S&P Capital IQ

CONTENTS

Zurich Insurance Group AG SWX:ZURN

FQ1 2015 Earnings Call Transcripts

Thursday, May 07, 2015 11:00 AM GMT

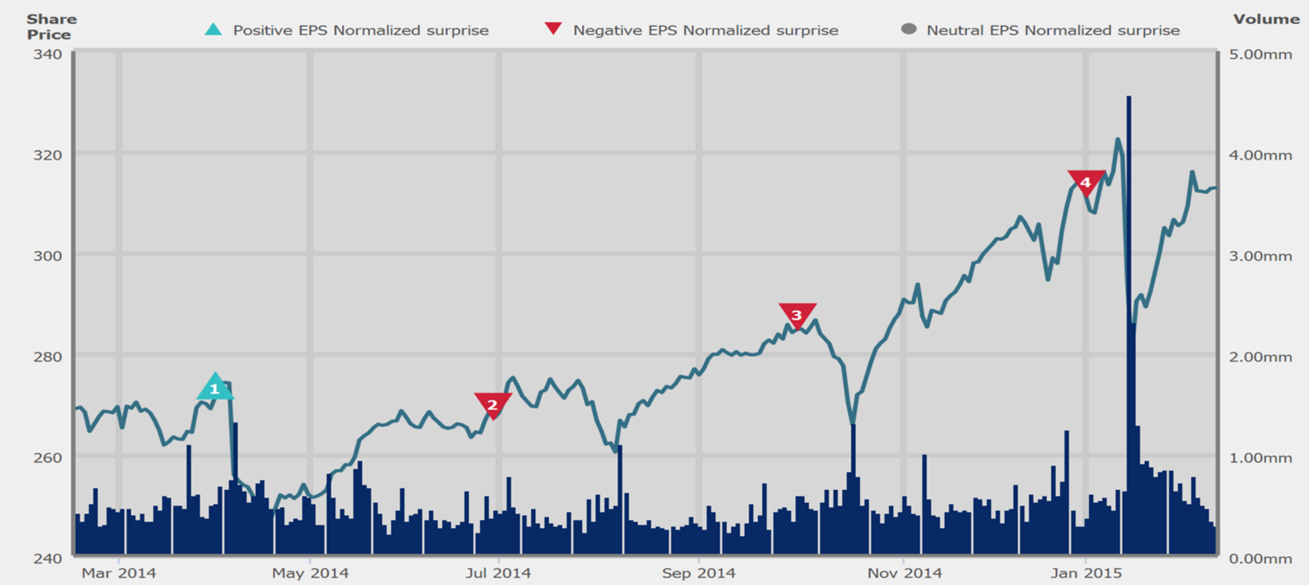
S&P Capital IQ Estimates

	-FQ1 2015-			-FQ2 2015-	-FY 2015-	-FY 2016-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	6.62	7.75	▲17.07	7.28	25.85	27.20
Revenue (mm)	-	-	-	-	51252.44	57364.45

Currency: CHF

Consensus as of May-07-2015 10:38 AM GMT

Stock Price [CHF] vs. Volume [mm] with earnings surprise annotations



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2014	6.70	7.67	▲1 14.48 %
FQ2 2014	6.69	5.13	▼2 (23.32 %)
FQ3 2014	6.16	5.70	▼3 (7.47 %)
FQ4 2014	5.83	5.27	▼4 (9.61 %)

Call Participants

EXECUTIVES

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

James Quin

ANALYSTS

Andrew Broadfield
Barclays PLC, Research Division

Andrew James Ritchie
Autonomous Research LLP

Dhruv Gahlaut
HSBC, Research Division

Farooq Hanif
Citigroup Inc, Research Division

James Austin Shuck
UBS Investment Bank, Research Division

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Niccolo Cornelis Modesto Dalla-Palma
Exane BNP Paribas, Research Division

Nick Holmes
Societe Generale Cross Asset Research

Paul De'Ath
RBC Capital Markets, LLC, Research Division

Stefan Schürmann
Bank Vontobel AG, Research Division

Thomas Seidl
Sanford C. Bernstein & Co., LLC., Research Division

Presentation

Operator

Ladies and gentlemen, good morning, or good afternoon. Welcome to the conference call on the results for the 3 months to March 31, 2015. I am Saiyan, the Chorus Call operator. [Operator Instructions] The conference is being recorded [Operator Instructions] The conference must not be recorded for publication or broadcast.

