S&P Capital IQ

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Zurich Insurance Group AG SWX:ZURN

FQ1 2017 Earnings Call Transcripts

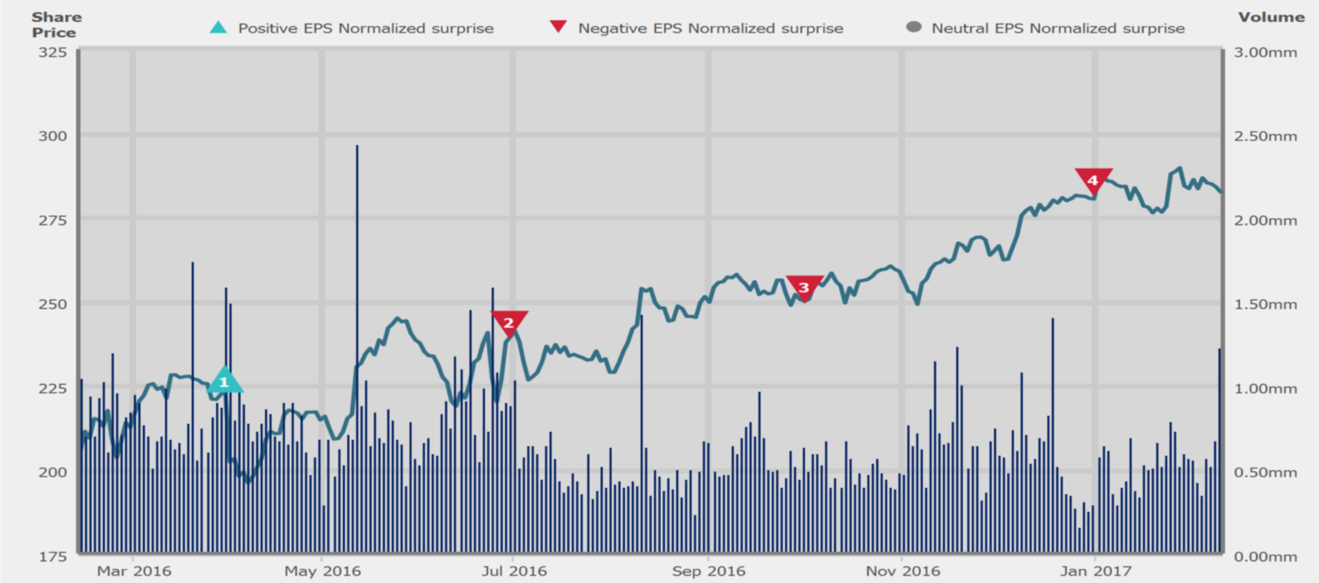
Thursday, May 11, 2017 11:00 AM GMT

S&P Capital IQ Estimates

	-FQ1 2017-			-FQ2 2017-	-FY 2017-	-FY 2018-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	5.49	4.05	(26.23 %)	6.02	23.11	24.67
Revenue (mm)	13281.90	13498.84	1.63	-	51408.17	52434.84

Currency: CHF

Consensus as of May-11-2017 11:19 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2016	5.41	5.81	7.39 %
FQ2 2016	4.93	4.74	(3.85 %)
FQ3 2016	6.82	5.92	(13.20 %)
FQ4 2016	5.81	4.55	(21.69 %)

Call Participants

EXECUTIVES

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

Richard Burden

ANALYSTS

Andrew Hughes
Macquarie Research

Andrew James Ritchie
Autonomous Research LLP

Dhruv Gahlaut

Farooq Hanif
Crédit Suisse AG, Research Division

Johnny Vo
Goldman Sachs Group Inc., Research Division

Jonathan Peter Phillip Urwin
UBS Investment Bank, Research Division

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Nadine Adrienne Marion van der Meulen
Morgan Stanley, Research Division

Nick Holmes
Societe Generale Cross Asset Research

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

Peter Eliot
Kepler Cheuvreux, Research Division

Rene Locher
MainFirst Bank AG, Research Division

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

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

Presentation

Operator

Ladies and gentlemen, good morning or good afternoon. Welcome to the Zurich Insurance Group First Quarter 2017 Results Conference Call. I'm Sarah, the Chorus Call operator. I would like to remind you that all participants will be in a listen-only mode, and 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. Richard Burden, Head of Investor Relations & Rating Agency Management. Please go ahead, sir.

Richard Burden

Good morning, good afternoon, everybody, and welcome to our call for the first quarter 2017 results. On the call today, we have our Group CFO, George Quinn. And before we start with the actual Q&A, George will make a few introductory remarks to the results.

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

Thanks, Richard. And good morning, good afternoon also from me to everyone on the call. Thank you for joining us for this Q1 discussion. Just before we move to the Q&A, I'll make a few remarks. Our results show a strong performance with BOP up 14%, adjusting for the impact of the change to the Ogden discount rate in the U.K., with the business across the board showing progress against the key objectives that we laid out at the time of our Investor Day in November last year.

