S&P Global
Market Intelligence

Zurich Insurance Group AG SWX:ZURN

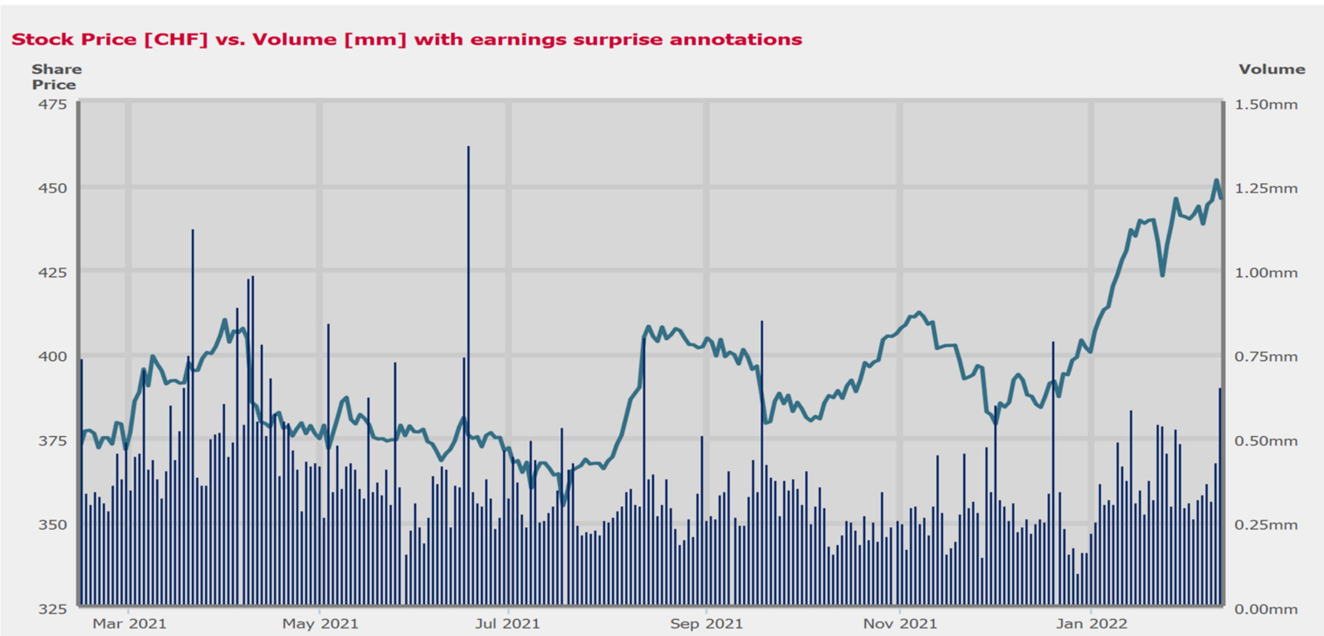
FY 2021 Earnings Call Transcripts

Thursday, February 10, 2022 12:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2021-			-FQ3 2021-	-FY 2021-	-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	6.84	NA	NA	6.35	26.69	NA
Revenue (mm)	NA	NA	NA	NA	49746.28	NA

Currency: CHF
Consensus as of Feb-10-2022 2:35 PM GMT



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Group CFO & Member of the Executive Committee

Jonathan Michael Hocking
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Group CEO & Member of the Executive Committee

ANALYSTS

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Autonomous Research LLP

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James Austin Shuck
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Louise S. Miles
Morgan Stanley, Research Division

Michael Igor Huttner
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Peter Eliot
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HSBC, Research Division

Vinit Malhotra
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William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

William Fraser Hardcastle
UBS Investment Bank, Research Division

Presentation

Operator

Ladies and gentlemen, welcome to the Annual Results 2021 Conference Call. I am Ali the Chorus Call operator. [Operator Instructions] The conference must not be recorded for publication or broadcast.

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

Jonathan Michael Hocking
Head of Investor Relations & Rating Agency Management

Thank you. Good morning and good afternoon, everybody. Welcome to Zurich Insurance Group's 2021 full year results call. On the call this afternoon, we have our Group CEO, Mario Greco; and our Group CFO, George Quinn.

Before I hand over to Mario for some introductory remarks, just a reminder that we currently ask you to keep your questions to 2 per individual in the Q&A session. Mario?

Mario Greco
Group CEO & Member of the Executive Committee

Thank you, Jon, and welcome, everybody. Thanks for being on the call. As we entered Zurich 150th anniversary year, the Group is in excellent shape. 2022 is also the final year of our 3-year strategic plan. We are on track to meet or exceed the targets that we established back in 2019 and I look forward to hopefully seeing you all in November when we will set out our ambitions for the next cycle.

As I said back in November last year at the investor update, we have had to be extremely adaptable with the shape of the results being very different than we expected in 2019 given the impact of the pandemic. I'm very pleased with what we have achieved in 2021. Results were among the best in Zurich history with the highest BOP and the best property and casualty combined ratio since 2007. However, we can continue to improve from here. And we believe that the trends in revenue and earnings growth will continue at least into 2023.

Across the retail business, we are benefiting from our work on improving customer engagement, which is evidenced by the strong net new customer numbers we have reported, robust top line in retail and SME Property & Casualty and by the excellent Life results. Commercial Insurance is reaping the rewards from its repositioning in the recent years with the continuing strength of the pricing cycle, providing an additional tailwind. We're also growing selectively in areas such as middle market, where we are continuing our build-out. Farmers is making good progress in integrating the MetLife business with a strong top line growth for 2021. And the balance sheet is very strong with the SST ratio at 212%, and a healthy increase in the dividend to CHF22. The SST ratio is before reflecting the benefit we expect to get later in the year when we complete the disposal of our Italian Life and Pension back book.

And now I hand over to George.