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

James Quin

Good afternoon, and welcome to Zurich's Q1 results call. Our CFO, George Quinn, will make a few introductory comments, and then we'll take your questions. [Operator Instructions]

I'll now hand over to George.

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

Thanks, James, and good afternoon and good morning to everyone on the phone. So just begin with -- Overall business operating profit for the group was $1.3 billion in the first quarter, and net income attributable to shareholders is $1.2 billion. Both numbers are about 5% lower than in the prior year period.

As you all know, currency has been a significant feature of the first quarter and it's likely to continue to be a feature over the course of this year. Currency is mainly a translational issue for us because we typically match the local currency liabilities and assets, and on a constant-currency basis, BOP would have been broadly flat. And the 5% decline in gross premiums written we've announced in GI would have been a 5% increase.

From an operating performance perspective, we see this as a solid start to the year, both in terms of top line and BOP, albeit with results for both Q1 and the prior period benefiting from a very low level of catastrophes and we have a number of positive one-off items in both.

Let me turn to one other topic before I start the Q&A. With respect to solvency, you've seen that both Z-ECM and SST ratios have declined in the second half of last year. Z-ECM ratio reduced from 126% of the half year to 122% at the end of the year and SST declined from 215% to 196% over the same period.

There are 3 moving parts. So the first impact, net market movements is mainly flatter and lower yield curves, which reduced Z-ECM by around 6 and SST by around 13. There's not all yield, but most of it is. Second, allowing for the expected growth that we expect to see in the business in 2014, that's had a negative 4-point impact on Z-ECM and a negative 5 on SST. And then thirdly and for Z-ECM only, these factors were partially offset by a change in how we model certain investment risks. This had a benefit of around 6 percentage points.

The interest rate sensitivity that you see in the capital figures that we disclosed today is greater than the previously disclosed simple parallel shift that we've given for 2 reasons. First and most important is convexity and of positioning. And the second, is the second and third order effects that interest rates have on risk capital, but not as particularly pronounced impact in SST.

Looking into the developments since the end of last year, we'd expect to see the Z-ECM ratio move lower in Q1, given the combined impact of currency movements and a further flattening and decline in bond yields, amongst other factors. And our best estimate is that we'll see a ratio in the upper half of our target range. In other words, still a very comfortable level. And given the levers that we have at our disposal to manage the overall risks, this does not impact our view of the employable capital that we hold.
With that, we'll open up to Q&A.

Question and Answer

Operator

[Operator Instructions] The first question is from Michael Huttner, JPMorgan.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Actually, two questions. And I must have -- I actually thought these were really good results. But within that, because you beaten a number of my estimates, where is the -- you have this target range for return on equity of 12% to 14%, you reported 12.9%, which is excellent; excluding one-off, 11.2%. So my 2 questions are both on this. Which, from your point of view, is actually the right figure? Is that the reported or the adjusted? And what's -- where is the main miss coming from? Is it still in Life? Or we're seeing a bit of a drift also in non-Life now?

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

Is that both of your questions, Michael?

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

That's it, yes.

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

Okay. So which is right. I mean, obviously, they're both right because they're both calculations. One's the headline number, but I think the more meaningful one is the underlying ROE performance because that gives you a better sense of what you could expect from a go-forward. And of course, that's particularly relevant for the remainder of this year and next year to make sure that we're in that 12% to 14% ROE range. If you look at the driver of kind of why we're not where we expect to be, I think there are probably, I mean, 2 key pieces. I mean, one is the same theme that you had from us at the end of last year. So it's mainly GI. If you look at the GI combined ratio, if we adjust for cat and for one-off expense on both sides -- the underlying ex-cat combined ratio hasn't changed by much. In fact, it's almost exactly the same. If you drill into it, we have a small improvement in attritional, which we believe is offset by a large loss. But of course the large loss piece is an estimate rather than a science. Overall though, we need about 2 to 3-point improvement over where we ended last year on GI. We've only made a relatively small step in the right direction. So we need a bit more from GI to be in that 12% to 14% range. Second is capital, we're still carrying more capital than we need, that obviously depresses the overall ROE. And as we've highlighted before, and I guess we'll discuss during the course of this call, certainly we'll discuss again on May 21, capital deployment also has to figure in us achieving that 12% to 14% ROE.