In Property & Casualty, we continued to focus on disciplined underwriting and delivery of our cost-saving goals. This focus is having a positive impact on our underwriting performance, with the accident year loss ratio ex cat improving by about 2.4 points year-on-year. On the expense side, we've achieved further absolute cost savings in the quarter. However, the decline in NEP, as a result of the underwriting actions from 2016, together with mix effects, means that these are yet to show through in the expense ratio. The stabilization in written premiums in the first quarter and the impact of U.S. crop premiums together with the further cost savings that we have planned make us confident that the expense ratio will decline over the remainder of the year.
Elsewhere, our Life business continues to deliver on a long-held strategy of focusing on capital-light protection business, with this continuing to support good growth on all metrics, while Farmers continues to see steady performance.The quarter has confirmed a very strong capital position with a Z-ECM ratio of 129%, above our target range and providing us with significant capital flexibility even after the completion of the recent Cover-More acquisition and the debt redemptions, which together will take around 4 points off of the ratio over the second quarter. We continue to review the capital levels of our business in the light of growth opportunities and the macro outlook. However, our near-term primary focus remains on delivering on our dividend policy and growing the dividend over the plan period. Now happy to take your questions.

Question and Answer

Operator

[Operator Instructions] The first question is from Farooq Hanif from Credit Suisse.

Farooq Hanif
Crédit Suisse AG, Research Division

Two questions on capital and one on the loss ratio. On the SST methodology change, do you think the 227 now is a fairly good comparative with Solvency II? So should we start looking at that as a comparison with some of your peers? How meaningful do you think that is? And related to that, second question, even after the Cover-More transaction, you'll still be at a Z-ECM ratio which is historically extremely high. Just wondering what implications that has for either dividend or further acquisitions? And the last question. The loss ratio, it's been a great improvement. You've done a lot of work. But when you look at the commercial ratio ex Ogden, it's still unprofitable. So should we expect that, as well as an expense program, we're are still going to have an attempt to bring that underlying loss ratio down further? And just what does that do to top line? And what's the timing of it?

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

Thanks, Farooq. So first of all, on the 227, I think if you go back to the Investor Day presentation from last year, I think that there were really, I mean, 2 key components that we saw as driving the difference in conservatism between SST and Solvency II. The ones that you've seen here I think are the methodology changes. So the -- so FINMA has taken out the scenarios that were added in and has changed the way that the market value margin or potentially capital charge is reflected in the capital -- in the calculation. However, if you go back to the Investor Day, there was also still a significant difference, and we've measured it by reference to what we can see on a -- our European businesses are subject to Solvency II versus the same number that we can see on an SST basis. So we will still be of the view today that the number is sounding more comparable but is not comparable yet because there are still significant differences between what Solvency II requires and what SST requires that it still has a unique conservatism in the SST calculation. So we think that if you were to look at the numbers, I mean Solvency II equivalent for us will be quite a bit higher than 227. And I think you've seen from some of the more detail, what one of our neighbors has done, that , that difference will still exist even these changes from FINMA.

Farooq Hanif
Crédit Suisse AG, Research Division

And presumably -- sorry to drop that. You -- we will get an SFCR from you on your Solvency II entities or we'll see some of that.

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

We are subject to the same reporting requirements and I guess that they are about to hit the wires I'm sure. So I think it's partly in May and then group numbers come a bit later. So our entities in Europe, you will see them the same way you will see the others, at least what's added. I mean, FINMA obviously are in the process of working with the companies on what FCR should look like. So I mean FCR will come for us as a group and for our Swiss entities at some point in the I think the not too distant future. On the second point on capital -- I mean, a learning for Cover-More and the impact of the -- let's call it the advanced financing that we did last year, that means that some of the maturities will not be replaced this year. I think the only thing I'd say on that for time being is, I mean we're in a good place on capital. I mean, we're still strongly capitalized. But as I said in the introductory comments, our focus -- and I really mean that -- I mean, our entire focus is on the operational side for time being. It's all about improving operating performance and using that to drive dividend growth. That's our #1 priority. On commercial, so like I know you guys don't have that much time today given all the other companies that are out there. But I mean we have the new disclosure, which will take a bit of time to get used to. But we have commercial as a separate business. I'd be tempted -- so I'm tempted to go back and try and take some of the negative impacts and then commercializes a slightly high cat burden in Q1. There's a few other topics around comparison with the prior year that I think the headline numbers don't fully represent. However, I think even if did all of that, I mean the basic issue remains the same. It's a tough market out there. We still have challenges in the portfolio. And Jim has a number of activities planned for this year. I like to tackle some of the weaker parts of our business. And I mean, one of those continues to be commercial motor. If you look at commercial motor globally, I'd say that we see very pretty rate in the U.S. currently. But commercial motor in other markets, particularly in Europe, is not providing adequate return currently. So there is a lot of work still to do on commercial.

Operator

The next question is from Peter Eliot from Kepler Cheuvreux.