George Quinn
Group CFO & Member of the Executive Committee

Thanks, Mario. I'd just like to highlight a few additional points regarding the strength of our financial performance. P&C's result in 2021 was very strong with 11% top line growth and a 2% improvement in the underlying combined ratio. As Mario mentioned, the 94.3% combined ratio is the best in 15 years. Growth was robust with both commercial insurance and retail and SME, driving growth and it's not just rate driven, but also coming from disciplined new business wins. Despite PYD being slightly higher than our guidance range, we believe that reserve strength has further improved. And consistent with our prior comments on anticyclical reserving, we've taken a cautious view and not fully recognized the continuing benefit of rate versus low cost trend.

2022 should be a further year of growth and margin expansion for the P&C segment, and we expect to see a further strong improvement in performance in 2022 with the pace only slightly slower than we saw last year. We're really happy with the Life result in 2021, which benefited from the recovery in markets, strong growth momentum in EMEA and Zurich

Santander as well as favorable claims experience. We aim to grow earnings in 2022 at a mid-single-digit percentage from the reported BOP level.

Our continued focus on protection and capital light savings is serving as well as is our strong presence in the bank channel. In Farmers, the integration with the acquired MetLife business continues to go very well. The Farmers Exchanges' GWP was up 20%, including Met and 7% like-for-like. As for 2022, we expect further growth in the high single-digit range.

The balance sheet is strong and the changes that we're making to capital allocation will improve this further, both in quantity and quality. As outlined at the Investor update in November, our first priority is the elimination of earnings dilution. This is not a small number as some of you have already started to estimate. The Italian transaction doesn't trigger any significant earnings dilution and the changes that well are likely to come later this year. So hopefully, this explains some of the timing.

On the use of capital, more generally, our preference is to reinvest any further surplus for earnings and dividend growth, but if this is not possible, we will not retain surplus funds that we cannot redeploy productively.
With that, I'll hand over to the operator for the Q&A.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Andrew Ritchie with Autonomous.

Andrew James Ritchie
Autonomous Research LLP

It's not often number one on the question. Okay. George, could you give us just an update on the reduction of the inward cat exposure? I remember at the Investor Day, I think you talked about a 10% AAL average expected loss reduction in the U.S. Just where you are on that in terms of progress. Also, I guess, has there been any thinking because obviously, you've reinstated reinsurance since then given more constrained reinsurance that was available, do you think the 10% reduction in inward AEL is enough? Or do you think you need to revisit that? So that's the first question. Second question is a simple one. Why do you realize gains so high in the second half? I though you mentioned of equity gains. I don't know if that was tactical or what else was going on?

George Quinn
Group CFO & Member of the Executive Committee

Yes. Andrew, so I mean, just a reminder that when we had the investor update in November, I talked about what we were planning to do. In fact, we started to do already around some of the exposures that the U.S. business, in particular, brings us. We're aiming to achieve about a 10% reduction in AEL. That affects a number of different risk types includes U.S. winds, includes U.S. tornado, includes California quake. If I look at the overall program, we've got about somewhere in the mid-300s in terms of accounts impacted. We're expecting to see about 60% of the benefit by the end of this year, remainder to come next year. And if I look at the progress we're making, we're on track for that. I mean we're driving it -- again, I gave a fairly high-level summary of I mean what we're trying to do to achieve this. But for example, on the wind-exposed topics, we've introduced new gradings, we've got new underwriting requirements to try and direct the capacity more towards the preferred risk. And in fact, for some classifications, we don't offer capacity anymore. So I think you can expect to see about 60% of this, this year, 40% next, and we're well on track to deliver that.

On the related reinsurance topic, sorry.

Andrew James Ritchie
Autonomous Research LLP

Yes. No, sorry, sorry, you're about to address that, yes.

George Quinn
Group CFO & Member of the Executive Committee

Yes. You have to trust me to remember the second part or the first part of your question. On the reinsurance topic, I honestly don't see these things as connected. I mean, I think as you've seen from some of the U.S. reporters already, it's pretty clearly aggregate market is a bit dislocated. I mean, we've taken the decision to keep a foot in the door and to see how it further develops. But I mean reality is that I mean even though cat aggregate is certainly been helpful for us in the course of the last couple of years. It doesn't make an enormous difference. And if you look at the impact of the changes that we've made, so we will retain about the $100 million of exposure. And that's before you allow for the fact that we do actually pay for it as a premium that you would now. So I don't think the change there is significant enough to have us change direction on how we're trying to manage the topic more broadly. So we'll continue to do the things we talked about in November.

Andrew James Ritchie
Autonomous Research LLP

On the AEL, obviously, it takes time for that reduced AEL to be in place. Is there any earlier benefit from terms and conditions on property exposed or cat-exposed property. I'm talking -- I mean a more immediate benefit things like deductibles or hour courses or coverage. That's what I'm trying to grasp at, that will affect the '22 underwriting year.

George Quinn

Group CFO & Member of the Executive Committee

So I mean, if you look at the market generally, and this is true beyond property. I mean there's -- it's not just price. I mean you are seeing contractual improvements across the board. So I mean, this range from some of the things that do help define the extent of a catastrophe from a property perspective. It includes things like cyber. There's a wide range of things that I think benefits. I mean we don't try and put a $1 number to all of these. I mean even simple things like deductibles. I mean it's a pretty common feature of a response to corporate to hire a price to retain more of the risk. So that takes us more out of the frequency and provides a bit less exposure to those lower down events. Now typically, they're not in that cat though. So it tends to help us more, say, the attritional and what we would describe as the large -- so kind of the large man-made events.