Operator

The next question is from Andrew Ritchie, Autonomous.

Andrew James Ritchie
Autonomous Research LLP

One straightforward question. The large loss noise you alluded to in Q1, is that still the same areas generating large losses, that generated large losses in Q4? Which I think was things like, for example, U.S. commercial auto, Brazilian surety. Or is it new areas? And maybe just give us a sense as to revealing any issues, or is it genuinely random? And then on capital, you said in your opening comments, maybe I misheard you that there was an effect in the required anticipate -- required capital for 2014 growth, but I thought the Z-ECM and SST took into account anticipated organic growth for 2015, so it's forward looking in its requirements. Maybe if you just clarify that. And if that is the case, what level of organic growth is kind of penciled in to that number? And is that one of the levers, I guess, the financing of that future growth that -- when you talk about levers and things you can pull?

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

So on the second one first, here, I misspoke. It's absolutely 2015. Thank you for that. I guess, as one of the levers -- I guess, levers [indiscernible] I guess, is a margin of prudence that we have in the calculation. We've got about negative 4 and negative 5 points on Z-ECM and SST. I apologize -- I don't really want to give you a forecast of volumes for the year, but we -- even with the growth that we see in Q1, we're well beneath the level of growth that we had planned for and allowed for in the capital calculations that you see. So we have a significant reduction in both that 4 and 5 if the current trend continued through the remainder of the year. On the large loss, say, I'm not sure of whether it's good news or bad news, but they are completely different from Q4. We have a large corporate loss in North America, it's by far the largest single loss in the quarter. And we have some large losses in Europe, in particular the municipal business in the U.K. stands out, the source of 2 of them. So they're completely different from what you saw last year.

Andrew James Ritchie
Autonomous Research LLP

Then the issues that cropped up in Q4, have they calmed down? Has there been development on them? Or have they just not really come across your desk in Q1?

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

There maybe -- if you look at large loss overall, is it actually a touch higher than it was in Q4, but the theme, like -- I guess there are no themes in large losses, are there? But the -- in the -- the large losses have occurred. You don't see the Brazilian topic crop up again. And the other items. you saw, I mean, even then looked as though they were one-offs. So the themes in Q1 are completely different on the large loss side.

Operator

The next question is from Andrew Broadfield, Barclays.

Andrew Broadfield
Barclays PLC, Research Division

Two questions. First one, on the need for capital for the growth, you mentioned just now that you -- the Q1 have missed what you had hoped to achieve and to -- and therefore to consume. Can you just give us a little bit of an outline on where that -- why you failed to reach that growth target? What part of the business it was in? And where you think you might be able to catch back up over the course of the year? And then the second question is also related to solvency, but in terms of what you anticipate. You talked about levers. So does that take into account things like the sort of steady decline in Farmers Re and quota share, et cetera? That -- although I know it's not in stone, is your intention. And I see the surface improved again in the quarter at Farmers. So does it capture those sorts of actions within your plan?

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

Andy, on the first one, I mean, all I can say in response to that, I mean, it's broadly across GI. If you look at GI in Q1, we got a pretty strong growth in Global Corporate. Though we actually think the headline there tends to overstate the growth that we expect to see from Global Corporate for the year. I mean, rate is generally still modestly positive, that continues the trend that we've seen through the course of last year even if the absolute numbers by the various businesses or territories move around. I mean, where can we catch up? I mean, I don't know yet. I mean, we're obviously looking to find sources of profitable growth. And we've allowed for that in the capital requirement that we forecast for the year. I mean, I think it's too early to declare that we will or won't achieve that, albeit we're behind already in

Q1. On the solvency side, I mean, the anticipated levers, I mean, Farmers Re is -- I mean, Farmers Re is -- I mean, I guess, it's not a lever currently because it's -- I mean, we've -- we'll have the reduction already baked into the new figures for this year, which is the benefit of the -- immediate benefit of the piece that's reinsured into ZIBB, or Zurich Bermuda branch. I mean that -- the levers I was thinking are more of a combination of our balance -- our ability to manage the required capital on the risk side because of the choices that we take and where we allocate that capital. I mean, it's not a surprise that the main consumer of capital requirements is market risk. I mean, that's something that the firm can choose to have more of or less of as it sees fit. On the available sides, it's obviously a bit slightly trickier to manage it. We can manage capital structure, which can be helpful, but mainly on the available side, there'll be the outcome of the year in terms of our financial performance and the impact of financial markets on the overall equity position that we have. The levers for me are more obviously focused on the risk-based capital requirements and what we can do there to influence capital consumption.