Peter Eliot
Kepler Cheuvreux, Research Division

The first one was just on your earned premium outlook. Are you still guiding to flat earned premiums in 2017? And just to understand, that presumably means that the Q1 developments were pretty much as you expected. So all of that, sort of timing difference, say, fully accounts for [indiscernible] your expectations. And secondly, I guess just given the comments on prioritizing profitability over volume in commercial, does that sort of pose any risk to that statement or -- just to understand how you think of that. Secondly, can I just understand how much of the Ogden impact is in the Z-ECM ratio at the end of 2016 and also what the outlook is in terms of we might still expect to come through to the P&L?

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

Thanks, Peter. So first of all on the premiums, so no change to the prior guidance. Our expectation is that we will flat for the entire year or be it with some peaks and troughs. And in fact we just had the trough as we go through the quarters. I mean, the main distorting factor is going to be crop. I think the -- I mean, what we've had in Q1 is by and large what we had expect because of the lag impact of handling the written redemptions that you saw last year. Q1 is also slightly impacted by the fact that we got a bit more reinsurance in the portfolio. It certainly impacts commercial more than other parts of the book. So the only thing I would say is that if go back to the disclosures we had when we talked about crop in more detail, there is some insights there into the pattern that you can expect. But I mean crop is very strong in Q2 and Q3 and it's still significantly present in Q4, but almost not present at all in Q1. So we expect flat premium for the year, but with a pattern driven by crop. On the action that we are taking around commercial, I mean so does create additional risks? I mean, we -- I mean, from an overall volume perspective, I think -- I mean, we don't see anything that suggests to us that -- I mean, what we need to do in our commercial book is somehow as extraordinary as some of the things that we did at the end of last year or the year before. I mean, if you look at commercial in general, retention is slightly better, new business flows are more in line with expectations. So we have some pockets that need to be tackled. I mean, at this stage, we maybe have a plan for commercial that would reflect those risks, so I don't expect today that we will be coming back for further discussion about why is the NEP at a different place. But having said that, I mean of course the priority is profit and we don't control the market. So I mean if the market was to move in a way that we don't anticipate today, I mean I guess for us and for others, that would put top line at risk. On Ogden, you can assume that we have Ogden in its entirety in the year-end number.

Peter Eliot
Kepler Cheuvreux, Research Division

Could I just ask one very small follow-up just on the sort of the timing pattern that you're talking about? And can we -- the 1.2% on the expense ratio that you said was basically due to timing, can we assume that is all sort of premium related and therefore actually that in Q2 and Q3 if we're getting sort of higher premium, actually that we should expect maybe -- I don't know -- 0.6 percentage points sort of tailwind in each of Q2 and Q3?

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

So what I've got to avoid then, Peter, is giving you a forecast. But I think the -- I mean, the components -- just to reiterate, the -- I mean, from an -- if you ignore crop, last year's written performance is a good guide to what you should expect to see sort of this year. So you could use that to proxy the underlying earned. From a crop perspective, I think you've got the original numbers from around the time of the acquisition and you got a pattern in there, so you could overlay the 2. And for expenses, I mean we have an absolute reduction in expenses, but it's a bit overwhelmed in the quarter by the NEP impact. But from expense perspective, it's obviously not going to go up and it will go down. And as you -- I think you mainly all know, I mean we have an ambition to take expenses down this year by the $400 million so that we get roughly to the halfway point in our expenses program by the end of this year.

Operator

The next question is from Jon Urwin from UBS.

Jonathan Peter Phillip Urwin
UBS Investment Bank, Research Division

Just 2 from me. So firstly, could you give us more color on the move on the Farmers new business account? 19% reduction in Q1, what caused it? How do you expect that to develop for the rest of the year? And secondly, just in the context of the sort of planned actions on the commercial book, there's some news flow out today in the [indiscernible] side of that. You're potentially looking to offload the German med-mal portfolio. If you've got any comments there, that'd be great.

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

Okay. So the answer to the second question is the easiest. So the answer to that one is no. On the first one -- so on the Farmers new business account, I guess as everyone -- as we've discussed several times in this forum before, if you look at the exchanges, one of the biggest issues that they face and, in fact, the U.S. auto market in general is the poor profitability in auto. So I think you see Farmers and, in fact -- I mean, in general, you see almost all markets pushing rates significantly. And in fact, if I look at some of the peers to the exchanges, I mean, their new business accounts -- so their new business changes quarter-over-quarter. I mean, are in the same place and, in some cases, even more significant than the thing you see from Farmers. Farmers actually has an improvement in auto in the quarter but not yet enough to get to the level that would -- for the overall portfolio achieve the level of profitability that the exchange is looking for. So that topic around rate I expect from Farmers and, in fact, I think I see from others that it continues to be a theme and I think will be throughout the remainder of this year. So we still expect to see Farmers grow premiums, but it's going to be driven by rates. And to the extent that, that has an implication for the exchanges around new business, I think the exchanges have decided that they are happy to accept that for the time being to bring profitability to where it used to be.

Operator

The next question is from Paul De'Ath, Royal Bank of Canada.