On the cat side, things like -- that was closely certainly will help. But it's a topic across the entire book. And in fact, I think it's a benefit that you'll continue to see in performance, not through just this year and next. But I think long after we've stopped discussing what the rate trajectory is like, we'll still have benefits from Ts and Cs. Realized gains. So why so high? So we made some tactical shifts in the portfolio towards the end of last year. I mean we don't try and constrain, we don't try and push necessarily for particular outcomes. But the team, they haven't changed the strategic view of risk, but they did reduce equity exposure towards the end of last year. And that's one of the driver of the gains. Probably the other principle one is that we have property on a mark-to-market basis, and of course, given current trends, that's generally been positive for the Group. Those are the key drivers of what's on gain.

Operator

The next question comes from the line of Louise Miles with Morgan Stanley.

Louise S. Miles
Morgan Stanley, Research Division

My first one, George, you just mentioned it in your intro, you talked about redeploying excess capital. Just so I can get a better understanding, in the release, you talked about net earned premiums in the P&C business growing at mid-to-high single-digits next year or this year rather. How does that translate into capital consumption on an SST point basis? It'd be great to understand that a little bit. And then my second question is on Slide 4. You talk about the EPS CAGR of 7.3% for the business. If you look at the DPS CAGR, that looks like it's about 5%. Do you plan to close the gap between the 2 of them? Just trying to have a think about dividend trajectory from here?

George Quinn
Group CFO & Member of the Executive Committee

Sorry, on the second part of the question, the -- you were comparing the EPS to DPS. Is that what you were doing?

Louise S. Miles
Morgan Stanley, Research Division

Sorry, the EPS CAGR versus the DPS CAGR.

George Quinn
Group CFO & Member of the Executive Committee

Yes, okay. All right.

Louise S. Miles
Morgan Stanley, Research Division

7.3% on Slide 4.

George Quinn
Group CFO & Member of the Executive Committee

Yes. So the -- I mean the easy one to answer is the second one because that's a foreign currency topic. So that you've got -- I mean from a -- if you look at the dividend per share and the underlying currency of earnings, it will follow what we've seen underneath. I mean do we at this point, believe we have a gap. I mean I think I would argue, given we're paying the dividend is Swiss francs, you've actually got a higher growth rate on the dividend than you do on the earnings at the moment. So I'm not sure from our perspective, there is a gap to close.

On excess capital, I mean, it's a great question. I mean, one of the interesting challenges of certainly the more economic models is that assuming that we grow the book in a balanced way and in particular, if we don't overemphasize some of the peak risks, and of course, and the question that Andrew asked, you can see that we've clearly got a restricted appetite for some kinds of risks at the moment that are more capital intensive. I mean the growth rates that we're guiding to today for 2022 don't consume significant amounts of capital. I mean it's highly diversifying across the portfolio at large. And if you look at our book and you look at our capital models, I mean, it's a traditional peak risk drivers that dictate consumption and very few of them are present in the growth plans that we have for P&C for 2022. So I don't expect organic growth ambitions to be a significant consumer of capital.

Operator

The next question comes from the line of Peter Eliot with Kepler Cheuvreux.

Peter Eliot
Kepler Cheuvreux, Research Division

My first question, actually, sorry, very similar to Andrew's actually. But if I -- I mean, hopefully, we won't, but if we did get another year like we did last year, are you able to tell us roughly what the net cat might be, obviously, 6.5% last year. Just wondering what that would sort of translate to for 2023, if we got a similar year bearing in mind the changes that you just talked about to Andrew? Second question, obviously, very impressive reduction in expense ratio. We saw that already at the half year. I mean I think you said that to be split -- previously you said that can be split into discipline and also the sort of economies of scale that come with the top line growth. Are you able to give us any more feel for how those 2 drivers do split out and whether we can expect a sort of continuation of that if we do get the further growth coming through that you pointed out specifically?

George Quinn
Group CFO & Member of the Executive Committee

Yes, Peter. So if you look at the aggregate cover, we allow for the change. So it's -- and we'll say for the sake of arm because obviously, I don't want to disclose the premium, but let's assume that the impact is $100 million. If everything was the same, using the capacity in the aggregate as a guide, it would be about 0.003 point higher. That would be the change.

From an expense efficiency perspective, I mean, I think it's become a hallmark of the Group, but it's something that we're very focused on. You're certainly right that we got the benefit not only of the work we've done to become a bit more efficient and a bit leaner across the entire Group, but we've also had the benefit of growth. I think as we go into this year and you look at the expense ratio, and we break it into the 2 components. So we have the acquisition cost ratio, and we have what we refer to as the OUE or the administrative or overhead component, the Zurich expense part of the expense ratio.

On the acquisition side of it, I mean, given the mix of business that we've currently got and the expectations of continuing recovery of pandemic, I think we'll see some rebound around travel. I think we'll also see some rebound around the mass consumer business, particularly in Latin America. They tend to be relatively high distribution cost businesses. So they probably will nudge up the acquisition cost ratio slightly. I don't expect it to be particularly dramatic, but like-for-like, would make it slightly higher.

On the expense side, I mean we continue to push on expenses. The -- I mean, will the trajectory change from where we've been in prior years. I don't think so. I think the -- if I look at all of the dynamics around expense and of course keeping in mind that about 60% of the Group's expense burden is salaries, I mean there is a certain pressure from inflationary drivers of expenses. I think so far, we've been able to manage that by offsetting that with efficiency gain. That's still the plan for us in 2022. But what it does mean is that, I mean, probably a larger part of the expense gain will go back to staff, because of the prevailing labor market conditions. So I would expect that volume will be a bigger driver of an improvement overall in the expense ratio in 2022 than perhaps it was in the last couple of years.

Operator

The next question comes from the line of Will Hardcastle from UBS.

William Fraser Hardcastle
UBS Investment Bank, Research Division

First one, just I guess, with lots of moving parts, COVID catastrophe losses, what's the extent of the favorable year-on-year development in '21? And how does this compare to the pace of change in '20 and without pinning you to any sort of targets, I guess from a high level, directionally in pace? Any color that you can give on that? And then the second one is a really big high level one, but you've had a huge upgrade, it seems on your life BOP today. I guess a little bit more color here on what's driving it would be useful?

