S&P Global
Market Intelligence

Swiss Re AG SWX:SREN

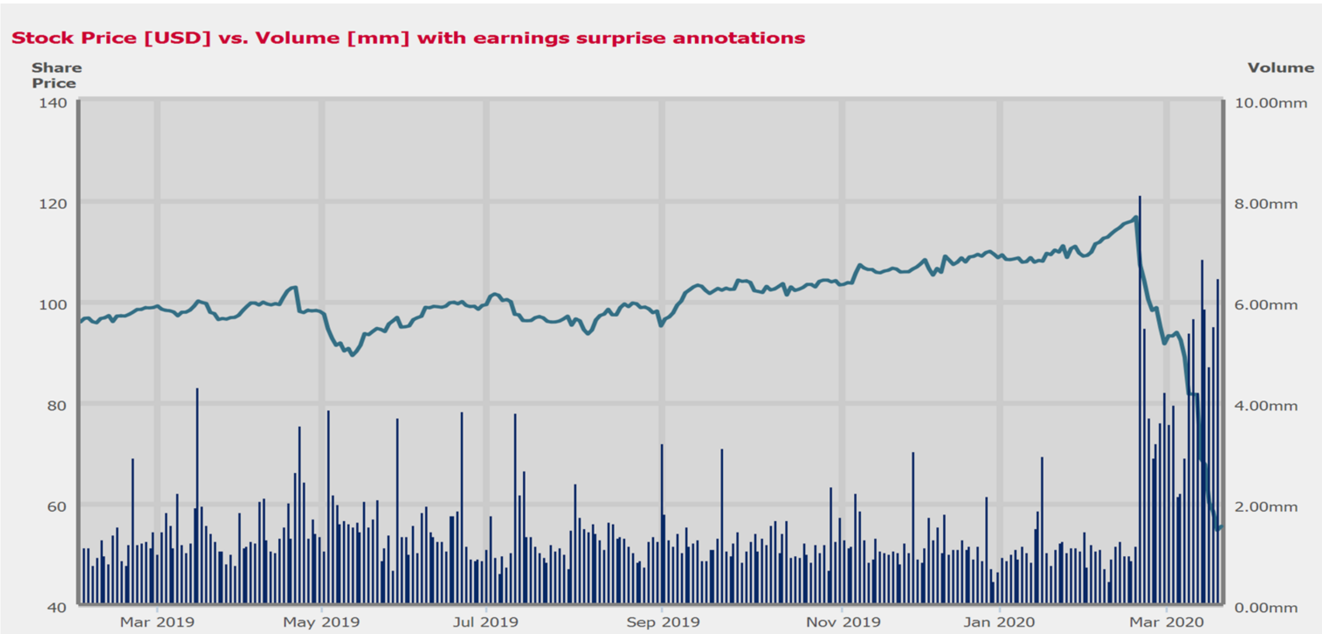
FY 2019 Earnings Call Transcripts

Thursday, March 19, 2020 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2019-	-FQ1 2020-	-FY 2019-			-FY 2020-
	CONSENSUS	CONSENSUS	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	-	-	4.35	2.39	(45.06 %)	8.28
Revenue (mm)	8231.49	9465.81	37064.80	37974.00	2.45	39064.81

Currency: USD
Consensus as of Mar-18-2020 12:30 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FY 2019	4.35	2.39	(45.06 %)

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EXECUTIVES

Edouard Schmid
Group Chief Underwriting Officer & Member of Executive Committee

John Robert Dacey
Group CFO & Member of Executive Committee

Philip Long;Chief Actuary

Philippe Brahin
Head Investor Relations and Head Governmental Affairs & Sustainability

ANALYSTS

Andrew James Ritchie
Autonomous Research LLP

Emanuele Musio
Morgan Stanley, Research Division

James Austin Shuck
Citigroup Inc, Research Division

Kamran Hossain
RBC Capital Markets, Research Division

Presentation

Operator

Good morning or good afternoon. Welcome to Swiss Re 2019 Annual Report Conference Call. Please note that today's conference is being recorded.