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

Just looking at the -- I guess the combination of the loss ratio and also the commission expenses, and obviously you talked about the change in mix as kind of the driver of the commission expenses going up. Presumably, at the same time, that is also a driver of the loss ratio moving down, the accident year loss ratio. And so I mean, is it better to look at those things combines, so at the loss ratio and the commission ratio together? It looks to me that the underlying improvement is more like 1 percentage point rather than the 2.4 on the pure loss ratio. Just any thoughts on whether that's a better way of looking at things. And then the second point was just on the crop business again. Obviously, you've highlighted the seasonality, I guess, in the net and premiums. Is there a significant seasonality in the claims in that business as well that we need to look out for?

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

Yes, thanks, Paul. So I mean -- so the first one is a good point. In fact I should have mentioned it in response to one of the earlier questions around I mean what do we expect in terms of future impact on expense ratio. I think it's not unreasonable to look at the combination. So I think if you combine commission and loss -- I mean, as we grow the mass consumer business, the commission ratio is going to pick up. Overall we would expect that to contribute profitably overall for the group. But I mean you may see some tradeoff between loss ratio and commission. But it's only to the extent that commission ratio moved in the remainder of the year, I think -- I mean, I would assume and I'd ask you to assume also for the time being that that's offset with an excess loss ratio improvement beyond the existing targets we have for improvement. On seasonality, I mean the short answer is yes. So I mean as you appreciate -- I mean, given the risks that we run in the crop business, there's a combination of topics around the commodity price, hail and these are the natural perils that would drive the outcomes. I mean, more or less, I mean I would assume that -- or I would ask you to assume that the seasonality around premium is a reasonable indication of the seasonality around claims.

Operator

The next question is from Andrew Ritchie from Autonomous.

Andrew James Ritchie
Autonomous Research LLP

Did the going -- looking at the underlying loss ratio improvement year-on-year, you mentioned in your commentary that you had lower attritional and lower life losses. I guess I'm just trying to judge -- and maybe you could give me your views as to how much of it was a bit of good luck on manmade or life losses. How much of it really reflects the portfolio effects and/or how much of it reflects the benefits of the change reinsurance program. Just a bit more flavor just to understand the sustainability of the current level and the improvement. And maybe linked to that, what you're seeing in terms of underlying loss trends, particularly in the U.S.? And I guess the other question, George, you talked -- I mean, in your opening comments, you were keen to talk about dividend growth. Now clearly, there's no balance sheet constraints. What is it -- what's the metric we should care about by thinking about the point at which you're comfortable to grow the dividend? Is it BOP ex Ogden, which you kind of make a highlight of in the presentation? Is it where you got -- get the combined ratio where you get to ROE? What was the metric that you care about the most before you switch on dividend growth?

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

Excellent. Thank you for that question. So on the underlying loss ratio, I think the changed reinsurance program I think from what I can see in Q1, I don't think there would be a net benefit. It would probably be a small net cost. But I don't believe that's had a significant impact. I think if you look at the -- I mean, the two big drivers, you mentioned it already. So it's roughly -- the improvement is roughly 50%, the lower side of attritional and the other being the large side of attritional. I mean, the large is going to come and go. It's very hard to reach any conclusions based on this quarter, but I could tell you that you can expect that improvement to stick throughout the year or be smaller or larger. I think the reduction in the smaller end of attritional rate is more meaningful and that will give us more confidence around the progress that we think we're making around the improvement. But I mean it's all caveat with the fact that it's 3 months. We need a bit more behind us before I think we can start to draw deep conclusions about the extent to which the changes that we have made are now finally showing up on the performance. But I think we feel good about where we are, but I mean there's clearly some luck.

Andrew James Ritchie
Autonomous Research LLP

Is there for -- on the reinsurance comment then, you still have quite -- you haven't touched any of the additional large losses cover you bought then.

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

So the changes in the program at the year-end -- I mean, probably the principal one was to seed a bit more of the U.S. property risk. I mean, we need a relatively active claim environment for that to really show up as a positive impact. And just given the return fee to run for these risks. I mean, these levels will show up in any given 3 months period. I mean that's more of a broader view of the market from us and indeed to make sure that we can serve our clients. So I mean just to recap, I think on that, I think we feel good about the 1/2 of the improvement that comes from lower attritional. The other 1/2 very hard to judge. And that general comment, that 3 months, makes the whole thing pretty hard to judge, albeit it's a good start for the year. Underlying loss trends in the U.S., so I mean, in general, I mean with the exception that commercial auto still runs reasonably hot, I would say, I mean rate has come up to a level that certainly makes it slightly more attractive. But I think we would still want to see the market -- we still want to see more improvement in commercial auto in the U.S. before we become enthusiastic. There's still not enough -- there's not enough energy yet from a rate improvement to feel happy about underlying profitability on that book. On the remainder -- I mean, in general loss trends are I'd say relatively benign. I mean, workers' comp is in good shape. I mean GL, we don't see anything that causes any concern. I mean, if you look at rates and you look at loss cost trends, I mean rate we see in the U.S. about 1% and we would judge loss costs slightly higher. So albeit loss trends in the U.S. are not particularly negative. Rate has kind of been absorbed by all of the market rate change. And what's the benchmark for dividend growth? I mean, it's -- I'll be answering in two parts. I mean, the key driver is going to be the dividend policy that we take in November. What do we feed into that in terms of the number? I don't think we would want to tweak and or play around with the figures. We did say at the time that there's clearly a forward-looking element to it, so it shouldn't just be based on what we see in the past. We'll take into account what we believe is coming. I think in terms of Ogden in the first quarter, I think all I see around Ogden is that -- I mean, the approach we've taken to Ogden in Q1 is to really say the U.K. is: "It's a U.K. issue, so you manage it." And the group's willingness to use reserve strength as you've seen in Q1 is relatively lower in that topic. And that's really been putting pressure on the market. Having said that, over the course of the year -- I mean, I would still expect today that PYD in total for the full 12 months, including Ogden, will be in that target range. So even though Ogden's a relatively big topic given the scale of it in Q1, I think it will be a much smaller topic by the time we get to the end of the year.