Andrew Broadfield
Barclays PLC, Research Division

Is it fair to assume that you make no assumptions around reduction in capital needs because of sort of natural runoff or changes that we anticipate as a market against what we're expecting on Farmers Re and other areas?

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

No.

Operator

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

Paul De'Ath
RBC Capital Markets, LLC, Research Division

A couple of questions on the Life performance. And again, on Latin America, specifically, and that you've had a relatively good performance in the front in the JV, but slightly disappointing in Zurich branded vehicles in Latin America. And what's the driver there? Is that kind of an active choice to favor the Santander JV? Or is there something else going on there? And that's question one. And secondly, I'm just looking at the flow, the net flows, in the Life business. The European flows have been very strong in the quarter and compared to prior year. And what's kind of the key drivers behind that? Is that the Corporate Life & Pensions business in the U.K.? And how much of that is coming from winning new schemes? And how much is from sort of general auto enrollment-type growth?

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

Thanks Paul. So first of all, on the Life performance in Latin America. It's not that we prefer the joint venture, but we have one particularly large contract that we haven't rewritten this year. So that's largely why you're seeing the underperformance on the, I guess, the Zurich-branded element of Latin America. Having said that, of course, the -- I guess the contrast is sharper because of the very strong performance of the JV, it's produced a, I mean, very, very strong growth in Q1. On the net flows in Europe, I guess there are 2 or 3 main drivers so I mean, as you hint, I mean CLP in the U.K., is a piece of it. And it's a combination of both new schemes and continued enrollment and also new product in Germany. So we have a new product that we distribute through bank assurance partner, and that's also had a positive impact on flows that was in Q1.

Paul De'Ath
RBC Capital Markets, LLC, Research Division

Is that a unit-linked type product? Or is it a protection or what?

George Quinn

Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

I guess we'd describe it as a hybrid product. So it's -- I mean, if you look at our product mix, we don't sell significant volumes with guarantees, but typically, many of the product have guaranteed elements. And this is a new product with a guaranteed element rather than an overall guarantee.

Operator

The next question is from Stefan Schürmann, Bank Vontobel.

Stefan Schürmann
Bank Vontobel AG, Research Division

Two questions to start. First on -- still on the Life part. You show basically new business margins down in so-called other retail, which has -- I think it's mostly done due to the traditional agent business in Germany and Switzerland. I mean, can you -- maybe can you expect that to stabilize? Or do you take any corrective action here like cutting commission? Or will that continue? Then the second one on the Farmers surplus ratio, that's standing at 39% and you guide towards a decrease to 33% to 36% in the near future. So I mean, I'm not quite sure to understand why that should drop there?

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

Okay, so Stefan, on the first one, you're right. It's mainly Germany and Switzerland as the impact of rates on the business there. I think in the short term, I don't expect it to stabilize. I think you'll see a further reduction in new business values given the further reduction that we saw in rates in Q1 for both those markets.

Stefan Schürmann
Bank Vontobel AG, Research Division

Maybe -- is that -- I mean, your volumes basically are up -- new volumes are up and margins are down. So you just continue like that? Or you don't take any corrective action there?

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

So 2 things. So I guess we do take corrective action. So I mean, if you look at where we sit in the league table on certain key measures such as bonus, we're not at the top end by far. I mean, it's too early to determine what the outcomes for this year will be, but I mean, that's one of the levers that we have to significantly impact the overall financial performance. And there has to be a close correlation between what we're earning on the portfolio and what we share with the policyholder. So I mean, that's one of the key levers for us. I think -- and you just be careful -- I think, on new business value, you could optimize purely for new business value. And I think you'd end up with potentially even more negative outcome. So -- I think we try and look at both new business value and BOP when we're trying to make decision about where we would prioritize growth. I mean, Germany and Switzerland both very difficult all because of where interest rates are. On surplus for Farmers, there's a key reason you haven't seen it fall straight back into the target range, is because of the way the calculation is done. The calculation is based on net rent [ph], so essentially as they recapture the reinsurance, you'll see a bit more strain as a few more quarters come by. And that will cause, all things being equal, and dependent on the earnings at the exchanges, the surplus ratio to fall. And we would expect to see it, again depending on the actual financial performance, fall back into the exchange's target range.