At this time, I would like to turn the conference over to John Dacey, Group CFO. Please go ahead.

John Robert Dacey
Group CFO & Member of Executive Committee

[Audio Gap] who are dialing in from the Americas, and welcome to today's Q&A. Joining me from Swiss Re's -- from the Swiss Re's side are Edi Schmid, our Chief Underwriting Officer; Phil Long, our Chief Actuary; and Philippe Brahin, our Head of Investor Relations.

Because of the current special situation -- excuse me, special situation related to COVID-19, Edi, Philippe and I are in a room in Zurich, maintaining the recommended distance from one another, of course, while Philip Long is in London, joining by phone.

Today, we published the 2019 annual report which includes our EVM or economic results and our Swiss Solvency Test reporting. We also published our P&C loss ratio development triangles and our sustainability report. As last year, we have prepared a presentation focusing on the most relevant areas of our disclosure and we will briefly take you through this in the next few minutes, highlighting the most important elements.

Firstly, on the economic results on Slide 4. We provide an overview of the main drivers of the 2019 EVM results. An elevated level of large nat cat losses and ongoing adverse U.S. casualty trends significantly impacted our results. However, there was a counterbalancing effect from the strong performance of Life & Health Reinsurance as well as an excellent investment result. This led to economic earnings of USD 2.9 billion in 2019. Details on how this breaks down is into the performance of each business segment can be found on the subsequent pages.

Moving on to Slide 10. We remain focused on delivering our group financial targets. In 2019, the economic net worth per share growth was 8.2%, representing an improvement compared to 2018, but still below our 10% per annum target over the cycle.

Moving on to the section on our economic [Audio Gap] record. We have demonstrated significant economic earnings strength over time, providing the basis for our capital generation, dividend and reinvestment capacity. As you can see on Slide 13, we have generated about USD 3 billion of economic earnings per annum on average over the last 5 years. This is mainly driven by strong EVM profit from new business, representing the value of new business written in each year after reserving for our cost of capital as well as the capital cost releases for underwriting and investments. While there can be movements from prior year developments or debt costs or tax, these are expected to average closer to 0 over the long term.

Today, we also published the group SST ratio as of 1 January 2020, which stood at 232%, including the proposed regular dividend and share buyback program on which the AGM will vote in a month's time. Clearly, the financial market volatility experienced globally since the beginning of this year will have impacted our SST excess capital and therefore, our group SST ratio. As things continue to evolve, the Board of Directors will evaluate the appropriateness of launching the buyback program in the second half of 2020. We will make a decision based on our usual capital management priorities with the best long-term interest of our shareholders in mind.

Nonetheless, let me reiterate that Swiss Re Group remains strongly capitalized and resilient to market shocks. We've had the chance to do an interim update ahead of our regularly scheduled Board meeting yesterday. And I can tell you that as we began the week, the group's SST was comfortably above 200%. Our capital position is also superior when compared to peers, as you can see on Slide 18. On a Solvency II basis, without the application of any transitional volatility or long-term guarantee adjustments, our ratio as of the first of January would have been in excess of 260%.

On Slide 22, we show the moving parts for the group SST 2020 ratio. You can see that the contribution of our economic earnings, the capital we deployed into the business through our P&C renewals and the growth in Life & Health Reinsurance, the impact of our deleveraging and finally, our strong capital repatriation to shareholders during the course of the year.

I'd also like to point out on Slide 24, on which we highlight our financial flexibility, particularly through the debt deleveraging, contingent capital not counted as part of the SST capital and our increased use of third-party capital for selected risk pools.

We have also updated the overview of dividend upstreams to the group for you on Slide 25. The overall capital repatriation for the 2015 to 2020 period would amount to USD 13.6 billion.

