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Zurich Insurance Group AG SWX:ZURN

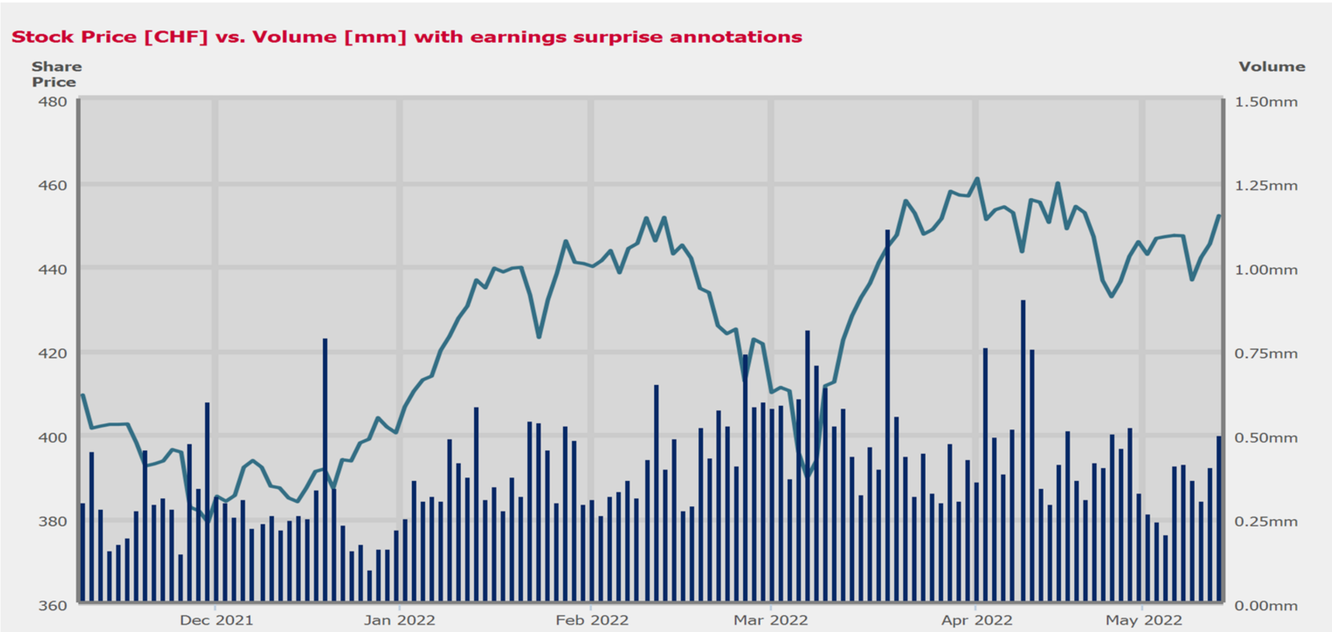
FQ1 2022 Earnings Call Transcripts

Thursday, May 12, 2022 11:00 AM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2021-			-FQ1 2022-	-FY 2021-			-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	6.35	NA	NA	8.44	26.69	NA	NA	33.84
Revenue (mm)	NA	NA	NA	NA	49746.28	NA	NA	54445.04

Currency: CHF
Consensus as of May-12-2022 5:11 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2021	6.84	NA	NA
FQ2 2021	6.84	NA	NA
FQ3 2021	6.35	NA	NA
FQ4 2021	6.35	NA	NA

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Presentation

Operator

Ladies and gentlemen, welcome to the Zurich Insurance Group update for the 3 months ended March 31, 2022 Conference Call. I am Anna, the Chorus Call operator. [Operator Instructions] The conference must not 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

Good afternoon, everybody, and welcome to Zurich Insurance Group's First Quarter Results Call. On the call today is our group CFO, George Quinn. Before I hand over to George for some introductory remarks. Just as a reminder, for Q&A, to keep your questions to 2 each, that will be much appreciated. George?

George Quinn
Group CFO & Member of the Executive Committee

Thanks, Jon. Good afternoon, good morning. Thanks all of you. Thank you for joining us. So before we start the Q&A, and I'm just going to give you a few comments. So as you've seen from the press release today, Group's made a strong start to the year with good growth across all the businesses. Strength and resilience of the balance sheet also gives us confidence in our ability to successfully navigate an uncertain macro and geopolitical environment. And this performance, combined with what you saw in the last couple of years means we're on track to exceed all of our targets for 2022, which as you all know, is the final year of the strategic cycle.

In the first quarter, our Property & Casualty business has continued to perform strongly. Top line growth of 8% on a reported basis, 12% like-for-like, driven by the continued strength of commercial insurance where we've seen rate increases of 9% in the quarter.

In North America, we've seen particularly strong growth with GWP up 17%, driven by a combination of underlying growth, the crop business and rate increases of 9% in that market. Although rate increases have moderated somewhat from 2021, I think as we expected, there are signs of stabilization at that high level, and we see that continue into April. We're confident that margins will continue to expand well into 2023 despite the inflationary pressures.

Life business also performed well. Our continued focus on unit-linked protection product leads to strong growth and new business volumes. And while the new business margin was lower than the high level that we reached in the prior year, this was due to mix effects within our preferred segments. In spite the market volatility, we remain confident that our life earnings guidance for the year will hold.

