, we haven't seen anything that signals a change in the loss (12:58) cost pattern from what you – what we talked about on the call here back in Q1. So we're still seeing positive margin growth with the rates that we're achieving, but it is relatively modest. So I mean, given the 1.5% headline rate increase we talked about, we're talking about 50 bps of margin expansion or thereabout.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

All right, perfect. Thank you.

Operator

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

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

Oh, hi, there. First question is for Mario. Mario, you quoted on the paper saying you feel more confident about the second half. I mean, the under – non-life is improving albeit more or less (13:48) the run rate you've targeted. What really is it making you more confident about the second half and relative to what point? Is this because you now sort of you understand more about the root cause of the problems were or you've done a bit more work on understanding where the cost opportunities are? I'm just trying to understand exactly what it is that's giving you so much more confidence about the second half?

And the second question for George, you talk about further attritional improvement coming through in the second half. What are the impact of (14:18) RCIS on that because obviously most of the premium earned in crop is in the second half, quite late in the second half, at what sort of combined ratio RCIS is running at? And when you talk about further attritional loss improvement, are you talking excluding that? I appreciate it's a high – I mean, obviously you had high losses, low expenses, but maybe just clarify what the impact of RCIS will be in the second half? Thanks.

A - Mario Greco {BIO 1754408 <GO>}

Andrew, I will start and then I will back it (14:49) to George. I think I was saying that we're all more confident, not just me. When I joined the company January, February (15:03) beginning of March, I found everybody is hesitant, scared because 2015 has been truly really bad year and very disappointing, and the disappointment and the sadness for the result was still there.

I think this result give a great boost or confidence to the underwriters, to the sales people, to the claims people, to everybody that they're doing – that they have been doing the right things that they put the situation under control, they took the right measures, and so we'll keep the natural confidence in continuing this trusting that this is working, and this is going to work also in the future.

But this was needed. And so it's not just me. I mean, it is the moral of the organization, it is the confidence of the underwriters who will be now negotiating with people and they know that they have been calling right shots over the last months. And it is rebuilding a little bit the pride and the conviction of the organization, which is very important. And still I see Zurich as a super competent organization, but moral and conviction are very important to make every day success.

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

Okay. Thanks.

A - George Quinn {BIO 15159240 <GO>}

Andrew, on the second point, on RCIS, I don't expect that to have a major impact on the overall combined ratio run through the full year. I mean, the components will have some impact on loss versus cost, but I mean given – I mean, some of the costs that we expect to incur on integration in the second half and the fact that – I mean, I think you're right, the premium is backend weighted. So I mean, we have about $127 million in this quarter, we will be about $400 million by the last quarter, but overall I'm expecting a result from RCIS that's not that far away from where I'm guiding for the group.

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

So, it will be more impactful next year, I guess then.

A - George Quinn {BIO 15159240 <GO>}

We certainly (17:07) expect more from it next year, yes.

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

Okay. All right. Thanks.

Operator

The next question is from Sami Taipalus, Berenberg Bank. Please go ahead.

Q - Sami Taipalus {BIO 17452234 <GO>}

Hi, thanks for taking my question. Just two things. First of all, on the global commercial premiums, I think you put through 1% of rate and you saw (17:31) about 13% drop in volume. It's a bit difficult to gauge from where I'm sitting how much of that – exactly how that came through. So I'm wondering if you have a feel of how much rate decline you'd have to take to keep the volume flat. So, that's first question.

Second question is, you gave us a bit of an update at Q1 about the positive impact that you're increasing reinsurance buying at hand. And I was wondering if you could give us a further update on that and whether that's changed your mind at all about buying reinsurance more broadly. I think in the past you've said that you bought reinsurance to protect capital rather than earnings. But what have you changed up (18:20) more towards buying reinsurance to earn – to help earnings rather than just to protect capital. Thank you.

A - George Quinn {BIO 15159240 <GO>}

So maybe on the first question, I think that's probably the opposite way from the way that we normally think about it, because I mean we're looking so for a return on income (18:36) rather than think of – I mean what kind of return that we have to give up to maintain the volume. I mean, I think – I mean, you raised a point earlier that – I mean, we continue to do what we said we were going to do at start of the year and that's to focus on the under-performing parts of the portfolio and essentially do what you'd expect us to do, and that's either push for the required reentries or give up that business. And that's something that, in particular, Global Corporate has been completely focused on through Q1 and Q2 and you see the largest impact there.