Operator

The next question is from Thomas Seidl from Bernstein.

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

Three questions from my side please. First, on pricing. I mean, I look at Page 11 of the presentation, you -- in the U.S., you grew net of [indiscernible] on underlying 1% basis but increased prices 1%, whereas the figures we get from the market, CIAD is saying minus 3%, March minus 3%. All other peers reporting a negative price change in U.S. commercial. I think you don't have any exposure to [indiscernible]. So my question is, how is it possible that you defy the pricing gravity there? Secondly, when it comes to the cost expense ratio, of course we hear your story about the mix change driving up the commission ratio. And I also saw your comment that the one-off effect from NEP is worth 1.2. But if you strip that out from the 33.5% expense ratio, we get to still above 32% level. So how confident are you that you get below 32% expense ratio all in by end of the year? And the third question is on the de-risking you announced at Investor Day. I read with interest that you stopped basically the de-risking of equities because of the rising stock market I assume. And when I look at the waterfall chart you presented at the Investor Day, you assumed that this de-risking would add equity and hence be dilutive to ROEs by 1 percentage point. So with basically equity 1.5 billion lower year-on-year, shouldn't that mean that you should see a much higher ROE coming out of all of those work you're doing?

George Quinn

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

Thank you, Thomas. So why don't I start with pricing? So if you look at the U.S. business in particular, there is growth but not in the commercial. Commercial has actually shrunk. And in fact, the growth is going to be driven by a combination of, I guess, what we typically refer to as alternative or direct markets. So that tends to be crop, this newly acquired business, and the F&I business that we have. And we think that from a pricing dynamic, that market today is quite different from the rest of commercial. So that explains how we have managed to decide the rate change. On expenses, so -- I mean, we've said that the program -- I mean, you know from us what we intend to do. You know what the ambition that we have for this year is -- I mean, if we combine that with what we expect from a top line perspective, as I explained to the guys earlier, I mean it's not so difficult to work out where we expect it to go, and we'd expect it to go down.

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

How much? I mean, below 32? Is there a confidence?

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

So -- I mean, take the 400 to make a reasonable estimate of how much that falls into GI and superimpose it on the impacts. I mean, you can work the number out. On the de-risking, so -- I mean, de-risking, we still -- because essentially, we've done the de-risking that we had planned to do. I think the issue around equity is, I mean, less equity impacts. But I mean, we do have some interest rate impact in the quarter. I mean -- and that will vary over the course of the next 2 years as we move towards the end of the planning period. So I think for the time being, I will stick to the guidance that we gave you back in November. I mean, there will be some volatility because of interest rates between now and then.

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

Yes. But clearly, with 1.5 billion lower equity than assumed at this point in time just makes the achievement of the 12% or 13%, whatever the number is, much easier, no?

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

So I mean, if everything ended today and we have achieved all the targets and equity was as stated, you're absolutely right, we would exceed the targets that we laid out in November.

Operator

The next question is from Nadine van der Meulen from Morgan Stanley.

Nadine Adrienne Marion van der Meulen
Morgan Stanley, Research Division

A question from me on the Life side. So a large part of the Z-ECM capital required is attributed to the retail life businesses, and quite a few of them have quite low ROEs in the past, which talks about around 6% or below. Could you talk about what action you're planning to take on the Life side and whether you're potentially interested to exit certain retail life businesses? And then the second question is on the capitalization, just referring to the first question on the call. If I understand it well, so you would be quite happy to remain overcapitalized for a longer period of time, is that right? Or could you maybe comment on the -- yes, on the excess capital and your potential plans for that?

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

Thanks, Nadine. So -- I mean, you're absolutely right about the impact of the capital that's allocated or the capital required -- not just capital, but capital required by some of the more traditional and particularly

European life businesses and the return. And I mean, we have talked in the past that, that's not an outcome that we're particularly happy with. The challenge is really to do something significant about it. I mean, we have all talked about, I mean, certainly one of the key markets that drives this. And unfortunately today, the availability of a market solution is not obvious. I think if the market did offer us ways to reallocate capital within the existing business and maybe take capital away from some of the [back booths] , which are typically the areas where most of the challenge comes from Life, then we would certainly be prepared to explore it. In fact -- I mean, you remember a couple of years ago, we did the transaction in the U.K. around the annuities. So we certainly have an appetite to do that. Having said that, we're not looking for a retail exit of any of our key markets in Europe. I mean, as you know from the reorganization that we did last year, we reorganized in a more customer-oriented fashion. And we are hoping that from a new business perspective, that starts to pay dividend as that organization starts to take form. So I don't want to leave anyone with the impression that capital management around the [back booth] has any necessary implications for the new business pool. On the overcapitalized point, I mean I wasn't trying to give any indication that there was some need now to sit for several quarters. I was simply saying that as of today, I mean, we are obviously well capitalized and the priority remains improving of operating earnings and using that to drive the ordinary dividend. But I mean, we've set out where we stand on capital policy before. I mean, we'll act accordingly as you would expect us to. But I mean, this is Q1. We have a long way to go through the year before we make any judgments there. And again, the focus is operating earnings and ordinary dividend.