Farmers Exchanges, which are owned by the policyholders grew GWP by 29%, benefiting from the inclusion of the acquired MetLife P&C business, which was completed at the start of Q2 2021. There's also a strong underlying growth in the mid-single-digit range, in line with the guidance that we've previously given.

Balance sheet remains very strong with a solvency test ratio estimated to be 234% till the end of the quarter, up from 212% at the beginning of the year. The underlying development has benefited from the rising yield environment. However, as you all have seen today, there's a temporary benefit of about 9 points from tactical hedge that we've put in place over the assets, just given the heightened risks that we see currently.
With that, I think we can start with Q&A.

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Question and Answer

Operator

[Operator Instructions] The first question comes from Bill Hardcastle from UBS.

William Fraser Hardcastle
UBS Investment Bank, Research Division

The first one is just related to the statement that the rate should be running in excess of loss trading well into 2023. I guess firstly on that, just confirmation that you're thinking about that on a written basis on the base of earnings. And what gives you so much confidence despite what must be elevated inflation level and I assume some pressure likely to arise given investment yields have risen so much?

Then the second one is actually a very high level one. Just can you talk us through the relative attraction right now for commercial versus retail P&C growth -- essentially it's really thinking about where you'd rather be putting incremental dollars of capital right now, even though I appreciate you've got plenty of capital, so it's not like constrained.

George Quinn
Group CFO & Member of the Executive Committee

Thanks, Will. So on the first one. So yes, I confirm that it's a written perspective rather than end perspective. Why the confidence? I mean if you look at our numbers, the number that we produced internally, we've -- I mean we've frequently done that to be far more pessimistic than the market outcomes. And in fact, if you look at this year, we would have expected to be lower in rate terms than we already see in the market. And of course, we had a continuing trend down.

As I mentioned in the introductory remarks, and I'll give a few caveats. But I mean, the numbers are the numbers. Things seem reasonably flat from a U.S. commercial perspective through the quarter and in fact, into the beginning of the second quarter. So if we look at April numbers. So rate, for the time being, at least seems to be holding around that level. If you look within it, I mean, there are pockets that are even more positive.

So for example, cyber pricing is showing huge rates at the moment. And if I see a low for that, you might actually see a tick up. And if you look at some of the commercial -- the external commercial statistics, I mean they may have that picture and number given the proportion of cyber that we raised. It's not a huge driver for us. So I think it's a combination of -- I mean, what we've seen already through this phase of the cycle, the early trends that we've seen this year that are more positive than we expected. And I think also the -- we had some of the most significant U.S. industry meetings. There's tons of discussion around inflation. I think there's interest, some nervousness of people trying to be careful around it. So I think the inflationary environment will sustain rate for longer than we might have anticipated. So all of that is what drives the confidence.

Where would we deploy incremental dollars on commercial versus retail? It's -- I mean it's an easy theoretical question. I think It's quite a difficult practical question. I mean we've talked throughout this hard phase of the commercial market that we have a distinct preference for taking rate on the risks that we know and continue to be cautious about the new risks or the risks that shuffle around the market. I don't think that stands -- it's going to change. I mean we do -- we obviously have new business in the mix mounting a significant push on commercial growth, I don't see us doing that.

The market is continuing to bring us quite a better growth through rate, and I think we'll continue to focus there. I mean the only exception to that would be the things that we've identified previously as priorities for the business. So the mid-market activity we undertake in the U.S. Some of the things we're doing around SME which is maybe a bit more retail and in particular accident health as we look to the future.

On the retail side of things, it's still a more challenging market. I think the -- I mean from -- I mean I think it's less unpredictable in terms of judging the likely outcomes, but it's also currently less profitable by some reasonable amount compared to commercial. I think I was quite a bit more optimistic into around the February release. I thought we'd start to see the market respond more rapidly. I think the retail market is still running hard to catch up on inflation. I think you're still seeing momentum start to rise around price on retail. And I think there is a point in the future where retail will start to become a far more attractive opportunity than perhaps it is right at this moment. So preference would still be for commercial, but we're quite happy to take the rate for growth for the time being.

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Operator

The next question comes from Peter Eliot with Kepler Cheuvreux.

Peter Eliot
Kepler Cheuvreux, Research Division

The first question, I guess, is a continuation of that topic, actually, George, you mentioned inflation in your opening comments. And again, just then -- but I was wondering if you could just give us a bit more color on what you are actually seeing on the ground in terms of the various forms of inflation that you think are particularly relevant for your business? That's the first question. .

Second one on solvency. I mean, I'm sure you're constantly doing a sort of cost benefit assessment of hedging and your exposure to market. But I was wondering if you could give us any insights into what might drive the decision to move your risk appetite back to a normal level other than the obvious sort of cost implications. And I mean, I guess, when that 9 points -- that 9 points will disappear at some point, but you've also got potentially 11 points coming from Italy. And has that changed? Slightly. So your solvency is -- shouldn't really fall much from the current level. And I'm just wondering at what -- well, how you think of it in that context? Is it too high here? Is there things you can do about it?