I'd like to conclude my introduction with some comments on the COVID-19 pandemic, which you can see highlighted on Slide 21. The group is closely monitoring developments as the situation evolves. As you know, we've developed a proprietary pandemic model to assess scenarios and enable active monitoring. Let me elaborate a little. First, I'd observe that Swiss Re's own business remains resilient in the current environment. We have long spoken about the depth and breadth of our relationships with our reinsurance clients. That is again serving us well as we continue and increasingly operate remotely. For example, our April 1 renewals, focus on Japan, are proceeding without any interruptions. Our Reinsurance revenues are secure. On proportional covers where primary company's premiums are below expectations or may be below expectations, there may be some impact on our revenues, but we have yet to see anything material. There may be more impact in our primary businesses revenues, but it's too early to say how much.

Second, the major impact of COVID-19 on the insurance industry to date is on the asset side of the balance sheet. We entered 2020 with an extremely strong balance sheet overall and prudent positioning on asset risk. As the pandemic started to unfold, we have put in place hedges that partially mitigate the economic impacts of falling equity prices and widening credit spreads. We have also recently opportunistically lengthened some durations as a partial hedge against further yield decreases.

Third, there are potential impacts from this pandemic on our P&C and Life & Health businesses. We assess all of these potential impacts to be entirely manageable at this point. With respect to event management and cancellations related to specific events, we believe we have an overall market share of approximately 15% to event covers that could be claimed due to COVID-19. We have a specific exposure of USD 250 million to the Tokyo Olympics, and a mid-3-digit exposure split between CorSo and P&C Re for other events scheduled over the rest of the calendar year. We have potential exposures through our credit and surety lines of reinsurance and CorSo, but it's premature to estimate any exceptional losses due to COVID-19. Similarly, it's too early to give any indications of industry and Swiss Re's losses related to business interruptions. While the vast majority of property and business interruption covers have a physical damage trigger, some policies may not, and those that do may have specific sub limits to provide modest covers independent of physical losses. We remain vigilant and continue to support our employees and our clients as the global economy, governments and society continue to weather this pandemic.

With that, I will hand over to Philip Long, our Chief Actuary, for the next session of the presentation.

Philip Long;Chief Actuary

Okay. Thank you, John, and good day also from my side. Now the materials published today also include the P&C loss ratio development triangles on an underwriting year basis, on which I will provide some remarks.

As you can see on Slide 27, these triangles cover approximately 75% of our total P&C reserves, as they do not include asbestos and environmental reserves and some other business, including the pre 2004 business. Now before we go into specifics, I'd like to point out that our overall reserving comfort is maintained across the group's P&C reserves. And that the adverse trends experienced in U.S. liability, which we highlighted with our U.S. GAAP full year 2019 results, are manageable in the context of our large and well-diversified book.

Taking a step back, as you may be aware, Swiss Re applies a best estimate approach to reserving as required under U.S. GAAP. Now on Slide 28, we have set out a reminder of the reserving philosophy and governance process at Swiss Re. This process remains very robust and transparent.

To outline how the process works, when contracts and transactions are concluded, the estimates of ultimate claims are typically based on the assumptions underlying the original pricing of the business. Over time, as the claims experience develops, the actuarial reserving methods gradually give more credibility to the actuarial experience, and so reserves are adjusted from the initial loss ratio. To allow this to happen in a timely manner, we have multiple feedback loops in place between the pricing and reserving actuaries. These links are vital and also take into account qualitative information on trends and market conditions, and information from our clients. This aims to improve reserving accuracy and to enable Swiss Re to react faster when actuarial experience deviates from expectations. Whilst reserving actuaries proposed reserves, the decision is made by regional and business unit management at the regional reserving committees and finally, at the group reserving committee.

The strong governance process in setting best estimate reserves is complemented by the second line of defense role played by my team, Actuarial Control, who carry out regular independent reviews and assess the positioning of reserves within our range of potential best estimate reserves.