Operator

The next question is from Nick Holmes, Societe General.

Nick Holmes
Societe Generale Cross Asset Research

Two questions. First is on the GI expense ratio. Just wondered if you could share with us how you see the Q1 result developing throughout the year. I was really thinking, I guess, the upfront distribution costs that have taken us up 31%, are they going to continue? And is 31% the sort of number that you would expect to see? And then second question is on the U.S. commercial pricing. Just wondered, again, how you see this developing. I mean, 2% rate change seems pretty good result. Does this some -- do you think, throw doubt on what markets' analysts have been saying about the appearance of a soft market?

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

Thank you. So on the first on the GI expense ratio, I mean, the -- I mean, what you see for this quarter, I mean, before we take action on the efficiency side, is pretty much what you'd expect. So there is no reason why, for example, the impact to the distribution would increase or decrease through the course of the year. Having said that, I guess we made it clear at the year end, and we're working on it currently, the expense ratio that we see is too high. And that's a topic we'll specifically address when we have the investor update on May 21. So maybe for time being, based on what you see currently, the current level is reasonably indicative of what you would expect, but we have intentions to bring that number down.

Nick Holmes
Societe Generale Cross Asset Research

Right. And sorry, can I just ask, would that be for this year or? Is that sort of looking out over the medium-term, sort of 2, 3 years? Or perhaps you wait -- you prefer to wait until the Investor Day to tell us?

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

Well -- so I guess the one thing I will say, Nick, is that a medium term would be too long [indiscernible] 2 to 3 years. The -- as I mentioned to Michael in response to Michael's question, an improvement is required to make sure that we achieve the required return on equity that we have as a target. So that means it needs to be achieved over the course of the next 18 months. On U.S. commercial pricing, the -- I mean, I guess, the challenges is that -- I mean, it's bumped around a bit if you look at our rate monitor. I'm not sure I would describe it as a particularly positive environment. I mean, we've been in our position in the U.S. for some time now, where the rate change is, I mean, roughly in line with lost cost inflation. I mean, Q1, I think we're seeing the market respond to some of the challenges. But where evident from a number of companies including, ours in Q4, for example, in commercial auto. So you've seen a number of areas where rate entries have been pushed through. But if you look at the market overall, we're still in the position where, I mean, rate is covering what we think lost cost is increasing by, which means that margin is not currently expanding. And also, if you look at the individual lines, I mean, property still has pressures. I mean, that story hasn't changed recently. And also, workers' comp hasn't been a pressure currently. So I mean it -- I don't think it's particularly negative. I think I mentioned on the full year call that I didn't share MarketScope's more negative outlook for the full year, but we certainly haven't turned any corners on the U.S. pricing environment. And I don't expect to see that take place over the course of this year. I think we'll see continued pressure.

Operator

The next question is from Farooq Hanif, Citigroup.

Farooq Hanif
Citigroup Inc, Research Division

I apologize if this question has been asked, I wasn't right at the beginning of the call. But looking at your Z-ECM ratio, I mean, you make the comment, obviously, that Q1 has been tough because of interest rates and obviously, that's reversed quite strongly in Q2. So presumably if this is maintained in the current environment, then you will recover back up to the upper end of your target range or above the upper end. That's one question. And then secondly, you have this kind of 4 points of business profit uplifting your Z-ECM ratio. Yet, is that a -- can we just sort of normalize that for the year? And believe that you'll grow pretty different, 8 points a year, in that Z-ECM ratio? Is that kind of decent rule of thumb? And lastly, in Global Life, you've mentioned getting to the $350 million or above the $350 million was hard because of FX. Now has that got worse or better based on movements to date?