George Quinn
Group CFO & Member of the Executive Committee

Yes. Thanks, Peter. So inflation -- and what's relevant for us. I mean, I think from a risk perspective, I mean, you're familiar with, I mean, the classical view of inflation risk clearly in the context of our P&C book. But we don't see a classical inflation scenario impacting our P&C book at the moment. And in fact, if you look at the book overall, Workers' comp continues to be pretty benign. So it's not causing significant stress. We talked before about the changes we've made to mix there to try and give us. I think it's a bit further away from the risk than perhaps we have been previously. .

Liability is still dominated by social inflation, which for me is an almost entirely different concept. With the net result, where you actually see it is mainly in short-tail lines. You see it significantly in more homes, motor auto physical damage. We see in property and retail. We actually see it in European markets, which is something we haven't seen for some time.

I think the positives for us, I mean first of all, I mean, we didn't come into this year assuming that the so-called -- the expectation of an inflation spike meant that inflation would be behind us already at this point. We carry some pretty significant loss cost trend assumptions into 2022. So we're not caught by surprise by any of this.

And I think probably the other thing that's important to point out is, especially when you think about the retail business, if you look at the year-to-date, I mean, half of everything that we've renewed in retail is Swiss, gives us some shelter from the inflation impact that you would have, if you had maybe less of a waiting to this particular market.

I mean having said that, I mean we're not complacent around the topic. We pay particular attention to it. I think the relevance for me is still more around those long-tail topics. So we pay far more attention to the risk that we start to see more of it emerge there. And for the short tail, we'll deal with that, as you'd expect, through pricing. So I mean, it's clearly a key topic, and it's going to remain a key topic for the industry, I think, through the course of this year.

Solvency risk appetite. So you've highlighted the numbers correctly. We have 9 points of temporary benefit from what we've done from a tactical perspective. One reasonably important comment around the back book, fair topic. So I mean, you've pointed out what we've previously disclosed around Italy. I would say that collectively, the market has expectations that you'll see more from us during the course of this year. i just keep in mind that I mean, one of the things that motivate us on that back book because is the sensitivity that some of those portfolios give us to interest rates.

And when interest rates rise, of course, they give us part of the benefit that one of those transactions would give us, if we do in the future. A long-winded way of saying that, if you're anticipating another transaction coming, be careful about double counting it versus the interest rate benefit that we already have. I think, overall, it's good news because it means that, of course, we have the resources readily to hand when we need them to address.

I mean, some of the issues that we need to deal with when we complete one of those larger back book topics. So on risk appetite, I mean no real -- but no real change from us. I mean, you've heard from us before that there's an earnings dilution event at some point in the future we expect. We'll deal with that through capital management.

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After that, we would prefer to support growth in the business. I mean, we take the ROE goals seriously, and it wouldn't be our expectation to create a very high capital levels over extended periods. I appreciate it's not a very clear answer, but it's a restatement of what you've heard from us before. And that first step around the back book is the most important thing for us. We want to get that done, and then we can talk in a bit more detail about capital management.

Operator

The next question comes from Louise Miles from Morgan Stanley.

Louise S. Miles
Morgan Stanley, Research Division

Just 2 questions from me, too, please. On the first one, it's to do with something that Will said actually earlier. So you said in the release this morning, the expected rates to exceed loss trend -- loss cost trend well into 2023. Does this still mean you expect peak commercial lines earnings to happen in 2023? Or is that being pushed out? And if peak earnings are occurring in 2023 or around that, does that mean we should have seen that any kind of leveling off or decline in earnings there will be offset by growth in the retail lines business? That's my first question.

And then the second one, I think, full year results, you said you expected the P&C investment income to decline by $50 million during this year. Is that still appropriate, given where rates are muting?

George Quinn
Group CFO & Member of the Executive Committee

Thanks, Louise. So yes, it's a good question, the first one. The -- so maybe if I can reframe the question. Apologies for doing this. So if you're really asking me, I mean, do we now expect to push out the peak margin point a bit further than we've guided before? The answer would be yes.

Now whether that's end of 2023, early part of 2024? I mean, really quite difficult to judge at this stage -- the -- I mean the combination of loss cost trends, issues driven by inflation, the more optimistic view we have around rates would cause me to expect start to see that peak margin point push out a bit beyond. On retail growth, I don't think it's going to be all retail growth that offsets some of that cycle effect.

I think there are things we can do within the commercial business. I highlighted some of the strategic priorities we have within the business in response to one of the earlier questions, I mean those remain true for us. We believe we're underweight in a number of these areas. And we do believe that we can profitably grow into them. So that will also help deal with some of the cycle-driven impacts and the larger end of corporate when that point comes. I do expect that retail growth will also help. Again, I mentioned earlier when we were talking about Peter's question on inflation. I think you'll see retail markets respond more strongly to the current trends. And I think we're relatively well positioned to benefit from that.

On the P&C investment income, that's another good question. We haven't quantified it today. So I'll probably do that for the half year update in August. But we seem clear to me that the drag that we -- the guidance we've given around the drag on investment income because of the lower reinvestment yields, that's going to reduce -- is reducing. I mean if I look at the current gap on reinvestment versus for P&C, it's about 1/4 of what it was last year. So the gap is closing very rapidly, which is generally beneficial, I think.

Operator

The next question comes from Michael Huttner from Berenberg.