I mean, in return for that, I mean, we did have a significant impact on rate. You see we've updated the tiering chart today. We continue to push very hard on the underperforming parts of the portfolio. That has impacts both on overall rate versus market. I mean, the market overall is clearly slightly negative, but we're still achieving positive margin improvement, but we are giving up business in the process. And that's something that I expect will continue throughout the remainder of this year as we cycle through the entire portfolio. I mean, it won't continue forever. But I mean, this adjustment is absolutely needed so that we get (19:42) that level of profitability that's required.

On the reinsurance topic, and I mean, there's not much more to say on that today from what we said earlier in the year other than to reiterate that, I mean, you won't see us go back where we were before and prioritize and keeping the (20:06-20:18). I mean, that's really where it can play the most effective role for us. I mean, so far this year, we haven't had to rely on reinsurance. The improvement that you've seen in the results today have come from what we've done on the underwriting side that is not driven by reinsurance, but the direction we set around our risk appetite continues, and that will be reflected in the reinsurance program that we've put in place for next years and the years to come.

Q - Sami Taipalus {BIO 17452234 <GO>}

All right. Okay, great. Thank you.

Operator

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

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

Good afternoon. Congratulations on the results this morning. And a question on the cost savings on the Life side, the operational cost in Global Life are quite a bit better than I expected at least. And how do you think about your existing cost savings target there and how should we look at your approach on the longer term there?

And secondly on the dividend, you've commented in the past that you felt perhaps one sort of fixed number was better replaced by dividend policy. Can you elaborate on that? Maybe give us an idea of what kind of policy you are thinking about. And then on the reinsurance that George just spoke about, I was wondering whether you could give the gross loss ratio just to gauge the impact of reinsurance program. Thank you.

A - George Quinn {BIO 15159240 <GO>}

So cost savings, particularly in Life, so – I mean, Life is not (21:50) Life has some relatively rapidly growing businesses which I mean need cost support and to continue that growth. So I mean on Life, I mean, the overall aim we've got the same discipline there that we've had in the rest of the business, what we need to have in the rest of business. And I think we see it, the – but the characteristic is different from GI.

Life is still expanding. Life has attractive margins in most of its businesses. And we continue to invest there where we can. I mean, where we've really seen the cost benefit on the Life side is, I mean, policy charges and so the impact that some of things that we've announced this year have had on the cost efficiency to some (22:32) translate through to the segments in the form of lower charges from the group. And that's a trend that I expect to see continue through this year, and in fact as we complete the cost saving process – program continue into next year.

The other thing that make Life slightly tricky to judge is the policyholder elements, of course the – I mean, cost savings shared with the policyholder in many of the businesses that we have, but overall Life is subject to the same discipline as the rest of us, but the benefit that you are seeing are probably coming mainly from lower charges from the corporate sector (23:08).

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

That's reflected in the acquisition cost as a percentage of GWP being lower, is that right? That fell from 10% to 8% I believe.

A - George Quinn {BIO 15159240 <GO>}

I don't know, Nadine. So I'll get you back and look at the precise driver there. I have done that in the past (23:25). On the dividend, I mean – I have nothing new to say on dividend today. The topic we come back to again is part of the Investor Day, I have nothing...

A - Mario Greco {BIO 1754408 <GO>}

(23:42) anyway.

A - George Quinn {BIO 15159240 <GO>}

Yeah. On the reinsurance, I am sure we can get you the gross. I don't have it in my finger tips, but we will get you the gross number on reinsurance.

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

Thank you.

A - Mario Greco {BIO 1754408 <GO>}

You're welcome.

Operator

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

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah, thank you. First question on the business mix in P&C between the four units. I guess, Global Corporate was expected than we observe, continued loss in Europe, UK, Germany, Switzerland, Italy you mentioned. You've started to divest international market and in NAC, you are mainly growing captives (24:17). My first question is, is sort of this, trends we should expect continue in those three segments. And the second question, I mean, we have seen quite dramatic fall in interest rates globally I'd say, yet you stand out as a company showing higher running yields in the fixed income portfolio when we look at slide 22, so I wonder how that is possible?