Mario Greco
Group CEO & Member of the Executive Committee

Yes, Will. So on the first topic, I think if you're prepared to look through the headline numbers and we characterize it in the same way that we have in prior years. I mean, we think that underlying is somewhere around the 92 mark. It would be about 2 -- maybe 2 to 3 point improvement over the prior year. If you look at 2020 over 2019 on the same basis, it's probably 1, 1.5 points of improvement. I think during the cycle, I would expect us to be closer to the improvement we saw in 2020, even 2021, just given the fact that rates moderated as we enter 2022 compared to 2021. I mean also worth adding that the rate that we're currently seeing is 2023 relevant as much as it is 2022. So to the extent that we continue this through the first half of the year, we will start to firm up precisely what's going to be delivered in 2023 already.

From a Life business perspective, I mean, the Life team, our Life business has globally done a fantastic job. If you look at it from a volume perspective, as a proportion, we write much more of the preferred risks. The growth -- I mean, it's not quite back to the level of 2019 on an APE basis, but the mix of what the teams are achieving is far better. So we write much less of any of the business that carry spread risk. We just have far more of the protection focus, the unit-linked focus driven by a wide range of businesses in Europe, the Zurich businesses in U.K., Germany, Switzerland are all doing a great job. Joint venture in Spain with Sabadell, very strong joint venture in Latin America with Santander also excellent. And I think -- I mean, one of the ones that has been a big driver in terms of turnaround is the Australian Life business. So as we get to the end of 2021, believe it or not, we're now starting to get very close to the business case that we committed to nearly 4 or 5 years ago when we announced the acquisition.

And I think the Australian business has more room to develop further. I think they're quite cautious on how they position themselves at the end of last year. We're the leading player in retail in the market, I expect to see further strength from them this year. The other thing that stands out in the results today, I mean we got -- we've highlighted what we described as one-offs. I think one-offs are not a very elegant way to describe some of the hard work that some of the local teams do in managing the in-force that results in changes, for example, in particular, reserving positions. I mean it's not always something that can be predicted with high precision, but we do have a good track record of producing a reasonably consistent level of income from what we do around in-force management. I mean looking at what's ahead of us, I don't really expect that to change in 2022.

Finally, we have COVID. It's the one place in the business where you continue to see the impact of the pandemic, tends to have more of a North American and South American flavor to it. I mean we've had slightly over $300 million of excess mortality in the course of 2021. It wouldn't be zero this year, but it's going to be a significant step down from where we were last year. So I think if you look at the book overall, I mean, we're very happy with the progress the team has made, and that's why we've given clean guidance from the headline number without adjustment today.

Operator

The next question comes from the line of William Hawkins with KBW.

William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

George, just picking up on the useful color you just gave about the Life business. I'm wondering if I could just press you more on some of the line items that are driving this. In the absence of your source of earnings disclosure, your profit is up about $400 million year-on-year in absolute terms. How much of that has come from what would have been the investment margin? And how is the technical margin, what would have been changed? And when you're thinking about the $100 million growth of 5% or mid-single digits implies for this year, which would be the key driver there is investment margin or technical margin or maybe something else? And if I can append to that, I appreciate you dropped the source of earnings disclosure because of the other pressures like IFRS 17 work. To what extent is there any restatement of your earnings going on behind the scenes so that you're creating a number which is strategically more consistent with what IFRS 17 may look like? I don't know if I'm taking a conspiracy theory too far. Second question, please.

Mario Greco
Group CEO & Member of the Executive Committee

I'm not sure I understand the second part of the question. What does that mean?

William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

Presumably, your earnings could be restated significantly under IFRS 17. And so I'm just wondering if whether your new earnings figure includes any kind of implicit smoothening into the new accounting regime. So is 1.8 a good base for what we're going to be thinking about under IFRS 17?

Mario Greco
Group CEO & Member of the Executive Committee

Yes, great.

William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

And then second question. In your guidance of high single-digit growth for Farmers premiums this year, how should we be thinking about the actual operating profit of the management services company. I'm not sure -- I mean, on the one hand, I can imagine it will be higher than that because you've got all the lovely synergies from P&C. And on the other hand, it could be lower than that because you still got the integration expenses and things. So do you take volume as also the sign of profit? Or if not, which way is the delta, please?

George Quinn
Group CFO & Member of the Executive Committee

Yes, great. So on the first one, so you're right. I mean we've removed some of the elements we would normally give because we have 8 clauses during the course of this year. I think if you look at the sources of the improvement over the prior year and just given the change in the mix of business, I mean, a very significant driver of this is going to be technical margin. It's coming from business that's typically carrying underwriting risk. So if -- I mean, I picked out Australia earlier because Australia is one of the biggest turnarounds compared to the prior year. I mean, that's a business that's almost entirely a combination of either what the Australians would refer to as lump sum i.e., TPD mortality at cover or DI, both of which are obviously dominated by protection features and therefore, technical margin. So there will be some of this, which is partly a recovery of markets, but I expect the largest driver of the outcome is the improvement in mix towards technical and that technical is driven by underwriting outcomes rather than investment outcomes.

On the second part of the question on the -- I guess, it's a different way of asking me what would your Life earnings look like under IFRS 17? All I can tell you is that we haven't done anything from a bulk perspective to try and anticipate IFRS 17 at this stage. And in fact, I don't expect that we will do that during the course of the year. I mean, the one thing that we did do, and we talked about this already on the Q3 call is we did make some changes that impacted -- to allow us to set up the best estimates in a way for transition for IFRS 17, so that some of the businesses that potentially could carry more risk into the new accounting standard would have more significant preference around them. But that's really the only thing we've done around anticipating IFRS 17 at this stage.