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

Terrific. Hungry for more questions. The results is so good. Well done. You must be delighted. I just wondered if one -- really the high-level question which occurs -- shows that really nothing. The main by your results is that what you worry about now given that everything is significant -- it's not -- if you're lucky, but you haven't worked very hard for that -- the one-way kind of following question, I guess.

And the other one is a continuation of the previous one, when the peak margins -- when this peak cash flow -- because if I think about it, so pricing is ahead of as Will said, little price is ahead of -- earned price is ahead above margin and my

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guess is that ahead of cash. So when do we get the high earn cash, is it '24, '25, '26 even, these are my 2 questions. And really well done.

George Quinn
Group CFO & Member of the Executive Committee

Yes. Thanks, Michael. On the first one, I mean, probably all the same things we've worried about before to be honest. I mean we -- there's not a particular issue in the company that is particular retention. But in the same way that you have high expectations of us, we have high expectations of the business. And I mean, we're doing everything we can to make sure that we support them with the resources they need to take the benefits of the current environment, to support clients.

So I say, I mean it's a very cheesy answer, but I mean I think you worry about pretty much everything all the time in reality. But I mean, given where we are, we're in a good place to have to worry about things.

On cash flows, I think for me to answer that question, I'd have to anticipate some of what we will tell you at the Investor Day in November. So if you bear with me, when we come to November, I'll give you a sense of where we expect cash flows to hedge. I'm not necessarily sure, I'm going to identify particular peak cash flow point for you at this stage.

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

Okay. And if I try to ask an interesting question. How about, this is really simpler one. What is the IFRS capital? I think SCOR gave a number, which is 9 billion. What did this IFRS 17, how much would it be presumed?

George Quinn
Group CFO & Member of the Executive Committee

Can I also hang on to that. So the -- so we're obviously going through a process at the moment. In fact, we've just had immediately after Q1, our companies have reported the transition balance sheet. We're going through the process of kicking the tires on that. We'll have our auditor take a look at it. And I mean our plan is to disclose that to you guys somewhere later in the year. So I mean it will come with, I mean, something that's pretty well vetted and pretty thorough. But we're not yet in a position where I could tell you what it is and explain to you the drivers. So again, Michael, apologies. But we'll come back to it.

Operator

The next question comes from Andrew Ritchie from Autonomous.

Andrew James Ritchie
Autonomous Research LLP

Sorry, I had a very basic question to start with, and I'm not sure -- I don't think it's been asked yet. But George, could you just give us a flavor for the loss experience in Q1, particularly Cat and large loss. I guess the way to frame it -- I don't want you to give us actual numbers. IFRS budget versus expectation versus planning, just some sense so that would be useful.

My second question, coming back to inflation on a different angle. Firstly, just confirm, I think it is the case, your renewal rate is pure rate. It doesn't include any natural indexation effects. And I wonder if you could tell us roughly what percent of your non-life book has what I would describe as natural inflation indexation elements within it.

So I'm thinking, for example, things like payroll, Workers' comp or property reconstruction value. I'm just trying to get a sense of what the -- because we focus a lot on headline renewal versus loss cost, but in reality, there's a lot of natural indexation going on. I wonder if you could give a sense what portion of your book has that? And I'm assuming that's a particular focus area in renewals right now to ensure the indexation is happening correctly.

George Quinn
Group CFO & Member of the Executive Committee

Yes. Very good. So on the first one, the loss experience in Q1, so -- I mean we typically don't break out large from attritional. We've discussed why in prior quarters. I don't see anything particularly unusual beyond what we'd expect to see. I mean, the large component always has a touch of volatility connected to it. But I mean if you compare what a large

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loss experiences today to what we saw, say, 3, 4 years ago, it's much lower. So I mean it continues to reflect more recent trends, the large components.

On the Cat activity topic. It's -- I mean it's -- to be able to have a normal quarter. I mean this quarter, we're relatively late in the U.S. We are pretty close to expectation in Europe, and we're high in APAC, and that's entirely driven by the Eastern floods in Australia.

If you look at the totality, I mean, of U.S. we would hold to the guidance that we gave at the beginning of the year. So we are still expecting about 3.5 points. And one of the most important drivers is that is what we're doing in the U.S. We talked I think at the Investor Day and again back in February about what we're trying to do on the large end of the business in the U.S. Kristof and the team have accelerated that activity. We're going to be ahead of schedule on a number of those changes. And in particular, we try to push a lot of that through ahead of the relatively important July 1 date in the U.S.

So I mean, from where we stand today, no change to what we said back in February. And in fact, the increased activity that we've got underway around the U.S. will certainly help us reduce exposure. But one last comment, I mean what we've done on the U.S. over the last 9 months or so, that's a concept we're going to extend out to the entire group.

So we've just actually a few weeks ago set new targets for cat capacity usage across all the territories. They are differentiated given the different risks that the business brings us, but we are serious about further reducing the exposure. But again, the aim of this is to try and make sure that we maintain on average over some reasonable period, a contribution from cat losses along the lines that we've been telling you to expect.

Operator

The next question comes from Kamran Hossain from JPMorgan.