Moving to Slide 29. You can see the actions taken in late 2019 as a result of increased client notifications, reflecting the functioning of this challenge process and the respective feedback loops. The slide shows the marked pickup in claims notifications in U.S. liability for both P&C and Corporate Solutions at the end of 2019. This led to immediate increases in case reserves as well as IBNRs as Swiss Re utilized the most up-to-date information to set reserves. Evidently, these reserve actions led to an increase in our 2019 ultimate loss ratios for U.S. liability lines.

As illustrated on Slide 30, these increases were offset by improved pricing for both Reinsurance and Corporate Solutions. Actions taken to reduce casualty exposure, which did not meet profitability levels and selective attractive growth, these actions justify improved profitability for our casualty portfolio.

Now I would like to reiterate the Swiss Re Group's overall reserving strength. Based on the measures taken at the end of 2019, our P&C results remain positioned on the upper half of the best estimate range between the 60th to 80th percentile. This also holds true for casualty reserves alone. Liability reserves remain adequate, as book reserves are closer to, but above the midpoint of the best estimate range. We continue to monitor developments closely in the face of ongoing industry uncertainty and will continue to respond in a timely manner. Overall, Swiss Re has a large and well-diversified P&C reserve book and has the resilience to absorb volatility.

With that, I'll hand over to Philippe Brahin, who will introduce the Q&A session.

Philippe Brahin
Head Investor Relations and Head Governmental Affairs & Sustainability
Thank you, Philip and John, and good day to all of you also from my side. So as usual, before we start, I'd like to remind you to please register yourself if you have follow-up questions during the call today. So with that, operator, can we take please the first question.

Question and Answer

Operator

Your first question comes from Andrew Ritchie from Autonomous.

Andrew James Ritchie
Autonomous Research LLP

First question, SST sensitivities. Just judging by what you said, John, if the current ratio is well north of 200% and the sensitivities -- the actual sensitivities have been less than the disclosed ones. Could you just give us a sense as to what the hedging has done with respect to the sensitivities? Could you also, on the same topic, tell us roughly what the sensitivity to credit would be, excluding ReAssure?

The only other second question I had, could you -- you didn't talk about life claims in relation to COVID. Could you just remind us what the underlying assumptions are behind your disclosed pandemic stress?

John Robert Dacey
Group CFO & Member of Executive Committee

Sure. Maybe I'll ask Edi to answer the second question. With respect to the sensitivities, you're right, some of the hedges we've been able to install in February and even this month have dampened the impact of the declines we've seen in equity markets, the spreads in interest rates. I think as a guideline, what we present on Page 20 is still directionally the best starting point. And I -- while these hedges may be on -- in place for now, we are managing dynamically, and I think it'd be premature to give you a different set of sensitivities.

The other thing I would say is some of these lines, and especially with respect to interest rates, are not necessarily linear, but have a convexity dimension to them, especially over larger movements. And as a result of that, I'd be cautious about trying to get a little too precise here. We -- currently, we would plan to give you a formal update based on the July 1 numbers. We'll see what might make sense in providing more information about sensitivity and/or the overall position when we give our Q1 results at the end of April.

So with respect to the impact of reducing ReAssure, I think the sensitivity on credit spreads would probably drop by a couple of percentage points, call it, 2, for an estimate. But the good news is the ReAssure portfolio itself was prudently positioned going into this crisis. I think there's no unpleasant surprises there for us or for Phoenix, and we continue to believe this transaction is on target, as we said, to be closed in the beginning of the third quarter.

I'd simply reiterate the other point with respect to that transaction that the impact -- the positive impact on SST from divesting ReAssure is not in the 232% calculation. And in spite of where financial markets have gone, we still believe that's going to be an uplift. Right now, we'll range it between 10 and 12 percentage points. I think previously, we might have said 12 percentage points. So it might not be quite as impactful given where we are, but it may end up that big. Edi, on the pandemic?