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

Thanks, Farooq. So I mean, first on Z-ECM. So the only comments I provided are through the end of the quarter. And I've commented on the fact that, I mean, given the continuing move on yield curves, we expected to see Z-ECM come down and we expect to be in the upper half of our range. And we still believe we are in a comparable position because of the extent to which we can control our capital consumption. I'm going to avoid commenting on what's happened post the end of the quarter. I mean, I guess, I may mention that when we come back on the Investor Day. I mean, interest rates as they rise, particularly at the long end, particularly in the some of the European markets, certainly would be helpful. I mean, I think we're going to have a relatively volatile period for a time. So it'll go up and down a bit. But I think the good news, certainly from our perspective, is that we have enough flexibility to manage. On the business profit piece, the -- so I'm not sure exactly which -- so I guess if you're looking at the waterfall chart, you need to be a wee bit careful that you got the business profit on one side and you got dividend on the other. I mean, given the payout ratios, you tend to find that, I mean, we pay back to our shareholders a very large proportion of the economic profit that we generate. So I mean, if it's 4.5 points and we have an accrual of, say, 3 points within the 5 that we've disclosed for dividend. I mean, it tends to be a relatively modest addition to the overall capital base because we hand it back. On the GL topic, maybe to give GL a bit credit for what they have achieved. I mean -- I think if we had stuck simply to the more than $350 million a quarter based on the foreign exchange levels when we first announced it, we'd be there already. But I've said that -- I mean, when we targeted more than the $350 million, we actually had in our mind a lot more than $350 million. I mean, today -- I mean, as FX moves, and particularly euro weakens against the franc, given the preponderance of earnings that GL has there, it becomes tougher. But when we looked at it earlier in the year, I mean, we were just above $350 million in terms of expectation once all the improvements had come through from GL. I guess the one point I'd like to add though, I was asked on the affiliate call about GI and GI's expectation of growing their earnings by 5% comp. And I commented there that, of course, I didn't expect them to compensate for any possible FX movement. And the same is true for GL. So we stuck to the $350 million, it's become tougher because of foreign exchange. But I mean, they've done a lot of what we'd expected of them already when we first announced this. But we still hold to the more than $350 million.

Operator

The next question is from James Shuck, UBS.

James Austin Shuck
UBS Investment Bank, Research Division

I have 2 questions, please. Apologizes for returning to the Z-ECM number, but I just wanted to pick up on something you said earlier on, George, that two of the reasons why your ROE is not hitting the target at the movement is, on the one hand, the GI combined ratio, but on the other hands, you have more capital than you need. I'm just struggling to see why that's the case because you're targeting 100 to 120 of Z-ECM, and you're currently, on a Q1 basis, towards the upper end of that range. I appreciate you got some believers to manage, but I kind of just wanted to understand whether you've actually got surplus capital and that's the way I should look at it. Or whether if this is more a case of where we going to pull some of those levers, and then that will release capital. And if that's the case, so I just wanted to be clear that there's no modeling changes that are planned, it is strictly around the required capital management. And when you consider the required capital, you're also considering what the impact is on the potential earnings growth, because obviously, if you take less market risk, then the outlook for earnings will come down even if volatility is improved. So that's my first question. Secondly, just around the underlying accident -- with the underlying loss ratio. And the ex-prior year. So if I look at the accident year loss ratio improved 70 bps in Q1 year-on-year, you had a higher large losses of about a point and lower nat cat of about 40 basis points. So in theory, you have about 130 basis points of underlying loss ratio improvement there. And I was just hoping for some insight geographically where that's been coming from, please.

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

Okay. So let me try to do the first one. So on the first one, I guess, would pretty clear. I mean, given the target range, we would try and measure ourselves over the -- off the midpoint of the target range, so 110, and if you think back to prior conversations about how much capital excess we had, we would often write it off and talk about the fact that if we have 16 points, the 16 translates into, let's say, around $6 billion, but we don't have $6 billion because we have other constraints, and therefore, we'd use the shorthand of 3. And in fact, that was the basis for that additional step that you saw on the ROE walk that I presented back in London in December. So I mean, part of what's happened through the second part of last year and the early part of this year is that, I guess, the constraints have come more into line with each other. I mean, some of the rating models don't move as rapidly in response to some of these things as the Z-ECM and particular at SST. So this -- the numbers have come down, but I guess the constraint picture has changed, if that makes any sense. So I don't see a fundamental change in the flexibility that we have. On top of that, you're right. I mean, we have the ability to manage required capital. We need to be careful that we don't give up efficient earnings as part of that, but again, our peak capital requirement is for financial market risk. I mean -- and that's something we manage actively, and we have done in the past, and we continue to do in the future. Would modeling changes be part of the story it would note? I mean, I think -- in one of the big differences you see between the 2 numbers today between SST and Z-ECM is that Z-ECM has the benefit of what we think is a significant improvement in the way that we model market and credit risk and the tail. I mean, I think in due course, we'll review that and we may propose that to FINMA for inclusion in SST. But of course the acceptance of that by FINMA is purely their discretion. And I would imagine that it would take some time from the point at which we propose it. And we don't need to manage the gap between Z-ECM and SST, so I mean, model change couldn't be a significant factor.