Kamran M. Hossain
JPMorgan Chase & Co, Research Division

Two questions. The first one is just in Farmers, I guess, adjusting for kind of all the, I guess, acquisitions and kind of everything else going on that, underlying growth was about 5%. Just wondering kind of given the backdrop in Farmers kind of what we should expect from here? And the second question, just on, I guess, on the hedge that you've put in place. Will there be any dampening effect on investment returns in the near-term loss of hedges on?

George Quinn
Group CFO & Member of the Executive Committee

Right. So Kamran, can I apologize, because Jon has just reminded me, I dodged the second half of Andrew's question. So I'm going to answer that. I'm definitely going to answer you. But I'm going to try remember to answer your 2 questions as well. .

So apologies, Andrew. So the second question was about inflation from a different angle. So the indexation effect. So I don't have a precise number in front of me. I mean, as you would expect, we have lots of activity taking a look at it. And I think the -- I mean if you look at the book, it splits into a number of lines that have activity drivers on premium. And there's -- I mean there's probably many more lines of business than most people would expect. So I think you anticipate. Everyone thinks like workers' comp, whether it's clearly a payroll connection.

Being in the Swiss accident business also has elements of this similar drivers in it. We even have -- and things like crop business because we said that by reference to cut prices for the predominant crops that we cover in February. The one thing, the thing that we're trying to do is to make sure that -- I mean where there are clauses in contracts that -- they're maybe not formally indexation clauses, but there can be drivers of premium or of exposure. And the classic example would be TIV, total insured value on the property book that we're making sure that, that is being automatically updated.

We want to make sure that we do end up in a position where, number one, a client is underinsured because the information is historic. But we have been making changes to the internal process is to make sure that the inflation that can be impacting exposure even in things like property, it's properly reflected. Yes. So I think the -- I mean the amount of indexation that's around beyond the pure activity drivers, it tends to be more of a European topic than a U.S. topic. But in reality, most contracts have some form of recognition, mitigation or other inflation feature. I was just trying to make sure that the underwriting process that we run properly reflects that in the exposure or price that we offer to clients.

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So I appreciate the patience, Kamran. So back to you on the -- your 2 questions. So on Farmers growth from here. So I mean we've given guidance for the full year, including what you've seen in the first quarter of mid- to high single digits. I think as we go into next year, it's slightly harder to tell. I certainly don't think it will slow down. I mean the auto market in the U.S. is in quite a bit of turmoil at the moment. You've seen frequency in severity. I mean, come back in spades, the entire market scrambling for rate. I mean you guys -- you understand how the rate system works in the U.S.

So in almost all states, there's some kind of process around that of varying degrees of complexity and difficulty. And I think in some markets, it's going to take quite a while before rates catches up with the current loss cost trend. So I think there's a very positive aspect for us, which is the impact that's going to have on growth.

Now quantum for next year, I don't have a view on that today, but I certainly wouldn't be guiding lower than the underlying level that we're seeing for this year. The one note of caution, and I think you see this again across the entire market, I think -- I mean, even the largest players are quite cautious at the moment. There's less interest in new business. There's more interest in making sure that the rate is adequate. So I think it's generally a good term position for Farmers.

I think the rates, in particular, will help. I guess the short answer to your question is, I would expect growth to be at least in line with more normal kind of mid-single-digit territory for farmers for next year.

Effect of the hedge on investment income. So of course, it's not free. It won't actually run through investment income. You'll see it essentially, I mean, the premium payable. In theory, if everything is fine, simply wind down through mark-to-market and the realized gain losses over the course of this year. I mean the cost of it is it's not that huge. And I expect we can manage that within the normal gains that pop up through active management of the portfolio, but no impact on the reported yield at least.

Operator

The next question comes from the William Hawkins with KBW.

William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

Can you give us a bit more information, please, about how you're booking your statements about Ukraine? Are you obviously, you haven't published a number, you're saying it's insignificant. But I mean are you making these considerations with regards to expected ultimates? Or are you booking these things as they are incurred? Because at the end of the day, I appreciate this may not be significant, but most commentators are still talking about a $10 billion kind of midsized cat event. So I'm assuming that there are losses that Zurich is getting.

And In your statement, you're drawing a clear line between the industry and Zurich. So can you just remind us some of the key differences of why you might be in a better position relative to the average for the industry?

And then secondly, please, thanks for all the stuff you said so far about inflation. Could you come back and just talk a bit more specifically about social inflation. You mentioned it but didn't talk much about it. I mean my take from -- for example, the litigation finance players is that to all intents and purposes, the U.S. Courts are still shut, which is fine for now, but it may mean that there's kind of a dam that is building up ready to burst.

So then kind of how you feel about that? And adjunct to that question, we don't often talk about it, but what is your ex house view about litigation finance as an asset class? Is this something that you completely steer away from because it's a systemic risk for claims inflation? Or is it potentially a tool for you to be hedging your exposures over time?

George Quinn
Group CFO & Member of the Executive Committee

Yes. Wow, that's the first time I've had that question. So on the different components. So on Ukraine, first of all, I mean you can take my comments as a futile ultimate rather than -- we haven't heard anything yet, maybe some events in the future. So why would we have that perspective. I mean if you look at what's expected to drive losses, I guess the most commonly identified ones would be, I guess, the issues around the aircraft leasing, which, of course, is well beyond our expertise because we're not present in that market.