A - George Quinn {BIO 15159240 <GO>}

You are right, it's not possible. So that when you look at the slide that you'd be careful with the number and the thing is not annualized. So you have to annualize one to the other. So I think if you're looking at the GI number (24:56) see 1.33% versus about 2%. Of course, the correct comparison would be to annualize the 1.33% and you get about 2.66% versus 2%.

Q - Thomas Seidl {BIO 17755912 <GO>}

No, the – to the prior year, it's 1.22%, right, so you improved running yield by some 20 basis points.

A - George Quinn {BIO 15159240 <GO>}

The other thing to watch for is, I mean, as we bring cash back to the center, that can have temporary impacts on how you compare year-over-year. So when you look at this year in Q2, I mean we can see some distortions because of the cash flow. So in fact the running yield in GI has actually risen Q2 over Q1. And that's mainly because of some of the internal routine of cash in the company rather than something that's taking place in the markets that would be inexplicable. So it's really that, Thomas, we're seeing.

On the P&C business, I mean, I think what you really see – I mean, it's typically the same answer to the – that I gave to the earlier question. The – I mean, across all the businesses we are looking profitability. We continue to prioritize that over volume. That process is going to continue through the reminder of the year. And I think you can still expect to see a GWP decline ex the RCIS business within that mid-single digit range. And that's going to be the key driving force for business mix shift in P&C, nothing more than that.

Q - Thomas Seidl {BIO 17755912 <GO>}

And in Europe in particular, I am interested like Switzerland is the ambition to regain some of the lost market share there?

A - George Quinn {BIO 15159240 <GO>}

So, I mean, again the ambition for all markets is profitability. I mean, we want to grow profitability all the time, but we are not going to grow at the expense of the firm's required returns. I mean, there are markets that will offer us opportunities to expand I mean even this year, but in general given the starting point and given the current prevailing market trends, we expect to shrink the overall volume in P&C.

Q - Thomas Seidl {BIO 17755912 <GO>}

In Europe?

A - George Quinn {BIO 15159240 <GO>}

So it's overall. I mean, again in some markets, in some lines of business. So if you look at, for example, go back to Switzerland, so you see an improved performance in Switzerland. We've given a piece of volume on one particular line of business, because we prioritize profitability in that line, and that we think had a positive outcome for us. I mean, market-by-market we'll respond as market conditions change, but we will give our market share if that's what's required to deliver the right level of return.

Q - Thomas Seidl {BIO 17755912 <GO>}

All right. Great. Thank you.

Operator

The next question is from Paul De'Ath, RBC. Please go ahead.

Q - Paul De'Ath

Yeah. Hi, there. And just a couple of kind of – some quick questions from me. Firstly, on the prior year developments, and there's another kind of rate of (27:46) increase going through there and offsetting some of the positive developments. I think in Q1 that was effectively increasing the group reserves. Is that still the case and what's the sort of plan going forward on that?

And then the second point was just on – you obviously changed your portfolio of businesses around a bit. You've announced the number of sales. Are those already included in the numbers (28:17) stripping out the businesses that you've sold or is that still to come and therefore could provide a boost in the second half? Thanks.

A - George Quinn {BIO 15159240 <GO>}

Thanks, Paul. So, on the first point PYD, (28:29) the reserve increases in the Group Re component, so you're seeing exactly what you saw again at Q1. We've taken advantage of the fact that Group Re comes relatively late in the process, allows us to sit back and look at all of the risks that the group faces and make an overall judgment of where we would like to land, and that's exactly what we did.

I mean – I think we all realize that's not a very elegant way to do it. We're not intended to continue that policy far into the future. I think you'll see that change. So that we'll avoid this gross (29:03) large PYD where it's a net number that offset at (29:07) the Group Re equals something that's in line with the guidance. We'll try and make sure that's integrated in future, but the picture you see is identical to Q1.

On the disposals, I mean we've made – so I mean, you'll realized what's happened, so Morocco, South Africa, Taiwan, Middle East, there is a very small negative impact from a goodwill and charge we take in, but it's not material in the result. Most of the impact is not in yet, and that will come as we close the transaction.

