S&P Capital IQ

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Zurich Insurance Group AG SWX:ZURN

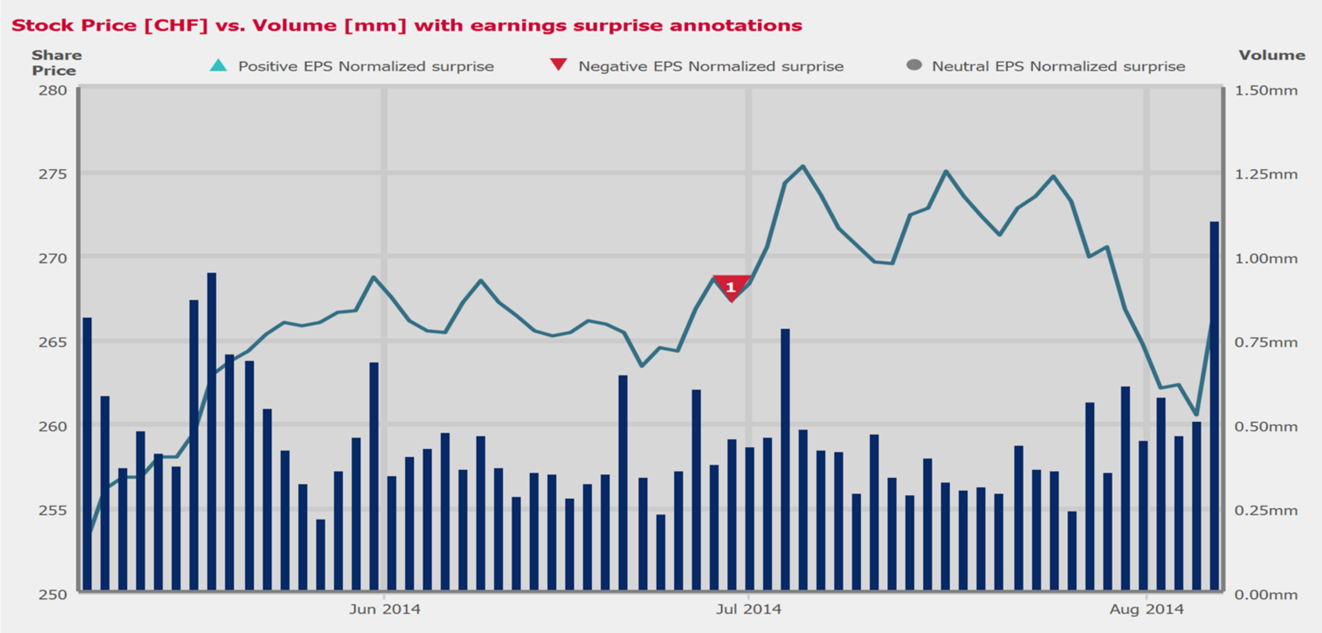
FH1 2015 Earnings Call Transcripts

Thursday, August 06, 2015 11:00 AM GMT

S&P Capital IQ Estimates

	-FY 2015-	-FY 2016-
	CONSENSUS	CONSENSUS
EPS Normalized	25.64	26.32
Revenue (mm)	57536.93	56424.50

Currency: CHF
Consensus as of Aug-06-2015 10:00 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FH1 2014	13.55	12.92	(4.65 %)

Call Participants

EXECUTIVES

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

James Quin

Martin Senn
Former Chief Executive Officer

ANALYSTS

Andrew Broadfield
Barclays PLC, Research Division

Andrew Hughes
Macquarie Research

Andrew James Ritchie
Autonomous Research LLP

Daniel Bischof
Baader-Helvea Equity Research

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

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

Vinit Malhotra

Presentation

Operator

Ladies and gentlemen, good morning, or good afternoon. Welcome to the Zurich Insurance Group Half Year Results 2015 Analyst Conference Call. I am Sally, the Chorus Call operator. [Operator Instructions] The conference must not be recorded for publication or broadcast.

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

James Quin

Welcome to Zurich Insurance Group's First Half 2015 Results Presentation. I'm joined by our CEO, Martin Senn; and our CFO, George Quinn. Martin and George will make a few short comments before we open to Q&A. [Operator Instructions]

And I'll now hand over to Martin.