Political risk, which is a business we've been running down since -- I mean, actually 2 or 3 years ago. I mean, credit to some degree, is going to be impacted. War-risk, which again is a specialty line of business. So I mean I think in the end,

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it's a reflection of decisions we've made in the past about -- I mean things we're capable of underwriting or not as the case may be. And that just led us to conclude that -- I mean, obviously, with no particular foresight that we're going to have Ukraine, but that we would adopt out some of these lines of business. So I expect us to avoid any significant effects from that. So I mean that would be the short answer.

On the inflation topic, yes, I mean it's -- so I don't know that I completely agree that the courts are still basically shut -- is still slow, I think. I think the -- there's an expectation, which I think is well in line with common sense that as we see the activity build, I mean, you will see the more likely winning cases come through for us. So I think you are allowed to see some type of bump early in the process around social inflation and trying to draw a conclusion of, I mean, what that looks like through the unwind of the entire backlog, I think there will be a difficulty for the entire industry. But I mean, the bottom line, there is no evidence currently that there's an entirely different outlook for social inflation. But I mean, I accept that there's not a lot of evidence yet to prove it one way or the other.

On the litigation finance topic, the -- I mean it's an interesting issue. The -- I mean in general, I mean, wherever litigation finance shows up in significant amounts. I think our primary considerations are probably about the underwriting risks rather than about the asset class as a hedge. And of course, it would be -- I mean, it'd be a badly bite your own tail if we were to throw a lot of money into it. So I don't see it as a topic where you would see us come to the conclusion. There's an upside for us to be a heavy investor in that topic.

Operator

The next question comes from Thomas Fossard with HSBC.

Thomas Fossard
HSBC, Research Division

Two questions left on my side. The first one would be, on the underwriting margin trend. Can you focus a bit more on what's going on in EMEA in Europe, where you're showing, especially on the retail side, where you're pointing to 2% rate increase, which seems to be running significantly below where cost inflation is trending at the present time, especially maybe in the U.K. So I just wanted to better understand what was your view and if we were to expect any pressure on underwriting margins in the short term in your European book?

And the second question would be more related to the U.S. And regarding your own cost related to a wage inflation, I mean, how things are going there? How can you resist the wage inflation in your own company? Are you subject to the great big resignation in the U.S.? And what about the talent pool? I mean how things are going and shaping up in the U.S. for your own business?

George Quinn
Group CFO & Member of the Executive Committee

Yes. Thanks, Thomas. So the -- I mean, I think if you look at all of Europe, and you think of a 2% increase and you think of the headline inflation rates, I mean I would agree that there's no way that's positive for margins. However, I think there are a couple of things that you need to bear in mind. I mentioned earlier that -- I think it's almost fully half of the premium that we've renewed year-to-date as Swiss.

So and of course, I mean, well, even in Switzerland inflation is maybe a bit higher than we've been accustomed to in the past. It's not like the U.K., it's not like Germany. And of course, strength in the Swiss franc ex some offset to some of the risk of imported inflation here. So I think when you look at Q1, just -- we'll be careful, you don't extrapolate it too much because it's a very significant proportion of what we're reporting here.

I think the other thing that continues to help with the margins, too many margins and this answer but, continues to help. I guess we still see, I guess, what we used to describe -- there's some degree as frequency benefit. I'm not sure, I can call it frequency benefit anymore. But there is still some absence of frequency in the actual loss cost experience compared to what we would have anticipated at the point of pricing.

And I think it's this combination that for the time being, it means that retail doesn't suffer the effects that you may expect like a 2% rate increase and maybe take a loss cost trend or inflationary pressure that's playing more than 2x that. So I think it's a combination of mix, combination of continued benefits on the frequency side of the claim experience. That means that it's not actually putting pressure on margins. I mean what it does put pressure on is growth in some markets. So we would be cautious on some of the European retail markets at the moment and would probably tend to shrink some

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of the marquee retail auto, retail motor markets and look more towards some of the mass consumer business that we have in Europe that has a bit less of the same issue.

Second part of your question, operational cost inflation. Yes. it's a challenge. I don't think I necessarily limit that to the U.S. If I look at what the U.S. team has done, I think they've handled it in a relatively smart fashion given the pressure. So I mean, we put through what by historical standards would be a pretty significant increase across the board. We've added on top of that a more targeted increase for a particular high demand skill groups, the obvious ones being people who are involved in the underwriting process.

So underwriting and some of the pricing actuaries to avoid that we suffer unwanted attrition. I think we've always been helped in the U.S. that -- I mean some of the things that, again, Kristof has done there around some of the restructuring that's taken place. That has created some natural expense benefit. We can't do that every year, but it certainly enabled us to weather some of these inflationary trends that you see that would impact the operational cost levels. But I mean, it's a challenge, and we are trying to manage it as best we can.

Operator

The next question comes from James Shuck from Citi.

James Austin Shuck
Citigroup Inc., Research Division

My two questions. Firstly, just coming back to the ROE for 2022. So I think you have an illustrative target of about 15%. I think longer term, it's 14% and growing. When that target was given, I think the outlook for P&C has probably improved overall. I think you're talking about overall margin growth. And that is allowing for some of the headwinds on the retail that's perhaps a little bit offsetting some of the stuff on the commercial side. So I guess just relative to the initial planning and where we are now, is that 15% starting to look a little bit conservative? Or are there offsetting features to consider? .