Edouard Schmid
Group Chief Underwriting Officer & Member of Executive Committee

Yes. Thanks, Andrew, for the question on our Life & Health exposure, what we disclosed is the 1 in 200-year pandemic loss, which is on an updated basis, as we disclosed USD 3.1 billion. Let me give a bit more color how this number is derived. Obviously, pandemic has been identified as a key risk factor for our mortality business in a long time. So similar to the nat cat space, we have a lot of in-house expertise and built a pandemic model for a number of years, which is, in the end, probabilistic model. So you have to picture something like 50,000 different pandemic scenarios applied to the underlying mortality book, which is then described in terms of regions, density of people, the age distributions. So all these 50,000 scenarios are run on the population and then we come out with this loss distribution curve and the 1 in

200-year point on that curve corresponds to $3.1 billion. Maybe try to make this a bit more tangible how such a scenario could look like that is equivalent to a $3 billion loss level.

Just on a high level, we would talk about excess mortalities in the range of something like 1 per mil. Again, it will depend in each country depending on the distribution of people, the capability of the healthcare system. But just as a rough number, we're talking about 1 per mil excess mortalities. Maybe I just pick 1 or 2 countries to make it a bit more tangible. If we were to look into China, because that's where COVID started, and give a perspective. So in our pandemic stress scenario, at that level, we would be talking about an excess mortality of 1.82 per mil. This would actually mean that in China, 2.5 million additional people would have to die to reach that level. And as you know, today, in China, we talk about a bit more than 3,000 people. So obviously, we are far away from that level. So that's China, where we have a conservative assumption.

If I look, for example, into the U.K., that kind of scenario would be equivalent to an excess mortality of 1.2 per mil. If you apply this to the U.K. population, we would be talking about something like 80,000 additional people killed from this pandemic. Obviously, at this point, this is all very uncertain how it evolves. As China has shown, it's very important that government and societies really take decisive measures to slow down or stop the spread and to avoid that the healthcare systems are being overburdened.

But hopefully, with these 2 points in China and in the U.K., it gives you a sense of what level of excess mortality we are talking about. And it's very clear that at this point, we are far away from that scenario, but we now really hope that the measures are taken so that the survivors can be contained. And then also the consequent death toll should hopefully be quite limited at the end of the day.

Operator

The next question comes from Kamran Hossain from RBC.

Kamran Hossain
RBC Capital Markets, Research Division

So I just want to touch back on solvency and the SST ratio. I hear it's really good news that it will come to above 200%. Can you just confirm whether the buyback assumption is still included within that come to be above 200%? Or whether there's some kind of pro rating or assumption that's not in there?

And the second question is, hopefully, we never reached this point, what flexibility do you have to run below 200% on an interim basis, given that you will have an uplift from ReAssure coming later in the year?

John Robert Dacey
Group CFO & Member of Executive Committee

Sure, Kamran. I'll take both of those. The first one, we've continued to include a deduction for the share buyback in the calculation of the 232%, if it turns out that we decide that the share buyback would not occur, that would be another 5, maybe even 6 percentage points in the SST ratio due to the available capital, therefore, in the -- remaining in the group. I think the -- that conservatism is appropriate. The Board discussion yesterday was we're in the middle of a very challenging situation. It's challenging for us. It's also challenging for our clients. We'll see to what degree that has an impact on demand for reinsurance over the next quarters, but you could certainly imagine a situation where we see real opportunities to put capital to work on a going-forward basis to help serve some of our clients who might be interested in either removing some of their own risks and/or enhancing their capital through the use of reinsurance.