Nadine Adrienne Marion van der Meulen
Morgan Stanley, Research Division

And well, just a -- when you talk about we're setting out where we stand on capital before, you mean the 100% to 120% optimal range.

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

Correct. So we have no change in our target capital range.

Nadine Adrienne Marion van der Meulen
Morgan Stanley, Research Division

And then maybe a quick follow-up question. The overall combined ratio, are you -- we've talked a lot about expense ratio and loss ratio on this call. But just to simply put on the overall combined ratio, can you give some kind of guidance there where you expect that to go over time?

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

Yes, thanks. So there -- I mean, given what I said to Andrew earlier, I think -- I don't want to repeat what I said at the year end. At some stage -- and our view and in fact our plan is to achieve an outcome consistent with what I said then, which was: we judge the underlying last year to be around the 99 mark and we were looking for somewhere around a 1.5 point improvement in the combined ratio and that's still the goal for this year.

Operator

The next question is from Ralph Hebgen from KBW.

Rene Locher
MainFirst Bank AG, Research Division

Just one question on the loss ratio development. If I look at the region split, you have now got a new segment called North America and in there the accident loss -- the accident year loss ratio improved very nicely from 71% or so in 1Q'16 to now much lower 67.5%. Now, my question is, would you be able to comment on the underlying dynamics, split it up a little bit into the dynamics in commercial and in corporate? Because if I understand this rightly, then the North America region now combines what used to be North America commercial and global corporate. And to the extent that this interpretation is correct, will be interesting if you could make some observations of how the loss ratio improvement relates to the dynamics in commercial business and in corporate business.

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

So I'm going to apologize in advance, Ralph. I'm not really able to do that. What we tried to do at [GEM] is to -- I mean, to refocus the way to look at -- I mean, because we have the new organization. I mean, to look at commercial in a different way today. I mean, I don't think the dynamics today will be vastly different from the ones you've seen recently. So I mean the issues that I referred to at the top of the call I mean still exist just only to be managed. I think if you look at North America overall, then what you do see is that commercial still clearly has challenges in what's a pretty tough market. I mean, the other markets in which we operate in the U.S., I mean they are in pretty good condition and are pretty strong. So the combination overall is actually doing reasonably well for us. And if we can do more to improve what we see on the commercial side, I mean that would be a good outcome for the firm overall and that's what we're aiming to try and do.

Operator

The next question is from Andy Hughes from Macquarie.

Andrew Hughes
Macquarie Research

Can I come back to Slide 11 for a quick question again? I think Thomas asked why is the 1% so high. It's a little right, these numbers have been resorted to include the global corporate business and basically -- and that global corporate business will obviously have much higher price rises because of the fact that you were running down that book. Has that now stopped, because these numbers are pretty much the same as they did without global corporate before? And I'm also a bit confused as to how the commercial kind of combined ratio over the expense bit gets much better from here, because you have kind of 1% price rise on North America doesn't seem to really get me to a dramatic improvement in the commercial business? And on the retail business, obviously the combined ratio at Ogden is very low. Is that the kind of level you would expect going forward, 91%? Do you think that's a sustainable retail margin?

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

On the rate increase, I mean if you look at the individual regions, I think -- I mean, I don't think, I know from what we can see come through. I mean, North American market is the toughest. I mean, if you look at the dynamics, I mean even if we've seen an improvement around, for example, commercial auto, the trends that we saw, for example, in workers' comp last year continue and we still see negative rate around that market. So I mean North America overall, there's still more work to be done. The team are completely focused on it. If you look at the portfolio combination, I think we can always be happier, but the overall outcome for North America I think is a decent one for the quarter and the aim is to look at how we allocate capital within commercial and try and adjust that so that we can take a bit more of those ones that we think is still stronger. I think you also know from us that there is a broader topic as well around some of the risk factors in the North America business and that's also something that we continue to focus on and target as a key activity for this year, which is to reduce some of the exposure that we have to some of the longer tail lines of business. As far as the -- I mean, what would we expect from retail, I mean I want to avoid that I say differentiated targets for different business and I'd only refer you to the guidance I gave earlier. I mean, the overall goal here would be to achieve that 1.5 points of improvement over the underlying 99 that we saw for last year.