Second question around crop insurance and really just sort of trying to understand this business a little bit better and understand some of the risks in it. So if you're underwriting premium, I think you mentioned February and then the crop center yield later in the year and that affects the earned pattern of the premium. But how do we think about the risks when it comes to commodity price increases when you potentially underwritten in February and then taking on risks of those commodity prices actually increasing quite materially? And how should we think about the risks around kind of low yields and potentially under-fertilizing due to high costs that had an impact on the yield outcome later in the year? If you just give me anything on the earned premium and expected combined ratio for 2022, that would be helpful as well.

George Quinn
Group CFO & Member of the Executive Committee

Yes. Thanks, James. So on the first one, maybe apart from the financial targets, we could have skipped some of the content back in November 2019 because it hasn't really turned out the way that we would have expected. I think we've invested a lot strategically to prepare ourselves for things that haven't yet come. So we talked a lot about what we were doing around retail, if you think back to -- I mean both the strategic commentary and the financial commentary, there was an expectation that we would see that become a much more significant contributor.

So the obvious change that we've seen over the course of the last almost 2.5 years now, is this big switch towards the opportunity that commercial has afforded us. I mean, Life has been pretty stable, Farmers has been pretty stable than what we expected it to do. But really that trade-off.

If you ask me -- I mean, is that the 15% [betrayer], [betrayer] is a lack of ambition. I don't think so. I think -- I mean if you think of how we presented last year's numbers, we didn't adjust anything. We told you what the headlines where we compare back to the goals that we had, right? So I think we're happy with the progress that we make. I think on ROE improvements, I mean I would expect that -- I mean, further steps really come from what we do around the back book more than anything else.

The price trends are really helpful. But I mean at some point in the course of the next couple of years, we aren't going to see I mean a different environment for commercial. I expect retail to step up, as we discussed earlier, I expect other parts of commercial to help us. But in terms of more significant change in ROE, I think it really has to be capital allocation around the back book.

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On the crop risk, yes, I mean, it's an interesting business. Obviously, we're very U.S. focused. It's very U.S.-centric. So it's run in a particular way. The federal government is heavily involved. Most of our crop clients will buy, essentially what amounts to revenue protection. So covering a combination of issues around yields and price. And of course, that means that the commodity price side of itself is not always the best pointer to the risks that you can face because, of course, yield on price, I mean, both interact when it comes to revenue and one can push the other in opposite directions.

I mean obviously, the significant growth in premium is simply a reflection that commodities are priced at a much higher level over the course of the last 2 years. So we charge prices base on that level. I mean there is risk that the harvest price deviates significantly from the base price that we set in February for the key commodities. I mean that's something that we price for and the product.

I think the interesting thing, I mean, obviously, we pay a lot of attention to currently, partly, because of some of the things you point to. So for example, is the -- I mean are the potash issues going to be relevant for the use of fertilizer in the U.S. I mean, the feedback we get is, if you look at how the U.S. farmers source the materials they need for the growing season, it tends to be quite domestic, either domestic to the U.S. or domestic to North America. There's an expectation and in fact, an obligation on farmers is that they continue to follow prior practices. So we wouldn't expect to see people, especially when the potential payoff from a price perspective is so strong, look to try and cut some of the inputs as part of this process. But of course, if they do, then that potentially raises challenges in the settlement process.

So I mean, overall, our view on combined ratio as the historical, it's pretty much unchanged for the business. We do continue to actively select the risks that we will seek to the federal government. And some of the risks that are triggered by commodities other than crop -- sorry, some of the input, commodity topics. It looks as though the U.S. industry at least is somewhat sheltered from these, at least for this year. So other than the much higher price, we don't perceive a particularly different risk in the business.

Operator

The next question comes from Dominic O'Mahony from BNP Paribas.

Dominic Alexander O'Mahony
BNP Paribas Exane, Research Division

Two, if that's right, I wanted just going back to the back book topic. Clearly, since you guys sort of started talking to us in detail about your ambitions. Your interest rate environment has changed quite a lot. The macro environment has clearly become volatile. Just wanted to get your sense of whether any of that changes your appetite a bit for the book that you're most interested in addressing whether there might be further opportunities? Anything that's changed in terms of your perspective on how best to approach the back book topic?

And indeed, same question for the counterparties. So whether you've seen any change in what they're interested in pricing and so on? And then just one brief second question. Just, towards the beginning of the call and the questions, you were saying, if I heard you correctly, that while the retail P&C businesses is pretty tricky right now, you're actually very optimistic into the medium term. I'm just wondering whether that's -- whether there's a specific reason you expect that? Whether this is sort of a matter of what goes down must go up and at some point, that business will become more attractive and then you're already anticipate?

George Quinn
Group CFO & Member of the Executive Committee

Yes. Thanks, Don. So on the back book -- I mean, of course, on the face of it, the -- you could take the view -- what -- hasn't the problem largely gone away. But I think the problem is in the absolute level of interest rates. The problem is the interest rate sensitivity. And I think the current environment is actually quite helpful for us to deal with this. But it does need to be dealt with because it's not -- it's not a good allocation of capital for us because it's relatively poorly rewarded capital, given the risk covering.