James Austin Shuck
UBS Investment Bank, Research Division

And just to clarify one point. If any decision on capital that you may not need, are either because you can't find sources for it? Or it might make sense to return that? That presumably would be a year end decision?

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

I've already said there, yes. So I think the -- I mean, we'd make it -- I mean, again, going back to what I said at the year end, I mean, we work broadly, I mean, to an annual cycle. So as we come up to the year end, we make any decisions there. But we see in terms of the inorganic or organic opportunities ahead of us versus return to shareholders. So I mean, in the early part of 2016 is decisive for us. Underlying loss ratio, so I didn't quite understand the walk that you did. I mean, in my head, I guess the numbers on the combined ratio were the -- if you adjust for some of the one-off expense in the prior year, if you adjust for the cat fluctuation, we're about the same that we have a positive impact on the attritional offset by negative on the large loss. So there is about a 60, 70 basis point improvement rather than -- you mentioned 130 basis points, but you may have included some of things I'm normalizing in my head. I mean, the improvements we see are a combination of various items, so it's -- I mean, it's something that we expect to drive profitability over the course of this year. So portfolio management, we describe as tiering. So I mean, obviously, emphasizing the positive parts of the portfolio and looking for significant rate in the weaker areas. And I mentioned commercial auto earlier in the conversation. We've had some small steps on turnarounds, so -- obviously Russia from a loss perspective, is no longer in the picture. South Africa is slightly better, albeit, Brazil is probably slightly worse than it was before. But I mean, those drivers are mainly the drivers of what we perceive the attritional loss ratio improvement to be in Q1.

James Austin Shuck
UBS Investment Bank, Research Division

And North America commercial, the -- how has the attritional loss ratio developed there in Q1?

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

It was -- it's say, I mean overall, North America commercial have improved, I mean, both from underlying attritional and from a PYD perspective. So the results in North America commercial stand out. It's one of the -- is very positive Q1 this year over Q1 last year.

Operator

[Operator Instructions] The next question is from Thomas Seidl, Sanford Bernstein.

Thomas Seidl
Sanford C. Bernstein & Co., LLC., Research Division

Two questions. Number one, on the Investor Day [indiscernible], we calculated you had a sharp drop year-on-year in regular investment income of 38 basis points. And I wonder, although, in the context of, George, what you just discussed, should we now expect Zurich to re-risk to mitigate a further sharp drop in the investment income? Or should we actually expect Zurich to de-risk in order to create more room to maneuver on the capital side? I'm not clear about that. And the second question. On the capital, I think that model changed, of course, at -- in the end would have been 116. The model change is not, as you said, available in SST [indiscernible] could perceive SST appears a more robust metric. And if I extrapolate the Z-ECM number you gave for Q1, I would say that SST is probably around 180 now after Q1. And I wonder if you also have a threshold for this, externally, you still have certified capital metrics. So how low would you be willing to go in SST before it gets painful?

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

So if I will start with the first one. I mean, again, go back to the full year. I mean, we indicated that we had decided that we would change asset allocation in a couple of areas. And that was predominantly in equities. So we given Cecilla and team a 1% shift in the equity asset allocation, predominantly away from fixed income. On top of that, the IM team already had an existing strategy around illiquids. They have been completing that, they haven't completed it yet, but they continue to do that through the course of this year. And those 2 steps were really the only steps that we had planned to take on the asset side to help mitigate the impact of negative rates in some of the countries we discussed earlier in the call. Will we take further steps? No. I mean, Cecilla has the ability to tactically decide to be slightly long or slightly short depending on the market circumstances, but we have no further intention to shift the SAA [ph]. On Z-ECM and SST, I mean, I guess you can get a sense of, I mean, where we're comfortable from an SST perspective, from where we've operated in the past. And I mean, 196 is still a very strong position for the company to operate at. I'm not sure you can do what you just did and extrapolate the thing straight-line. I mean, if you look at the moves we've had both for Q1 and some of the comments around what happened in April, May. I wouldn't get to the same level that you estimated. But I mean, Z-ECM is where our focus is. I think the point you make, though, that we need to manage the gap is absolutely true. We haven't set a formal floor of SST. As we would expect, over time, Z-ECM and SST to remain somewhat in some kind of harmony. But I mean, SST is not a formal part of the risk tolerance, and we're still very well capitalized under SST.