With respect to the flexibility, I'd say, we talked about 220% as a target, I think the Board appreciates that we are in a -- in this challenging environment where there are areas of stress. We've been proactive in managing what we think are some of the bigger sensitivities that are posed by the financial market movements and frankly, feel pretty comfortable that we've done a good job of managing the volatility and position to continue to manage that volatility. I think when I say we're comfortably above 200%, it doesn't mean that 200% is going to be the point where we stop writing business. We have the ability to adjust around that so long as we continue to maintain the dialogue with the Board. I would also say that in addition to the 10 to 12 points we expect when we close the ReAssure deal, we do have sitting on the sidelines here, the $2.7 billion of continuing capital available to us at our discretion to bring in to our capital structure. And again, none of that is counted in the 232% SST or the number that I just gave you, which is indefinite, but the above -- comfortably above 200%.

Operator

[Operator Instructions] The next question comes from James Shuck from Citi.

James Austin Shuck
Citigroup Inc, Research Division

So 2 things from me. Firstly, on the casualty side of things, I'm just trying to get a feel for where we're at in terms of that reserve development and loss picks, given what's happening in markets as of now? I appreciate your direct exposure through event cancellation, business interruption, et cetera, that might be quite limited. But one might expect a casualty crisis 2.0, possibly emerging in 2020 for certain reasons. So Edi, I'd be keen to get your view on the outlook on the reserving and loss picks on that side?

Secondly, just a point of clarification. I know that you're saying that you expect ReAssure to close at the beginning of Q3, you've been pretty clear on that. Might it be possible a material adverse change clause be invoked at this stage or something similar? Just clarify on that point, please.

And I guess, the final one is just around the debt situation. So I think you mentioned the $2.7 billion prefunded sub debt. You got $1.9 billion of drawn letters of credit. At what stage would you look to draw down more of those letters of credit and to actually draw down on that refunded sub debt, given what's happening in markets?

John Robert Dacey
Group CFO & Member of Executive Committee

Jim, thank you. Maybe you start, Edi, on the real developments, casualty?

Edouard Schmid
Group Chief Underwriting Officer & Member of Executive Committee

Yes. Thanks, James, for the question. I think your question is quite a difficult one to project the kind of the impact of the COVID development, recessionary outlook overlay with the general casualty development in the U.S. I think that's quite a difficult picture to paint. I think excluding COVID for the time being, we really remain on the same view as we were before. U.S. liability has been very tough space to explain the situation in terms of low rates the last couple of years, the very aggressive tort environment leading to increased severity driven by social inflation on particularly covers, indeed umbrella or excess. I think that's continue to see the underlying market has reacted a lot. Rates are going up a lot, limits of that cases are going down. So I think that development will just continue. What now will be the additional, let's say, impact of COVID and recessionary outlook, I think there's many factors, pluses and minuses. You could argue that a recessionary outlook could dampen inflation, so has a positive impact, but there will also be some coverage challenges out there. So it's really hard to predict. So I think, at this point, as you pointed out, we have exposure, as John explained, on event cancellation, credit and surety is exposed. But again, it depends on how the recession develops in terms of scope and breadths and at lengths. And then there may be exposures also on the business interruption side. I think John explained that in the beginning, that usually, it really requires physical damage trigger, but there is policies out there with sublimits for nonphysical damage, including some noninfectious disease, so that there is potential for losses, but I would not see, let's say, the U.S. liability or casualty space is particularly additionally impacted by the COVID development. Some pluses and minuses, and we -- as we explained earlier, we stick to anyway, a cautious approach to U.S. liability based on these underlying factors. That's what I would say on the casualty one. I couldn't quite catch the second one.

John Robert Dacey

Group CFO & Member of Executive Committee

I think it was with respect to ReAssure. So let me jump on that. There is no mat clause in the sales and purchase agreement with Phoenix. As I mentioned, I can say that to date, the turmoil in financial markets does not have any surprising impact on the ReAssure balance sheet. And I don't see any reason why there would be a particular problem. Obviously, the share price of Phoenix has been negatively affected along with most all the other insurance stocks in the world. The PRA is still evaluating the transaction and has not given their final approval. I think that is largely the one approval that's condition precedent that we're waiting for. But there's been no indication that they've got any red flags or other problems there. So I think it's not over till it's over, but we've got no reason to be less confident than we were 5 weeks ago.