Martin Senn
Former Chief Executive Officer

Thank you, James, and welcome, everyone, on the call on my behalf as well. As you will have seen from the results we published this morning, we continue to make good progress in our Life and Farmer businesses while the performance of General Insurance is below our expectations. We set out at the Investor Day the actions underway to improve both expense and loss ratios. Let me be clear, delivering on these commitments is my #1 priority.

While we are not fully satisfied with the progress made in achieving our business operating profit after-tax return on equity target of 12% to 14%, we are well positioned with respect to our Solvency ratio, which is at the top of our target range, and we now expect to achieve cash remittances in excess of $10 billion over the course of the 3-year strategic cycle ahead of our target of $9 billion.

Let me now say a few words on the press release we issued last week regarding our interest in RSA Insurance Group. At this stage, there is very little that we can say on this topic. However, we believe that the transaction could bring significant benefits to us and to our investors in terms of the complementary fit of RSA's business with our own operations and in terms of financial benefits from, for example, expense and other synergies.

But let me make one point absolutely clear. This or any other investment must meet the hurdles that we set last year: 10% unlevered. And as we have said repeatedly in the past, if we are not able to achieve this organic or inorganic opportunities, we'd rather return capital to our investors.

Let me also reassure you that this does not and will not distract us from our core focus on delivering on the commitments to investors that we made at our Investor Day this year.

And with that, I will now hand over to George, who will give you his perspective of -- on the numbers. Thank you very much.

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

Thank you, Martin, and good morning, or good afternoon to you. I'll make a few short introductory remarks on the results. As part of that I'll try and answer some of the questions that we've been asked this morning.

Naturally, most of the focus has been on the higher-than-expected combined ratio, and I'd break this down into 3 parts. First of all, we've experienced a particularly significant level of large losses in both Q1 and Q2. We're around 1.5 points above expected and around 1 point higher than we were for the full year 2014.

Taking a look at Q2 compared to Q1, we see an uptick in the attritional loss ratio around 1%. This is due to several individually small factors that we don't see them as representatives of the run rate. We will steer you towards the half year results where the attritional loss ratio is essentially flat compared to the full year 2014 levels.

Third, a higher expense ratio is, as we expected, and in line with the indications that we gave to the market back in February. I've no doubt that you have a lot of questions on each of these topics, but let me stand back from the details for a second.

At the recent Investor Day, we told you that we have plans in place to improve our combined ratio by 2 to 3 points from a normalized full year 2014 starting point of 98.5%. Our half year combined ratio is 98.3%. Our cat losses are below plan, large losses are well above recent experience. So the reported number, in our view, is close to a reasonable starting point. In other words, we are in a similar position to where we ended 2014. Of course, this is not where we want to be, but the bottom line is that we still need to improve our loss ratio by 1 to 2 points, and we need to reduce our expense ratio by 1 point. This is the overriding priority, and we have plans in place to achieve this. Time is short, but we are confident that we can deliver.

Before we start the Q&A, however, I want to emphasize the progress that we are making in our Life business and in Farmers, and in fact, in many parts of our GI operations. And naturally, we remain in the strong place in terms of Solvency and our cash remittance and cap for generation continue to be excellent. With that, I'll now look forward to your questions.

Question and Answer

Operator

[Operator Instructions] The first question is from Andrew Ritchie, Autonomous.

Andrew James Ritchie
Autonomous Research LLP

I wondered -- I mean, there's clearly evidence that the pricing environment continue to get a bit tougher. Now, I guess, you've flagged this earlier in the year, but maybe just give us perspective as to what do we need to be more concerned as to the feasibility, if you're hitting your combined ratio improvement targets given the pricing backdrop, has that changed materially in your thinking over the last quarter? Second question. Is there any specific areas inflating the attritional loss ratio in Q2? I mean, I'm thinking areas that have been problematic in the past, for example, you have some issues in U.S. commercial auto, and we're seeing a lot of your peers have issues there. Maybe just give us a bit color as to any specific blocks that affected Q2 attritional?