Thomas Seidl
Sanford C. Bernstein & Co., LLC., Research Division

If anything, I would have expected SST to react more strongly to the macro risk that occurred in Q1 compared to Z-ECM. And that is also what you have seen in 2014, isn't it?

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

I think that's what I said at the beginning of the call. So I mean, SST reacts more strongly. But I mean, first, because of things like market value margins and the way that calculation is done.

Thomas Seidl
Sanford C. Bernstein & Co., LLC., Research Division

And hence, I would have expected that the 196 you reported at the year end, after Q1, is easily in the 180s if you have like a 10% drop on Z-ECM after Q1, that's just my [indiscernible] of course, on the linear extrapolation, yes.

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

Yes. So I mean, I tried to give guidance around Z-ECM because we see that as the essential capital measure for us, I haven't given guidance around SST.

Operator

The next question is from Niccolo Dalla Palma, Exane BNP Paribas.

Niccolo Cornelis Modesto Dalla-Palma
Exane BNP Paribas, Research Division

Just one follow up question on a comment you made at the beginning of the call regarding the 2, 3 points combined ratio improvement needed in GI to bring you closer to the center of the target ROE. Could you give us any sense of how big a role expense ratio improvement compared to underlying loss ratio improvement have to play in there? Or we have to wait a couple of weeks to get more clarity on that?

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

I mean, we'll do much more in a couple of weeks when we have the Investor Day. But I mean, we already said that of the 2 to 3 points improvement, I mean, broadly a bit 1/3 is from expense, almost 1/3 from turnaround and the remainder from portfolio management. I mean, that's roughly how we expect it to break down.

Operator

The next question is from the Dhruv Gahlaut, HSBC.

Dhruv Gahlaut
HSBC, Research Division

Just 2 questions. Firstly, we talked about pricing in different markets, but if you had to look at how the rate evolution has been compared to the claims, how would those 2 compare on a group level? Secondly, on the FMS business, there was commentary in terms of an uptick in terms of the expenses. Is that one-off? Or is this the number going forward?

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

So rate versus claims, I mean, broadly in line with each other. I mean, they vary market to market, but from a group perspective, one broadly equals the other. On FMS, so the comment on expenses was due to the fact that last year, we had a margin on FMS of about 7.2%. And I guess we've guided that we'd be at 7% over the course of this year -- next year. And we've arrived at 7% a bit more quickly, I think, than we had anticipated. That's due to that expense feature, but I don't expect to go further. 7% is where we expect it.

Operator

We have a follow-up question from Michael Huttner, JPMorgan.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

It is just one question. The -- so Life $350 million, you're keeping your target, and that's brilliant. Well, of that $350 million, we achieved $319 million. Which regions or which levers which -- where do you think there's a little bit of easy wins?

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

I mean, first off, would you excuse me for describing any of what you have to do as easy wins. I mean, I think the broad buck is, Michael, be a combination of -- I mean, I guess what we refer to as enforced management in some of the more mature European markets. So that means expenses, persistency management, those types of things. But I mean, I think on the more positive side of it, I mean, given the growth that you've seen again from the joint venture with Santander in the quarter, we expect that also to be a pretty significant contributor to the growth on the positive side of what Life's doing. I mean, those would be the 2 most obvious areas we expect further improvement from Life.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

And if I may just very briefly, if you were to consider selling the remainder of your U.K. business in the kind of run-off deal, closed stock or whatever, what impacts would that have on your ROE metric?

George Quinn
Chief Financial Officer and Regional Chairman of Europe, Middle East & Africa

The -- so I guess the only straight answer I can give to that, Michael, is that we don't expect to sell the remainder of our U.K. Life business. In general, we're looking at the entire Life backbook for opportunities to try and optimize, to find maybe parts of the portfolio that would find better owners who would perceive a higher value. And that's something we continue. But I mean, our Life business in general is actually expected to contribute, I mean, strongly positively through some of the strategic priorities that Life has currently, particularly CLP.

Okay, that was our last question. Thank you, all, for dialing in. We wish you a very good day. And we look forward to seeing you at our Investor Day in Zurich in 2 weeks' time. Thanks very much.

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.