For farmers, I mean I think for the management company, I mean, there obviously there are 4 components. So I'm going to put the life company to one side a second. I'm going to put farmers read to one side assuming that, that has no significant impact. So we're left with, I guess, what was the management company now has the addition of MetLife to it. I think the growth figure that we've given for underlying is a pretty good guide to where you'd expect the fee income to go. I think you need to allow for the fact we still have some restructuring to do. So that will continue to keep pressure on the margin on the Farmers Workplace component, which is the old MetLife P&C business. But I think if you work off of the overall guidance that we've given for the exchange and you're prepared to make a reasonable split between the, let's call it, the old management company and Workplace Services and apply the 2 margins with a bit of a step up on what place, I mean that will give you a pretty good guide to where I'd expect the fee income to come out overall.

Operator

The next question comes from the line of Michael Huttner with Berenberg.

Michael Igor Huttner
Joh. Berenberg, Gossler & Co. KG, Research Division

And well done on macro profits for a record year. Two questions. The cash conversion. So it's really a way to ask what's the cash remittance growth going to be. But if I do the ratio of cash to net profit 85% being 5-year average 95%, but if I imagine convergence, there's a lot of growth to come. I just wondered if you could maybe so share some of the drivers of what could be. And then the second question, so Italy done the other deal which I imagine in Germany, as you say, maybe end of this year. So we'll have a lot less volatility on your asset side, a lot less risk. How much do you release in terms of capital, if you imagine that you could live with lower solvency buffers?

George Quinn
Group CFO & Member of the Executive Committee

Thanks, Michael. So on the first one on cash conversion. So the numbers are correct. We are through the first 2 years of the strategic plan that we have ending this year. First 2 years, we are pretty much at guidance at about 84%, 85%. And if you look back on a longer-term historical average, we have been higher than that. I mean we have said today that obviously, the ambition is to meet or exceed all the targets that we've given. I think if you look at cash remittance, I mean, I see no reason why it would slow down as we go into 2022. There's obviously some continuing impact from COVID, although it's not so significant as it was in the prior year. And we continue to have pockets that we would like to go after. So we've talked before about the fact that one of our largest entities continues to run at capital level that's in excess of the level that we target. And even though we've been successful in repatriating that -- some of that in prior years, it continues to exhibit that characteristic. And we would intend to go and tackle that again this year.

And I think that I mean the reality of those processes are that, I mean, we need to have local boards where comfortable. We need to convince regulators that these things make sense. So I don't expect a shift from where that business is to perfect line with target in 1 year. So I think there could be benefits from this that will flow this year, maybe also next year. So I think from a cash remittance perspective, I'm going to obviously avoid giving you a firm number, but I'm very comfortable that we'll be in excess of the cash remittance target that we established.

So on the second thing, so obviously, we've announced the transaction in Italy. That will have a small positive impact on the SST ratio when it closes has a smaller impact on liquidity. But I mean the real reason for us to do that again was the volatility that the predominant investment in that book can be traded issues for us around volatility of capital. It's a challenge to take too much beyond that because, of course, I'm not going to talk about other transactions that we are or are not considering. I think -- I mean, we've made a commitment that we want to go further in addressing the back book challenges that we have in the company. I think people can draw conclusions quite easily about what that might mean. I mean there's a certain complexity when we move into other jurisdictions. Again, that to some degree, reflects also the comments around the cash topic. So we need to work with business -- business team, the -- our local partners and very importantly, the regulators to make sure that all the stakeholders are comfortable with what we intend to do here.

I think the positive thing around some of the things we do intend to do is that, I mean they're not dependent on a flowback of local capital. We've been able to put in place relatively efficient financing structures already. Really the benefit of doing some of these things is for us to remove some of the super imposed capital requirements or as you highlighted, to have a lot less volatility and therefore, to be comfortable operating a level of capital that's lower than the one that we would typically target today. That doesn't mean a reduction in the 160. It just means where we operate in the range above 160.

In terms of quantum, I'm going to resist the temptation to make any comment on that yet. But obviously, the things that we intend to do are far more significant than the thing that we have done.

Operator

The next question comes from the line of James Shuck with Citi.

James Austin Shuck
Citigroup Inc., Research Division

In terms of the underlying improvement in the combined ratio at the full year, and I think about the accident year number ex coded, there was a slowdown from the first half to the second half. I think you kind of 3 points or so and then to 190 basis points or so. To some extent, I mean that should -- we could expect that, and I think you've probably got higher loss picks on some of your liability lines. But when I kind of break it out into expense and loss ratio, it seems like the biggest slowdowns on the expense ratio side. So just some color around whether that's timing differences or how to think about that slowdown. And kind of linked to that is, if we split it out the other way and look at it in commercial lines versus retail and SME. SME, I think, was improving by about 80 basis points the first half and then it was flat at full the year. So it looks like the reason actually deteriorated in the second half of the year. I guess that's kind of one thing about a possible headwind for you as we go into 2022. So just some thoughts about the retail SME outlook would be helpful, please.

And then secondly, on the PYD. So I mean, you are -- and have done recently for the first half of this year, second half, the PYD is kind of at or above the top end of your target range. You are saying that you are building margin at least in this period. So just should we be expecting that number to be coming out at the higher end as it has done in recent times? And if you are able to just comment on IFRS 17, when it comes to P&C reserving situation, are you likely to have to reserve closer to best estimate under IFRS 17?

George Quinn
Group CFO & Member of the Executive Committee

James, that's a long couple of questions. So on the underlying combined ratio, I mean, so your analytics are spot on. The -- one of the things I would love to cure is off is the fact that we have a significant expense skewed into the second half of the year. It seems to be one of those things. We can manage to bring down the total amount we spend, but we don't really seem to be able to fix the skew so much. And I think in the scheme of things, I'm more concerned that we become more efficient in total. So I'd love to tell you that we could get this thing more even, but there is a skew into the second half that's partly driving the characteristics that you see.