Your last question, I think, was related to the contingent capital and sub debt letters of credit. What I'd say is, we've included these instruments as part of a broader approach to maintain a very robust capital strength and exactly the kind of prices we're seeing. We don't feel like we're near a point where we need to call on them. But should we find ourselves, for one reason or another, in much more difficult circumstances, we have them at our disposal. I'd also say, while the crisis is putting stress on lots of people and lots of places in the industry, I'd just reiterate the comment I made earlier. There may well be some very interesting opportunities for us especially in our core Reinsurance business to support our clients over the next quarters and being sure that we've got enough capital to do that is one of the responsibilities that I hold as CFO of the group. So we will try to keep some of this powder dry until we can use it, but we won't be afraid or shy to use it if we think it's in the interest of shareholders and does not otherwise put the group at risk.

I'd say, in addition to this, I mean, you probably remember a long time ago or it seems like a long time ago, it's probably 4 years, we've also issued some CoCos, which are capable of providing additional capital under true stress situations. I think the one we have, if I remember correctly, had an SST trigger down at 135%. We are far away from that. But in the meantime, we'll -- if we believe it's smart and in our interest to utilize some of this other capital, we'll do so.

Operator

The next question comes from Emanuele Musio from Morgan Stanley.

Emanuele Musio
Morgan Stanley, Research Division

I have 2 questions on COVID-19. The first one relates to the U.S. In U.S., lawmakers are urging insurers to pay BI losses from COVID-19. Policy wording in many cases seems to be excluding BI coverage for pandemic. So I was wondering what is your view on this. The last time we had something similar was in the aftermath of Hurricane Katrina and insurers were under legal battle after years of calculating basically. So if you can give me some color in this respect.

Secondly, regardless of what the outcome of this element will be, I'm wondering whether this might anticipate a trend where policyholders or lawmakers start to claim on the insurance industry, will lead to an increase in legal costs. So perhaps a higher attritional losses or anything like that?

John Robert Dacey
Group CFO & Member of Executive Committee

So Emanuele is the one American in the room. I'll take my best shot at this. There has been some anecdotal indications where legislatures or individual lawmakers are looking around for deep pockets and in particular, asking whether the insurance industry might step in here. I think it's pretty clear, Swiss Re as an institution in the industry, our peers and reinsurance clients are keen to play their role correctly in managing some of what are undoubtedly tragic losses along the way. But we also are keen not to expose ourselves and our shareholders to pay in losses, which were not part of original coverages, and for which we did not receive premiums. And so I think, at least, at the moment, we've not seen what I would say is a serious attempt to move this concept forward. It's not obvious to me why the insurance industry should be more at risk on this than any other industry in terms of covers.

What we would like, frankly, and you may be tired of us speaking to this, but Swiss Re Group has been talking to the protection gap for years. And part of this, especially on the covers for individual lives, is related to that. We are constantly evolving and trying to build products which we think cover real risks. Our ability to absorb a massive amount of true pandemic cover is finite just because of the accumulation, but we're happy to try to do more on a going-forward basis. But retroactive redefinition of risk exposures for the industry broadly make no sense to us and no sense to our Reinsurance clients. So I think you'll see a major resistance by the industry and by reasonable people around this. So our goal is to do what we can to help support the healthcare industry, in particular, to manage this crisis, to use the modeling tools and data that we have to help better informed decisions to mitigate the worst scenarios that we can see play out here. And that's where our focus is.

Might there be some legal costs associated with this? Yes, there might be. But at the moment, we don't see a particular source of losses for us or the industry.

What's the space, we're paying attention.

Philippe Brahin
Head Investor Relations and Head Governmental Affairs & Sustainability

Actually, we have come to the end of our Q&A. If you have any follow-up questions, don't hesitate to reach out to any member of the IR team. So thank you again for joining today. We wish you all to remain safe and healthy. Operator, back to you.

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