Andrew Hughes
Macquarie Research

I guess the bit I'm struggling with is if the price rises aren't coming through in commercial especially in place like North America and you're aiming to move away from long deadlines towards short deadlines, which we had talked about before, that would suggest a decline in the commercial premiums. But you're guiding to flat premiums overall. So it's basically what's happening, the commercial business is shrinking and the retail business is growing. Is that where the -- a key driver of the improvement this year?

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

So a key driver of the improvement last year and part of what flows into this year is exactly that. So of course we've reduced the capital we allocate to commercial particularly in some markets where the performance has been weak. And you've seen us emphasize in some of the things we've done more recently and things with mass consumer because it provides a bit more stability to the overall book. I mean, the extent to which we can do that depends on the opportunities the market offers overall. Maybe just one thing on commercial versus corporate -- I mean, Richard was just pointing out to me that if you look at historical time, those 2 businesses have been moving about the same rate recently. So I mean I'm not sure of that and not sure in the overall. And the overall question, I mean where do we expect to see it come from? I mean, we expect to see some improvement in commercial. I mean, where we are at the moment is not a level that we are happy with. I mean, Jim conducted his review of the business when he came on board last year. I mean, he has views of how he will shift the capital allocation. And I would expect as we go through the year to see improvements in commercial.

Andrew Hughes
Macquarie Research

Can I ask you to follow up on the capital? Because obviously, the ratings position is driven by the operating performance of the group and the operating performance isn't where -- is still not where you want it to be really is what you're saying. Is that one of the reasons why you potentially have a more conservative capital policy? Are you kind of waiting for things to improve on the operating performance side before you look at capital?

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

I would say that must be the most creative way to ask the capital question because we have too much at the -- I mean you can see the numbers that we have outstanding. I mean, if I look at all the key capital metrics, I mean we are not constrained on any of them currently. So there is nothing in this -- the emphasis that I'm trying to give that the capital number we are reporting is at the end of Q1 and we come back later in the year we can revaluate it and it's not a key thing for us to do. And it's not because of some of the weakness elsewhere in the portfolio. I mean, we're in a strong capital position, which is a good place to be. But the priority remains operating earnings and what that can do for the dividend.

Operator

The next question is from Nick Holmes from Societe Generale.

Nick Holmes
Societe Generale Cross Asset Research

Just one question, sorry, coming back yet again to U.S. commercial. I wondered what's your view of where we are in the cycle. We seem to be getting some mixed signals from the market. I am thinking market scouts seem to be saying pricing is better than expected. What's your view?

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

Thanks, Nick. I mean, look at the numbers, I mean how have things changed from what we saw last year. I mean, property is more stable, and if you look at the numbers, maybe even has a very small increase in property, which is a trend that I mean we hadn't anticipated. I think I like to see more of that before you really can point that there's something radical taking place there. And in the product liability book, commercial auto again, as I said earlier, is the one that's showing the most strong improvement, but again off of a very weak base. And workers' comp is the one that has some weakness, albeit off of we would perceive as a very strong base. So I mean again difficult to draw conclusions based on the impact of just the quarter. But there are some changes in the general trend, albeit when you add them up, I think we end up back where we started.

Operator

The next question is from Vinit Malhotra from Mediobanca.

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

So I have got a different topic now. So on Life, obviously we saw some very strong technical margins. And I'm just also looking at market expectation. I think there is definitely what we would have delivered in 1Q seems to be much stronger than the run rate we had in mind or what consensus has in mind. Is there anything one-off-ish or -- because I remember back in January or February there was a bit of more caution on Life because of German [indiscernible]. If you could just guide a bit about this beat and what it means for the outlook? And second question plays on the reserve comment, which was very interesting because what you implied, George, is that the rest of the year we see obviously north of the, say, 2.2%, 2.3% kind of a level of one-off. And this is obviously a different position for Zurich from the past. Is this coming from workers' comp, as you've mentioned in the statement? Is there anything else to note? Is it coming more from the corporate center reserve and is this also meaning that going forward we could have more stronger or more reliable reserve releases?

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

Thanks, Vinit. So on Life, I mean Life is a business I mean not only for us, but I mean for most. The business always has some impact of management action. I mean, our judgment of the quality of the performance in Q1 is that the I mean the underlying quality has improved. I mean there is some management one-off impacts in the quarter, and it's relatively modest. But I wouldn't change the prior guidance that we've given around Life if you adjust for the move of Farmers New World Life. I mean, we will see whether we can continue to deliver those same strong performance through the year, but there is certainly some management action in the overall result. And if I adjust it back to the old structure we were familiar with, we would end up around slightly above the guidance levels that we have given before for Life. On the PYD -- so the PYD comment I made earlier in reference to the Ogden topic, I mean it was intended to be a comment I am going to pull it from here or there. It's simply a recognition that I mean over the course of a 12-month period rather than a 3-month period and given the range that we have around PYD, I mean we have a great ability absorb items that impacts the year. I mean, if I look at our reserve in position, I mean we continue to be in our opinion well reserved. If you look at the first quarter, then you'll see again something that you saw sometimes last year, but we've added the reserve strength in the corporate center. And if that combination of factors gives me the confidence that over the course of the year Ogden, as I said earlier, should be much less at the 3-month, full year than it is in the result today. And in fact I would expect PYD including Ogden to be in that 1-2 range.