In terms of counterparties, I don't perceive a radical change, and how they see things. So I don't think it alters the level of interest or the supply of capital that's available to help us deal with some of these issues from our perspective. So short answer would be, no real change here. We're going to continue to do what we had planned to do. The only thing I would emphasize again is one of the things I mentioned earlier, just I mean, please, I know there's lot of optimism out

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there, please be careful about adding the old number on top of the current SST number because, of course, some of that interest rate benefit is in the 234 already.

But again, I think that's a positive because that means we have that resource on hand, and we don't need to wait for it to pass through some kind of sausage machine before we can do something with it.

On retail, I mean, yes really good question. So is it a blind optimism or do you have a theory? Probably somewhere in between, I think. I mean, obviously, I can see trends in a number of markets. I can see how businesses are behaving. I can see some of the competitive trends. And I think there's going to be increasing pressure for people to address the weakness.

I think if you look at the U.S. market, it's probably -- it's the most clear to me at this stage. And of course, as you know traditional retail market, but I'm not sure that other markets are going to face very different dynamics in the end. You've seen huge increase in frequency and severity in claims in retail auto in the U.S. Everyone has to address it to make a reasonable return.

And you can see from the activity around rate filing, and that's exactly what everyone is doing. And in Europe, that process is quite different because, of course, typically, you're not filing -- you're not -- in most cases, you're not in a tariff market. So it's not as easy to see quite as clearly. The inflationary trends might not be quite as pronounced as the U.S. but they're also not normal. And as we discussed earlier, I mean, if we were running a business that was not Swiss, but say was maybe concentrated in the larger EU markets, we were seeing a 2% rise in price, I mean that's not going to cut it, is it? So somewhere in between, Dom.

Operator

The last question for today's call comes from Vinit Malhotra from Mediobanca.

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

So one thing is -- and apologies, if I missed a little bit in the beginning, so I don't know if you addressed some of this, but -- the first one is just on the pricing moderating trend. We talked about it in the summer of last year, but it's happening now. How much of this do you think is sort of a base effect? And how much do you think is something changing in the market in terms of how much can clients bear or any other risk demand topics? So I'm just curious how much is base effect of this moderation?

Second topic is, in the life book, there's a commentary about not very favorable business mix driving down a little bit deep in business margin. I'm just trying to square that with what I remember from the full year was a more optimistic view on life. Is it something we should be thinking about? Or is it just a blip in a quarter or something like that?

George Quinn
Group CFO & Member of the Executive Committee

Yes. Thanks, Vinit. So the -- on the life topic, I mean that was really a coded way of saying that we had a large single transaction in the same quarter a year ago. And that's slightly distorted, the numbers. So I don't think it's particularly directionally relevant for the business. So it's not a source of concern for us. You'll see it naturally move around from quarter-to-quarter. But certainly, if you look back in time, Q1 this year, doesn't suffer by comparison to prior Q1 so other than last year, which, of course, unfortunately, is the one we have to compare it to. So if you're asking me, is it relevant for consideration for the remainder of the year? I don't think so.

On the pricing trend, kind of what's driving this base effects, how much can clients bear? I mean it's -- it's obviously -- it's a very difficult question to answer. The -- I was talking to Alison Martin, who runs our European business. She's been at a number of client events, recently talking to risk managers, CRO, CFOs about how they perceive things.

I mean there's quite a lot of feedback in the system that the extent of rate rise is challenging for clients, particularly given the experience they had prior to this phase of the cycle. I think most of them are going to appreciate that there's clearly an inflationary trend. And in fact, I look at the activity of some of our largest clients who fairly regularly announce price increases for their client base simply because of the impacts that they face.

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And of course, I mean, we're not insulated from that. And the fact that they increase price in itself drives a bit more risk into the insurance relationship. I mean, interestingly, the clients also complained about the lack of capacity. So there's a feeling that across the industry, risk appetite is still not growing, which, I guess, also has some impact on pricing trend and potentially, again, helps sustain it for longer than we might have expected otherwise.

I mean having said that, I mean these client relationships are extremely important to us. I mean, we do try and differentiate within our portfolio, for our clients who are very active around risk management and can demonstrate from the demonstrated outcomes that provides significant risk mitigation. You'll have a different outcome. And in fact, I think, I mean, already for, I think, at least a year -- I mean for clients that had that different experience, they've had a different outcome of pricing already.

I mean, the pricing trend may look like the one we saw towards the end of last year, but I think it continues to be much more differentiated. So if you perceive it to be a poor risk, you're going to have problem. I think if you're a good risk, they may still not be precisely what you want, but we believe it would more reflect the risk that you bring. So pricing trend, actually, we would be slightly optimistic. I mean given the comments I made earlier, we've seen the current rate sustain for a bit longer. But we are aware of making sure that we try to support our clients in the best way that we can.

Operator

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

Jonathan Michael Hocking
Head of Investor Relations & Rating Agency Management

Thank you very much everybody for dialing in. We're aware there's a few questions left standing. The IR team will be available shortly to answer them. Over that, thank you for your time, and good afternoon.

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.

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