So I think at this stage, the ones that are meaningful from a reported result perspective will lately close in Q4. And we've got one where we'll take a relatively substantial gain, one we'll have a (29:58) the intangible book, but we'll have a book value loss, I mean, overall we expect to see a loss of around $60 million from the transaction so far, most likely Q4.

Q - Paul De'Ath

And just to follow-up on that. What impact will that have on the combined ratio (30:17) they have a higher combined ratio if the business is sold?

A - George Quinn {BIO 15159240 <GO>}

I mean, overall nothing material. I mean, some of the – I mean, the businesses are – I mean they are decent businesses, but they don't have a huge impact on the results of the group.

Q - Paul De'Ath

Thanks.

Operator

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

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes, thank you. Just on the Z-ECM estimate of 107%, there is a footnote that there is a plus/minus 5 points of margin of error in this quick calculation probably. Would you say that you're on the conservative side of that? Because I'm otherwise struggling a bit to see how come after adding, say, 1 point for earning and 2 points for some debt, you're actually below your 1Q level. So if you could just please comment on that or maybe even help us more by commenting on the interest rates in place that you expect – do you have a view on that (31:26)?

Second thing is just on this whole attritional thing, there seems to be an improvement also in Brazil, or is it only LatAm, but maybe mostly Brazil, which is probably from speaking to IR around (31:46) 5 points of delta y-o-y. Now we have seen some other players also talk about an improvement in Brazil. Given where the economy is, et cetera, what do you think is driving this improvement and are you more bullish about this turnaround story now than you were last quarter? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Thanks, Vinit. So on Z-ECM first, given this is not a regular year-end. We gave a comment around some of the increased risk we have around the estimate. We have given you the best view of what the number is. It wasn't intended to be conservative. It's not intended to be aggressive. It's intended to be what we expect it to be.

On the moves in sales, I think the – and if you look at what took place in the quarter, your right, we have some additional capital which is really the refinancing of something that matured already last year. I think the part that's – it's obviously very difficult to judge for outsiders, it's actually very difficult to calculate for insiders as well and that's some of the market moves. Some of them are obvious around spread and equity market. Interest rates are tougher. The disclosure we gave, we tried to improve it at this time to include some of the non-financial market on the interest rate piece, but it's a parallel shift. And of course, most often the cuff tends to have a bit of a twist somewhat in it.

And I guess that's what you've seen. I think you saw already in Q1. You see again in Q2 the very long end, things are pretty flat currently. Also, the Brexit timing, it couldn't be worse from a financial reporting perspective coming at the very end of quarter and, of course, some of that will have bounced back already as we've entered Q3. But, in essence, what you see in the Z-ECM move, the impact of financial market interest rates and the mark-to-market impact on equities and corporate partly offset by the issuance of the hybrid.

On Brazil, I think the – I hope before, we didn't leave you the impression that we didn't actually expect to achieve the goals that we set out for Brazil. I think we had the confidence. I think we talked before about the changes in the team that have taken place, the increased focus we have there.

I think, from a market perspective, it's quite tough given the economic conditions, but I think we have the benefit of – we were tackling some particular problems for Zurich, which I think the team has focused on and addressed very well, so that's certainly helped on the performance side, and we've also had the benefit of the – we know the impact of a transaction we did about 18 months ago on the mass consumer side. The volumes on that deal are impacted by the economic conditions, but the deal is actually performing pretty well for us. So, I think that combination has helped Brazil produce the performance that you see now.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Is it large losses as well there, because maybe that's something that could be influencing?

A - George Quinn {BIO 15159240 <GO>}

Typically, its less of an issue in Brazil given the nature of the business, most of them are mass consumer-oriented business.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Sure. All right. Thank you.

Operator

The next question is from James Shuck, UBS. Please go ahead.

Q - James A. Shuck {BIO 3680082 <GO>}

Hi, good afternoon. Thanks for taking my questions. Two questions for me, please. I just wanted to return to the combined ratio outlook for the full year. Mario mentioned that the 2-point to 3-point improvement is still on track for this year. So, I think that's implying you kind of do around 97% for the full year 2016. You've already mentioned that H1 is normalizing at about 98.5% or so.

I wasn't really too clear what you meant around the degree of luck in large losses in the first half, maybe a point or so of good luck. I guess the implication is if you're going get to 97% for full year 2016, then H2 is going to have to be much better than the 98.4% you published at H1. So could you just help me understand have I done my math right on that and what is it that's kind of driving close to 95%, 96% in the second half of the year?