On retail SME, again, you're right by the outcome. I'd be more optimistic than you are. I think the -- on retail and SME, it's been a pretty tough market, especially for retail. I mean we've seen a rebound in the business, mainly driven by partnerships. So that certainly helped us. But if you look at the price dynamics, they're pretty flat in retail. I mean I think just given the prevailing market conditions and some of the challenges that are out there. I think in some markets, you have started to see an improving trend on price, and I expect that to broaden across all the businesses. So I mean, I think as we get deeper into this year, I'd actually expect retail to produce a stronger performance than they have from a rate perspective than they did in 2021. That's also true for farmers and the benefit that it will get from a fee perspective from what I think the emerging price dynamic is in the U.S. retail market.

On PYD, I -- so where are we going to be? I mean, I would expect us to be at or very close to the top end of the range. As you saw last year, we struggled to keep it within the range. I mean, in general, pressure tends to be to release more than to release less. We've tried to be appropriately cautious or prudent than what we've done, but I certainly think that as we go into 2022, at the high end of our target PYD range is a better indicator to the lately outcome than the low end.

On IFRS 17, I mean it's a listing issue. So the -- I mean you're obviously aware that there's a high -- there's a great perception of a best estimate component to the choices that are made. I mean we have not yet been all through that process with the auditor. I think it would be our intention to make the argument that the management's best estimate, which will include elements that there may be limited evidence of in historical data should still be incorporated into the IFRS best estimate outcome. So rather than see a very large reduction in the expected outcome, I think we're going to try and make the argument that the -- what might be perceived as margins are actually simply reflecting the fact that the data is never perfect. We get constant reminders of issues that can crop up that had not previously appeared in the data. So I'm hoping we won't see that step change down and that we can maintain a similar philosophy as we move into the IFRS 17 world.

Operator

Your next question comes from the line of Vinit Malhotra with Mediobanca.

Vinit Malhotra
Mediobanca - Banca di credito finanziario S.p.A., Research Division

Some of my questions have been addressed, but 2 I could think of. One is on the PYD that you just indicated, to a little bit high end of the range, 1% to 2%. What about inflation, social integration, those topics? I mean, would that be something that has been considered in this sort of revised guidance, if I can use that word? So that's the first question. Second question is just on the dividend and cash flow. So of course, I mean I have to say my attritions were met and consensus as well. But the payout ratio, 63%, cash flow, much stronger I mean, was the reason for not doing a bit more because you didn't want to ratchet up? I mean, the dividend policy is higher of last year -- so if you could just comment a bit about that would be helpful.

George Quinn
Group CFO & Member of the Executive Committee

Yes, Vinnie. So on the PYD topic, have we incorporated a perspective on inflation, social inflation, yes. In fact, on the introductory comment that I made, I mentioned the fact that we haven't fully recognized the benefit of rate versus loss cost trends. That's a bit of a departure from prior years. If you look at what we've done in terms of building reserve strength in the earlier periods, I mean, typically, we would have been releasing workers' comp reserves or something similar, maybe auto liability in some of the European markets and maybe adding to some of the most social inflation exposed lines in the U.S. I mean, this year, we've actually held back part of, again, what might be perceived to be margin just to increase the level of prudence and give us more ability to manage that topic if it becomes more significant. So I think we've tried to be preemptive around it and the PYD guidance considers those risks.

On dividend and payout ratio, I mean it's an interesting challenge. I mean I think -- I mean go back to the first question from Andrew. We clearly have a relatively unusual level of unrealized gain in the result today. So I would never simply take the headline number and base the outcome on that. I mean, arguably, I think you could argue a 75% may imply something slightly higher. I think there's -- I mean, there are several thoughts in the process that we went through. I mean, we've looked back over the course of the last 4 or 5 years. And if you look at earnings on average over that period in total, we're very close to a 75% payout ratio. So in years where perhaps for -- because of major losses, we've seen lower earnings or last year with COVID we saw lower earnings, in other years where it's been stronger, it has offset, if you allow for the passage of time. I think we also said at the investor update back in November, I mean, we clearly want to make sure that shareholders benefit in a way that reflects the improvement in earnings. But that for a topic -- as a topic for us it is going to be something for the end of the cycle, not the middle of it.

Operator

The next question comes from the line of Thomas Fossard with HSBC.

Thomas Fossard
HSBC, Research Division

Two questions on my side. The first one, George, will be to come back on the reserving strengths currently at Zurich. Will you be able to comment on the level of confidence currently that you have any reserve compared to where it's been in the past on an historical level, just to be understand if here also on a historical basis you feel very, very safe. And well, actually, you're building some additional prudence level, but maybe not all of it will be required going forward? And the second question will be related to your debt maturity. Actually, you're showing a slide, I think it sounds 41 of the slide pack, where you've got pretty significant amount of maturing debt, and subordinate 2022 to 2024. And I was wondering how much this was potentially putting some constraints on you to return a bit more cash to shareholders? Or I mean, is there anything that you could comment on the desired level of debt ratio you want to keep?

George Quinn
Group CFO & Member of the Executive Committee

Yes, Thomas. The -- I mean, obviously, as I look at the reserves, I don't have reserves for events that I don't expect to happen. Otherwise, I would be in trouble, quite quickly. I think what we try to do is to be consistent, to be conservative around how we approach it. And recognizing this is to rather than something that I'm scientifically proving. I mean I think in all of the last 3 or 4 years, even with the level of PYD that we've had, from our internal metrics, the percentile in our reserve range has increased. I think the only time that I've seen it go down recently was Ogden when, of course, we used part of the reserve strength to deal with Ogden. All other years, it's gone up. And currently, we would be at one of the highest numbers I can recall here if I'd probably the highest number.