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

So I'll start. So on the pricing environment, I mean, it's slightly tougher than it was at the end of Q1. I mean, we have come down from our perception of about slightly less than 2% and rates increased to a bit more than 1%, and that from a perspective of what we had anticipated and what we've included in the commandments that we read [ph] doesn't change the overall picture materially. I mean, this is not driven by a rate topic today. On specific areas impacting the -- and attritional, let me just be clear for everyone. If you compare Q1 versus Q2 and look at the sequential, there is a deterioration on the attrition of about 1 percentage point, even if we still have retained about 0.4 points compared to last year in the half. I mean, the main driver Global Corporate in North America is the piece that stands out. And within Global Corporate North America, there are really 2 drivers. So one is, property is far away the largest part of it. We've seen not only elevated large loss, but we've seen much higher attritional losses in the quarter; I mean, far larger than the rate change would suggest you would expect to see. I mean, our conclusion there is that, that really is again natural volatility in the result rather than a trend that we'd expect to continue into the second half of the year. Liability is a smaller contributor to the overall. If you look at U.S. commercial auto, we were booking across all of our businesses around the 104 mark last year, which, of course, was too high. In Q1, we saw a pretty good rate across most of the portfolio, certainly exceeding our expectation of what was happening on the loss cause side. However, rate has -- well, not declined, but the pace of reentries has slowed in Q2. At the end of the half, for the 6 months, we have booked commercial auto at 107. Again it's a -- in the scheme of things, it's a relatively small move, but it gives you evidence of an area that we have to tackle to be able to achieve the overall goal.

Andrew James Ritchie
Autonomous Research LLP

You've looked into the large losses in terms of identifying any trend to do with economic recovery or any -- I mean -- is there any sort of commonality across the large losses?

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

That's a good point. So as you can imagine, we've looked at that period intensely as we prepared for today. I mean to give you some sense, in Global Corporate alone, we have 13 large losses in the first half of this year versus 4 in the first half of last year. And 4 of the 13 are more than 10 this half versus 1 last half. We have large losses in the Zurich municipal business in the U.K. We've got 2 that total $18 million. We've done the normal post-loss review, which means, we go back, we look at the risk engineering, we look at the underwriting, and we compare the cause of loss and identified risk drivers of loss. And for all of these things, we're within the P&L's identified and all cases, for these items, the cause of the loss is the primary risk drivers identified. So I don't see anything from the underwriting or acceptance perspective that would have us conclude that this is a frequency issue, and there's clearly severity on the property sides in Q2, but there's no reason for us to see that as a trend. Hence, what you've heard from us today is that we don't think that Q2 is representative of the underlying run rate. We think the half is a better guide.

Operator

The next question is from Daniel Bischof from Helvea.

Daniel Bischof
Baader-Helvea Equity Research

2 questions from my side. First of all, on your debt capacity, at the Investor Day, you mentioned that Zurich might increase leverage and move the hybrid debt share from 14% to 20%. In addition, there's this 5% volatility buffer. Now my question, is this buffer mainly for market movements and unforeseen events? Or could you cease entirely for M&A? And then the second one a rather broad-based question on the industry consolidation that's taking place. What's your view on the potential impacts of these in some of your main business areas, such as Global Corporate, North America Commercial and Farmers?

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

So on the first one, on debt capacity, the 5% that you saw on the slide in the Investor Day was intended to be a loaf [ph] of passive movements. So I mean, I don't expect you see us actively use that to heat up a low [ph] for natural volatility, equity or the AFR the denominator that we use in that calculation. On the industry consolidation side of things, I don't have the sense that that's a big driver of current trends. My sense is that we're in an industry generally that's very well capitalized. There's more capital chasing the available risks that are there, and of course, that puts pressure on price. It started in reinsurance, particularly on the property side. It's fed through into the primary market. And I think, for me, Daniel, that's probably the main driver of some of the dynamics that you see currently.