And then secondly, around the – just hoping for a little bit more insight into Z-ECM normalized capital generation, what a kind of normalize run rate is for that. I think based on your current kind of growth requirements, which – the portfolio is shrinking somewhat as you re-underwrite and also the level of earnings is probably not quite where you would like it.

So, if you hit your kind of required target on the combined ratio and once you move to a kind of more normal level of growth for this company, which I'm sure you can elaborate on it at the Investor Day, but what should I be thinking about the normalized level of Z-ECM capital generation and how do you see that in relation to the dividend, please? Thank you.

A - George Quinn {BIO 15159240 <GO>}

Yeah. So, on the first one, so apologies, it was because I gave two answers to the first question, I probably confused some people. So, I talked about the fact that the half year is, I think, a good gate to what we believe the underlying to be. That would require us to do better than that in the second half.

I think, for us – one point to bear in mind. We don't expect to offset any natural catastrophe scenario. So far in the year, we're quite close to – expected to – there's no significant negative impact, but we do expect to see improvement in the second half.

(37:39) if you focus on Q2, the headline number is 99%. We would knock off about 2.5 points for excess nat cat. We'd probably take about 0.5-point for attritional, it's quite hard to judge, but given the rate of improvement we've seen that's what we'd expect to see roughly and through.

On the expenses, we'd expect to see the expense ratio for the year come back up to around somewhat slightly over 31%. And for the large loss piece, given we believe we actually have a bit of asset randomness – I don't want to use the work luck, but obviously, there's some volatility in large losses. I would add back a point for that. I think if you do all of that for the full year, we'd expect to see the combined ratio aligned in the 97%, 98% range.

On the second topic on capital generation at Z-ECM, in many ways – I think if you look at it in a very detailed way that becomes a phenomenally complex question to try an answer. I think if you step back from it and you say, well, let's ignore all the noise that can come from the mark-to-market element. If we focus a bit on the fact that interest rates are just very, very low, so the discounting elements are also quite small given our bias to fee and GI business that also tends to reduce the discounting element to a relatively low level.

You have some of the capital requirements to be driven by some growth, I guess, in the short term and we're not going to have significant growth rates. And I don't mean just because of the portfolio actions underway, I mean just because of the general prevailing market trends, so growth in our business will be quite modest. And if you look at the diversified capital requirement, it's going to be very, very low for us.

So, for me, I think the best indicator is actually to look at the expected cash generation. That's a good indication. If you look through all of the capital requirements that exist in the group to give you a sense of what we expect the capital generation to be. The two in the longer term are going to synonymous with each other. And we would see cash being back to the level that we've guided to you before provided we achieve the turnaround that you can see the beginnings of within GI currently, and that would imply somewhere around that $3 billion mark.

Q - James A. Shuck {BIO 3680082 <GO>}

Thank you very much.

Operator

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

Q - Nick Holmes {BIO 21515144 <GO>}

Hi, there. Thank you very much. Just a couple of questions. First one is, looking at NAC and Global Corporate, you're still showing rate increases in a soft market, and I wanted to ask, do you think this can be relatively easily maintained and, presumably, there are some pricing pressures you're up against and can you tell us more about which are the lines – which are the biggest challenge?

And then secondly, turning to the life business, I wondered if you could talk us through concerns about the low interest rate environment. Your investment margin seems to be holding up very well. But, I guess, my question specifically would be if interest rates don't rise, then when do you see this investment margin starting to erode? Thank you.

A - George Quinn {BIO 15159240 <GO>}

So, on the first one, I think the only way that you can really achieve rate increase in the current market conditions is either being very, very focused in a very small number of businesses that are actually showing improving rates or by doing the basic things (41:33) that we're doing on the portfolio currently.

If you look at NAC, NAC has, even ex the RCIA acquisition, headline growth, but the reality is if we back out the captive impact from that, NAC has a decrease as well. Is that risk selection that's driving rate. If you look across the businesses that we focus on North America, given its NAC, what we would see there is that the softer end of the market continues to be property and workers' comp, has also come off of a position 18 months ago when we saw relatively healthy rate increase, and over the course of the last 18 months, it came to a level that's pretty flat today. But it's really risk selection, portfolio management that's driving the rate improvement. On the life...