I mean that doesn't mean to say that we've got a port that we can draw in when we wish. But what it does mean is that we create more resilience around some of the risks that we all know are out there, whether that's the inflation topic that was discussed earlier, whether that's just any other risk that can come up in the portfolio overall, and that includes the social inflational litigation topic in the U.S. So there's never any guarantee, but any number is going to be enough. But the number that we have today is higher than the one we had a year ago, and it's higher still than the 1 year before that. And I think it just gives us a measure of protection against some of the risks that are out there.

From a financing perspective and the general question does that produce any constraints for what we might like to do. Otherwise, I mean, not really. I think the -- if you look at the -- I mean, we gave this simplified capital structure picture. I mean, we are very close to the target levels. And in fact, after we do some redemptions, which will take place earlier in this year, it will actually look a bit underleveraged potentially compared to the target. Our aim would be to maintain it around those kind of levels going forward. So I don't expect the financing needs that we have over 2022 and 2023 to create any significant constraints on what we would like to do, either to invest in the business more broadly or if it comes to it, to increase cash returns to shareholders.

Operator

The next question comes from the line of Dominic O'Mahony with BNP Paribas.

Dominic Alexander O'Mahony
BNP Paribas Exane, Research Division

Two for me. Just the first one on the farmers outlook, the high single-digit premium growth. I wonder if you could just give us some color on the breakdown of that, the inorganic state, the organic. And I so what I'm really getting at is any sense of how you see that business progressing on a sort of a normalized basis into the next several years in terms of top line. The second question is really just, George, I wonder if you could expand on your opening comments on capital management. The -- in terms of the use of surplus capital to support growth, one of the things you said earlier was that your organic growth doesn't really seem to create much strain on capital at all. And so I'm sort of wondering if you have surplus capital, it's not really matter too much if you wanted to sort of press and accelerate organically. Is that the right way to think about it, that actually to the extent that you have service beyond that, organic isn't going to be the way that you deploy it, or have I misunderstood that?

George Quinn
Group CFO & Member of the Executive Committee

Yes, Dominic. So on the farmers topic, I think the easiest way to think about the split of growth, I mean, if you look at the growth, I mean, we've given 2 numbers for last year. So one was like-for-like, one is including Met. The net contribution is about 75% of the full year. So I expect to pick up the other 25%. So that would explain a slightly higher than normal guidance around farmers. And I'd expect both books to be growing kind of in that mid- to single-digit territory. I think the rate dynamic, as I mentioned earlier, seems to be picking up momentum in the U.S. It's clear that -- I mean, there are issues across the market with frequency and severity. That's going to drive rate filings, I think pretty much everywhere. And also in some of the key markets for the exchanges, you've seen some people step away and maybe move more to an E&S type structure. And I think, again, of course, that has a big impact on capacity and hopefully, some influence on the regulators where rate has to be filed for us to get -- or for the exchange to get the required approvals. So -- but I think this should be a pretty decent year, I think, for both of the businesses. But if you're trying to think of the Met part versus the former management company, the major part of the driver will be that 25% pickup because of the additional 3 months.

On the opening comment I made on capital management, I think your interpretation is pretty much spot on, so it's not zero, but if we grow the firm by 10%, and we grow it across -- especially across P&C and we don't grow in the highly exposed risk categories. I mean, we're not going to get close to a 10% capital usage type number. And in fact, I've said in the past that if you think of the capital generation, I mean we gave about 75% of it back, we keep about 25% of it. I mean that would fund pretty high single -- I mean, potentially even low double-digit growth rates across the entire firm. So the organic, I just don't see that being the principal way in which we absorb the capital levels that we currently run with.

I think from our perspective, I mean, we would like to deploy it if we see things that make sense. I think we've been reasonably successful in doing that over the course of the last 5 years. I mean things are not quite as active on the buy side as maybe they have been for some time, certainly for the types of risk that we're interested in. But I wouldn't completely exclude the possibility as we go through the year, we'll see things that we think could actually allow us to accelerate achievement of some of the strategic priorities, grow earnings, which, of course, grows the dividend, which is the primary goal.

Operator

The next question comes from the line of Henry Heathfield from Morningstar.

Henry Heathfield

Morningstar Inc., Research Division

Can you hear me, George?

George Quinn
Group CFO & Member of the Executive Committee

Yes. I can. Go ahead, Henry.

Henry Heathfield
Morningstar Inc., Research Division

Yes. Great. Just a couple of clarifications, really. So well, and interest in some accounting movements as well. On the acquisition of MetLife into farmers, I mean, I know you touched on this in answering one of the questions, but I'm just -- can I get a better idea -- can we get a better idea of how this business is now changing? You used to have farmers management service company, which was really just administration services working on the back of farmer exchanges. And now it seems to the acquisition of MetLife, you're actually moving more into kind of an underwriting business for farmers. Is that the way we should kind of -- I should think about it? So we've got this MetLife business, which now sits side-by-side and lists the Farmers Exchanges and the Farmers Management Services optimist, administration and management services for both those elements, if you see what I mean, maybe you could help me onto that. That's my first question.

And then with regard to your insurance contracts, it seems there's been a bit of kind of compression in the valuation, particularly within future life policyholder benefits and then in the policyholder contract deposits. I think on the first one of those, there's the big outflow of about $3.4 billion, which relates to the sale in Italy on Life. I was wondering if you can help me understand whether that's predominantly driven by the traditional guaranteed spread business, what you're really wanting to move away from that and move more into a unit-linked business or there's something else that I need to think about? That would be really helpful. And maybe if there's any color you might provide any more changes in the future going forward on kind of that divestments within that kind of traditional part of the business, if that's the case?