Operator

The next question is from Michael Huttner from JPMorgan.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

I wanted to say that they are great numbers, but the disclosure is fantastic, long -- made at last. I'm struggling for questions because you've been so good on your answers. But hey guys, the 97.5 kind of implicit guidance, I assume now from what you said that this includes Ogden, so this will be the published number. On the U.K., I note that the reserves for [asbestos] have gone down quite a bit and I was a bit surprised by that because I thought that the Ogden charge would actually affect that number. But, hey, I have no idea. So I just wonder if you can talk a bit about that and the necessity on reserving risk. And then the last point you've made again on reserves, you said you added the reserve strength on the corporate centers. Your colleague very, very kindly in IR fully helped me out and I managed to work out the number was somewhere around 200 million or 250 million for last year. I just wonder if you could do the math for me for Q1.

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

I never thought I'd hear Michael Huttner introduce a call. I thought you will stop for a question.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Well, you've been -- you're so good I promise. Compared to the standard of disclosure of the other groups, you are outstanding and you continue to be lovely. It's wonderful.

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

Thank you, Michael. Yes. So on the reserve basis, I'm not aware that we made any significant moves. We will need to come back to you on that. I mean, that's sits within a team that's my responsibility. I mean, we haven't deliberately moved anything there. And in fact -- I mean, you're absolutely right, there is an impact from Ogden in the number. So I mean let us come back to you on that topic. On the question around what does the PYD comment mean for the combined ratio guidance for the full year, I mean I'm not going to add anything to what I said earlier other than to say -- and what improvement we are targeting. I mean, you have guidance on PYD. And again, I expect over the course of the full year that Ogden will be much less of an issue than it has been within that.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

But the -- given that you've given some focus on Ogden now, is it right to kind of jump to the full year -- I mean, is it right to understand that your comments on the full year on a reported basis excluding the count of this kind of noisy focus on Ogden here?

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

I mean, to be completely blunt, I'm trying to avoid being very precise. That will get me in great deal of trouble.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

No worries, no worries. That's right. No. Okay, I get that. No worries.

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

Yes, some of the comment means directionally. On the impact really in the corporate center, I mean it's a much smaller number than the total we took last year. I don't have the numbers in my head at the moment. We can come back -- we will come back to you, Michael.

Operator

The next question is from Dhruv Gahlaut from HSBC.

Dhruv Gahlaut

Just 2 questions. Firstly, sticking with Slide 11, it seems the rate increase stays around 2% or has stayed around 2% for the last couple of quarters, and the guidance around claim inflation was it's always been below that. You're still seeing improvement or help on the underlying loss ratio. Does that still hold true as in where does your claim inflation lie at this point? Secondly, on reinsurance, last year, you had -- you took a cover for large loss, the 300 into 300. Has that changed much this year? And if so, what has actually happened there? Have you changed the retention there or anything?

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

Thanks, Dhruv. So the claims inflation would be slightly more negative today. So I think I might have said in response to one of the earlier questions that we would see around 2. On the reinsurance -- on the volatility protection that we've commented, there are some very small changes. So the attachment is very slightly lower, but otherwise, the cover remains unchanged.

Dhruv Gahlaut

Right. It's still 300 into 300? Does that still remains?

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

That's a good assumption.

Operator

The next question is from Johnny Vo from Goldman Sachs.

Johnny Vo
Goldman Sachs Group Inc., Research Division

Just 2 quick questions. Just a clarification what you said regarding the dividend and that you have a policy. But if you see something positive in the future, then you would potentially hack on the dividend sooner. So can you just confirm that was the case? And then the second question was just on M&A. Zurich has been linked with numerous targets across the world from Australia to various other targets. I mean, is there a particular target or type of business that you're looking for, given the capital strength that you have?

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

Okay. So I think the easy clarification to the first one is it's correct. The policy is designed to take into account a forward-looking view and not simply a backward-looking view of what's taking place, although of course -- I mean, I think it's important to look at what we're doing at the moment, and I think the best evidence that we're on the right track is the results we've just delivered. So I think for the combination that we currently have, both are very important. But there'll always be forward-looking decision-making in the dividends that we say. On the M&A topic, I mean not much to add there to what we said before. So I mean, first of all, in the plan that we laid out from the Investor Day doesn't depend on M&A. So it's -- I mean, it's not the #1 priority for us. It's the operating performance. And to the extent that M&A is relevant -- I mean, Mario laid out when we had the presentation what the priorities would be, and that's around -- I mean, if we do, do it, we would look to strengthening existing market positions and avoid that broader mass-market transformational-type transactions. So -- I mean, part of what it means is to the extent we do, do it, more of what you've seen from us already.

Operator

There are no further questions at the moment.

Richard Burden

Okay. I'm feeling that it's a busy day with the number of results. We'll wrap it up there with no other questions. Thank you very much, everybody, for dialing in today. If you do have any further questions, obviously, please do not hesitate to contact the investor relations team. We thank you for your attention, and we'll speak to you in due course.

Operator

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