Q - Nick Holmes {BIO 21515144 <GO>}

Sorry, George, just as a very quick follow up, other areas of worry for you in maintaining this big improvement in risk management?

A - George Quinn {BIO 15159240 <GO>}

I wouldn't say that it's a worry, but I think what it really means is that the limit (42:46) you can push this in a relatively soft market condition. So, while we're working on the portfolio composition, you can expect to see it continue. But once we get to the end of that, we'll be subject to the same vagaries of the market as everyone else.

So, I think that means that the improvement that we're pushing through the portfolio, certainly on the loss cost side, they have natural limits given the market trend. I think on expenses, we can definitely do more. But the loss cost side, obviously, has limits.

Q - Nick Holmes {BIO 21515144 <GO>}

Okay.

A - George Quinn {BIO 15159240 <GO>}

On the life business topic, obviously, the interest rate moves are – it's not new, it's not helpful for the life business in general. It's particularly problematic first on markets in Europe. I think you know already that the markets that are particularly impacted are markets that we de-prioritized quite some time ago. So they are relatively a smaller part of our portfolio.

So we're less exposed to the downside, although we're also less exposed to the upside. For us, (43:54) rates really don't rise. For example, in Germany, it means the initial pressure that we'll see from ZZR, we've talked before about the impact between 2017, 2018, 2020, 2021 and the need to fund ZZR. Just for Germany, that impact will continue for much longer if interest rates don't eventually start to demonstrate some upward momentum.

I think if interest rates do stay here, I think we all obviously assume – it can't be assume. Insurance companies would have to act. The model is that we pass this through as part of our business model. Maybe given the current competitive market conditions, it's difficult to do that, but at some point, we all have to do it. And if interest rates stay where they are, I don't think that day is particularly far ahead of us.

Q - Nick Holmes {BIO 21515144 <GO>}

Okay. Thank you very much for that. Can I just quickly follow-up with a specific question on the speed of the impact from low interest rate? If you say – you've described in the past in Germany, pressure building sort of over five years. Can you be more specific as to the effect on the investment margin over the next two years if interest rates do not rise? Would you actually expect much effect on the new earnings or not really? Would it be longer down the road?

A - George Quinn {BIO 15159240 <GO>}

The short answer is, if we assume that the interest rates stay where they are and we really do nothing in response, what it really means is that much further down the road, the earnings don't recover as quickly as they would otherwise. I don't see that it accelerate things, but equally I don't really believe that's the outcome we're going to have. I would expect us to take action to start to pass through the impact of that in the products that we have.

Q - Nick Holmes {BIO 21515144 <GO>}

Right.

A - George Quinn {BIO 15159240 <GO>}

If we don't do that, that issue is – because of the duration that we have in the portfolio, we have many years before you have the problem. You don't have the recovery you'd expect to see.

Q - Nick Holmes {BIO 21515144 <GO>}

So, for the next couple of years, you wouldn't expect to see much negative impact from low rates?

A - George Quinn {BIO 15159240 <GO>}

Not beyond that we discussed already around Germany.

Q - Nick Holmes {BIO 21515144 <GO>}

Yeah. Okay. Thank you very much.

Operator

[Operators Instructions] The next question is from Michael Huttner, JPMorgan. Please go ahead, sir.

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

Fantastic. Thank you very much. And again, yeah, these are great numbers. Well done. And so my question is really to find out or to try and see how much more there is in terms of improvement. On the combined ratio, if I look at it from two points of view. So the first question, you explained in great detail and answered to the last question and the one before where the combined ratio could be. But I'm still not clear whether that means the second half combined ratio, so somewhere between 97% and 98% or the full year combined ratio between 97% and 98%?

And, of course, I'd like to hear the answer 97% to 98% for the full year, because that implies that there's a big improvement coming in the second half if you did 98.5% in the first half and 97.5% for the full year, you need 96.5% in the second. And then kind of in pretty much the same topic, you discussed a lot the impact of the pricing, but you didn't identify separately, and I just wondered if that could come on top, the benefit of all those cancellations in your Tier 4 where you're canceling twice as many or twice as much as you would in the other portfolios. So you're retaining 62%, although you're retaining 80%, so you're canceling huge amounts, so hopefully, they are very bad or not very attractive business? Thank you.