And then secondly, within the development of policyholder contract deposits, sorry, that was on the prior question, I'm referring to Page 42 of your financial statements. And then on Page 43, within the development of policy of the contra-deposits, there's a decrease of around $2.6 billion. I understand within both of these movements, FX had the largest part to play, but there's a decrease of about $2.6 billion that relates to other comprehensive income. Is that -- should I just -- is that really just movements in investments that relate to the value of the investments that sit in the liability -- perhaps you can just help me answer that. So that's my 3 questions.

George Quinn
Group CFO & Member of the Executive Committee

Henry, so the -- on the last one, can I ask you a favor. Can I have the IR guys call you back on that one because they can give you a better answer than I would on the call. On the other 2, on the MetLife P&C topic, so apologies, if I've left the impression that the Zurich side of the relationship is now engaged in underwriting, is not. So it continues to be a management company structure. As you pointed out on the -- in the traditional model, we provided service for a fee and it continues to be that. On the MetLife P&C following the MetLife P&C acquisition. So Zurich is not underwriting alongside the exchange.

Henry Heathfield
Morningstar Inc., Research Division

Isn't it quite Life -- that I mean did you acquire the underwriting part in the Life or?

George Quinn
Group CFO & Member of the Executive Committee

The Farmers Exchanges acquired MetLife.

Henry Heathfield
Morningstar Inc., Research Division

You paid no money for this?

George Quinn
Group CFO & Member of the Executive Committee

Well, certainly -- so the way to think of this is that the exchange has bought a business, and we will benefit from a stream of fee income into the future as a result of that acquisition. The exchange expects to be compensated for giving access to that stream of business. So of course, we pay them for that as part of this deal. So the way to think of this is that they acquire the underwriter and we're essentially paying them for a perpetual distribution agreement, if that makes sense.

Henry Heathfield
Morningstar Inc., Research Division

So you bought MetLife and you're providing the exchange access to the underwriting of MetLife. And you don't engage in the underwriting on the MetLife acquired business? Is that the way to think about it?

George Quinn
Group CFO & Member of the Executive Committee

Almost. But the exchanges on the insurance company, MetLife P&C.

Henry Heathfield
Morningstar Inc., Research Division

Okay. So and the exchanges bought MetLife P&C?

George Quinn
Group CFO & Member of the Executive Committee

They did...

Henry Heathfield
Morningstar Inc., Research Division

They did. Right. Okay. And you have no interest in the exchanges?

George Quinn
Group CFO & Member of the Executive Committee

No. And they're completely independent.

Henry Heathfield
Morningstar Inc., Research Division

Other than just the management fee, basically, which is -- there is no -- you said it does not hold a monetary interest in the underlying exchanges?

Correct.

George Quinn
Group CFO & Member of the Executive Committee

Correct.

Henry Heathfield
Morningstar Inc., Research Division

Okay. I think I have to get out of it.

George Quinn
Group CFO & Member of the Executive Committee

I mean if it helps, we can spend more time with the off-line and then go through it in more detail. On the -- on your analytics around the dynamics, I mean they are -- spot on so we have a preference for protection for unit-linked for the nonguaranteed types of life product. And therefore, I mean you potentially do see some compression of asset balances over time because of that. I mean you will also see quite a lot of volatility because of market movements. But given the

Group's preference, risk preferences and life, acquiring assets set back guaranteed life products is just not a priority for us.

Henry Heathfield
Morningstar Inc., Research Division

Traditional output is not a priority. Could I ask are the discount rate on the liabilities. Is that fixed a point of policy rising and they don't change over time. Am I correct?

George Quinn
Group CFO & Member of the Executive Committee

So we get into a detailed conversation about ALM, but basically, you're correct. I mean these are really viewed -- if you view it from a portfolio perspective, it's a fixed term liability. So you should match them at the point of sale.

Operator

The last question is a follow-up from Mr. Huttner with Berenberg.

Michael Igor Huttner
Joh. Berenberg, Gossler & Co. KG, Research Division

This is my quick question and I'm sorry, but, if you are -- well, you've got to see on the line, but if you will take some moment, you're starting to -- you step into -- and you think either for the next 3-year plan or the 3-year plan where you're clearly on target to beat everything, which particular metric do you think is the one where you've got most upside?

Mario Greco
Group CEO & Member of the Executive Committee

Good try Michael.

George Quinn
Group CFO & Member of the Executive Committee

I mean, there's obviously a part of me that really wants to answer that Mike, but the other part of me screaming at me not to answer it. So I'm going to thank you for the question, but I have already given your response.

Mario Greco
Group CEO & Member of the Executive Committee

It's a good try.

Michael Igor Huttner
Joh. Berenberg, Gossler & Co. KG, Research Division

We tried. But the other question, if you do have 2 seconds, you mentioned potential deals and priorities, et cetera. If you could just remind me or us what those strategic priorities, where would they lie?

George Quinn
Group CFO & Member of the Executive Committee

I mean they reflect the priorities we laid out back at the 2019 Investor Day. I mean, we are -- I mean, a lot of the activity internally. I mean we've got Ms. Sierra and the team where the country has done a fantastic job in commercial. We've actually given a lot of time and effort to the customer topic. You see it reflected in the customer growth. So you see it reflected in the customer satisfaction feedback that we're getting. We've done some very small acquisitions lately that we think will help us improve that over time. I mean, it's entirely conceivable that we would do a bit more of that going forward. I mean, beyond that, it's pretty opportunistic in the end, Michael, because it becomes -- I mean, what's available and what fits with what we've told people we want to do, and it's pretty hard to predict that in that.

Operator

Ladies and gentlemen, that was the last question. I would now like to turn the conference back over to Jon Hocking for closing remarks. Jon?

Jonathan Michael Hocking
Head of Investor Relations & Rating Agency Management

Thanks -- thank you, everyone, for dialing in. If anyone else got any outstanding questions, then please just reach out to me or one of the other members of the IR team. Thank you very much for your time.

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