A - George Quinn {BIO 15159240 <GO>}

So the combined ratio gain was for full year. So we expect to produce a combined ratio within that 97%, 98% range full year. On the cancellation, a couple of comments on that first, so the – you've seen (48:18), we talked already I think on Q1 the proportion of the business that was in Tier 4 in particular.

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

Could you remind us? I had forgotten that.

A - George Quinn {BIO 15159240 <GO>}

(48:29) I think it was somewhere in the mid to high teens, percentage wise of the overall portfolio. Tier 4, just because of the portfolio mix and the renewals that we have in Q2, is actually quite a bit smaller. So it's maybe slightly more than half of the size of Tier 4 in Q1.

Then the cancellation element is fully factored into the rate change component, so I think if you look at that and you're using the volumes to project forward the benefit of that rate fitting through, I think to then separate that part of the portfolio (49:07) I think I'd probably be double counting, Michael, if did. So, I look at the rate change as the base indicator to the improvement you should expect to see.

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

The 14%?

A - George Quinn {BIO 15159240 <GO>}

Well, I wouldn't pick out only that one piece. I look at the overall portfolio, so 1.5% overall.

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

1.5%, okay. I just have one tine little bit. On solvency, so I was a little bit disappointed by the 107%. I didn't think that you had so much in sensitivity to market, particularly because you're not so big in German life. Is there – at what stage should we – would you see a potential risk that you're merely 100% lower than (49:48) your target range?

A - George Quinn {BIO 15159240 <GO>}

I guess, the first thing, maybe a couple of comments around how we measure things. I think I regret the fact that we didn't double the index that we use because we can be down about 214% solvency ratio against the target of 200% to 220%. Our sensitivities are greater not because of a risk driver, but because of the methodology to supply.

So, we have no – unlike Solvency II, we don't have the benefit of the ultimate forward rate, we don't have the benefit of matching adjustment, we don't have the benefit of volatility adjustment. So, in our numbers, you get a complete mark-to-market movement. That means that as a company, we've tried to calibrate our range to allow for that and we accept the fact you'll see more volatility in our figures.

Given what's happened in this quarter, I'd expect to see a bounce back from a combination of -some of retrace we've seen in the market since the end of the quarter and, of course, we have been doing – it wasn't driven by this, but we have a refinancing program underway. And one of the things we've done is refinance a piece of senior as hybrid. And that of course will benefit the capital strength of the group in the second half.

I think if you prepared to step back and look at the sensitivity from a real world perspective, we could not be more sensitive to this issue than most of our European peers given the mix. So it's purely a reported number issue. And of course, we won't – we're not going to panic. I think we see a capital number that's resilient. We're roughly in the middle of our range. The trend we expect for Q2 will be positive, but of course, we don't know what will happen in terms of markets through the remainder of this quarter or next. But, overall, from a capitalization perspective, we feel quite comfortable.

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

Fantastic. Thank you very much. And well done again, brilliant results.

Operator

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

Q - Stefan Schürmann

Yes. Hello. Just two questions, the first one on – update on (51:59) acquisitions. George, you mentioned that the impact will be most in Q4. I just wanted to make sure that the $60 million or so you guided was basically in NIAS or (52:11) or both. The second one, just generally update on duration gap. Can you give me an update if there's anything changed from Q1, end of Q2, life and non-life, please?

A - George Quinn {BIO 15159240 <GO>}

So, on the first one, the figure I've given you is NIAS in fact. And consistent with our past practice, we'll keep that outside of BOP, but watch for it coming in NIAS. On the duration gap, we were very slightly long. We're currently very slightly short, but the change is completely immaterial.

Q - Stefan Schürmann

Okay. Thank you.

Operator

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

Q - Andy Hughes {BIO 15036395 <GO>}

Hi. Thanks so much, guys. A couple of questions, both about cost, I'm afraid. So what you've done in the U.K. is kind of bring the life and GI businesses close together under common management. And I think this is kind of mainly the life guys who are running that. And so the presses are jumping on it and kind of doing the (53:10) in the GI business. I just want to think is that the kind of strategy you're going to rollout? Is it going to be bringing the kind of life and GI businesses close to together and kind of how is that going to work in terms of a life guy managing a GI business and vice versa?

And I guess, the question on cost savings was, so I know you talked about the life cost savings being shared with the policy holders. But, obviously, you've achieved a life cost savings and you put it through the renewal cost reduction in that year, you certainly get a leverage benefit on your earnings and a leverage benefits also on capital, I guess. So, I guess the question is, so can you break down the kind of $1 billion in 2018 or the $300 million benefit is between life and non-life and give us an idea about how that impact Z-ECM. Do you get kind of big benefit when you realize the cost saving through the life business? Thank you.

A - Mario Greco {BIO 1754408 <GO>}

Andy, this is Mario. I kindly ask George to take care of the last question because I wouldn't be able to address it. On the campus organization, yes, we're putting together life in GI in the campus and we're testing now this simpler organization in three European countries, but not yet in UK. UK is a different market. In there, what we want to achieve is to have a unified digital view on the UK market, avoiding having competing request from this joint business unit. But I don't think that we will go into the direction in UK of merging GI and life. I don't think this make sense given the market.

Now, this is mainly relevant to retail. In retail, I think it does make full sense to do this, because when you confront an individual, the individual doesn't really distinguish between products. They have needs and they don't like to have different answers to their needs depending on to which Zurich units the people bringing the answers belong to. So there are lot of advantages in terms of customer management and customer facing in unifying the retail management skills and people.

Now, you said how can life people run GI? So, first of all, we're already have in Switzerland, Germany, in Italy country CEOs who are already in charge of both businesses, and I think they have proven competences irrespective of where they're coming from before. What we're doing is not only working on the country CEO, but unifying the country structures, which we're, even under on CEO, often still disjoint from each other.

And ultimately, your question is if we will choose good or a proper country CEOs given the skills we have available. I think, so far, I'm pretty much relaxed that we have competences in place and we will closely monitor also for the future. Did I catch your question?

Q - Andy Hughes {BIO 15036395 <GO>}

It's fine. Thank you. And the numbers?

A - George Quinn {BIO 15159240 <GO>}

And the other one on the life cost savings, so let me answer it to the extent that the cost saving impacts life is a capitalization impact and given the duration of the business, that can have a positive impact. The short answer is, I don't know the answer to your question today. The main focus is actually on driving the cost of assessment, improving the operating performance. And if you allow me, I'll give you more thoughts when we come back for the Investor Day and we touch on costs again there. But you're absolutely right.

Q - Andy Hughes {BIO 15036395 <GO>}

Okay. Thank you very much.

Operator

Our next question is from Niccolo Dalla Palma, Exane BNP Paribas. Please go ahead.

Q - Niccolo C. Dalla Palma {BIO 16052945 <GO>}

Hi. Thanks very much. Just a quick and boring one from my side on the tax rate, you have clearly guided for what we should expect in the second half of the year. Just wondering if the previous guidance of around 25% normalized tax rate is still valid for the years after that so what's driving the difference also for the second half of the year and how we should think about that? That's all. Thanks.

A - George Quinn {BIO 15159240 <GO>}

Thanks, Niccolo. They are still valid. So the longer term expectation is still around that 25% range. What's really driving what you see at the moment is, the principle thing is restructuring. So we had restructuring last year, we have it again this year. It tends to fall disproportionately in the centre and we get very limited tax relief on that cost. And that's what tends to push the rate up.

We have another factor in the first half, which is around the cat losses or cat protection. Our center of excellence for that is in Bermuda and that also means we get in a bad year less tax relief then we would like. But the main driver is restructuring, but longer term, 25%.

Q - Niccolo C. Dalla Palma {BIO 16052945 <GO>}

Very clear. Thank you.

A - Richard Burden {BIO 1809244 <GO>}

Well, thanks very much, everybody, for dialing in today. We are conscious there are a few more questions out there, but unfortunately, we don't have any time to take them right now, but obviously, the IR team remains at your disposal for any questions you have this afternoon.

I'll just remind you tomorrow, obviously, we have the supplementary call around the GI reserve disclosures. There's also a webcast with that. So please follow that from the slides. So, with that, we'd close the call. And thank you and look forward to speaking to you in due course.

Operator

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