Martin Senn
Former Chief Executive Officer

If I may quickly add to that -- good afternoon, Mr. Bischof, just on the industry consolidation and the impact on Zurich specifically, we naturally observe that very closely and think about the impact on our sort of positioning and with that as well behavior and our customers, and clearly, some of the large transactions. Without referring specifically to it, there's not -- and some of them does no customer interaction. Some of the customer segments in some of the regions, you actually do not even cover, but with that immediate impact on Zurich as such, I would say is in no way material.

Operator

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

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

And the first point was on the capital position. Because, obviously, it's kind of a quarter delayed that we get the numbers through on that, and so I just suppose any indication on where that might have moved in Q2 would be good. And second point kind of related to it, I guess, and you've said before about the $3 billion of deployable capital that you have. And has there been any change to that figure over the last quarter and given the higher level of cash that you're now targeting for the year, et cetera? That'd be great.

Martin Senn
Former Chief Executive Officer

Thank you, Paul. Let me start with the first part of the question. Now, obviously, the Zurich economic capital model of 120% at the upper range refers to the first quarter. And if you just look on how the interest rates have moved, all other factors being equal, you probably would have to assume that our economic capital position, if anything, has improved in the course of the second quarter. I do not want to see that now as a very firm guidance in any way, but I just would like to guide you in looking at interest rate changes and respective sensitivities, and then you can come to the conclusion that, if anything, our economic capital model as of the end of the second quarter will be better than what we have reported now for the first quarter.

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

Paul, it's George. So on the $3 billion number, I guess, I updated on the $3 billion number back at the Investor Day in May. I think we believe we have a good line of sight. I mean, we have cash generation that's coming out. And we've been pretty confident to some time that we were going to exceed expectations both last year, and again you've seen we're going to exceed the target that we've set for this year. So what it really means, though, is when we put the $3 billion together at the Investor Day, I had anticipated what you're seeing today. So I'm not at this stage lifting the $3 billion number.

Operator

The next question is from Thomas Seidl from Bernstein.

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

Two questions. The first is on the combined ratio improvement. You've said and reminded us that you want to improve by 2% to 3%, and that you had specific action. And if I understood you correctly on the transcript, you said these actions should already strongly materialize by year-end. Can you share with us what type of actions you have in mind that should lead to such quick materialization of an improvement of the combined ratio and loss ratio in particular, and especially in the context of, as you already mentioned, the rather weak pricing development in the recent quarter? And the second question is, on the reserve release side, we know that Zurich is much lower in terms of reserve release than peers. I wonder what is the driver? Is that basically you're not experiencing the same benign claims inflation or why is it that peers basically report all much stronger reserve releases?

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

So, Thomas, on the first one, just to make sure that we're very clear on when we expect to see various elements, so I think there are 2 comments in the transcript. Martin made the comment that you will start to see improvement by the end of the year, which, I think, we all expect. I think, be careful, those are in the expense topic. I mean, the expense piece takes a bit more time, because of the need to move people around as part of that process. So in my transcript, I'd like to make it clear, that I think you'll see the benefits of that more clearly in the beginning of next year. I mean, for us, what would drive the improvement of combined ratio, I mean, the market rate is not going to be the driver of this. So there's no assumption that the rate environment will help improve this. Again, going back to what you had at the Investor Day, we have an approach that we describe as tiering has been successful for us in the past. I guess, at its simplest it means pruning out or pushing for much higher rate increase on the weaker part of the portfolio. And I guess, I mean, what that really means is, it puts volume a bit at risk in the short term as we make sure we get the required level of profitability from the portfolio. Maybe the second chance we have, it goes back a bit to Andrew's comments earlier. I mean, it's not a fixed target we're aiming for in terms of the outside world. Things are moving. So of course, we have to adapt and adjust to the external changes. And again, going back to, for example, the commercial auto topic, I mean, we saw rates that was more or less as we expected in Q1. The market again is more competitive in Q2, and that again is an area where it needs increased focus from us, and that will mean reducing footprint in U.S. Commercial. On the expense side, we have a number of things underway at the moment. The first waves have started. So we started communication to the staff. But again, because of the need to transition, for example, for shared services, I mean, we'll be up and running for a number of the functions at the very beginning of next year. So you'll only see the most significant impact of that in 2016. And that will continue as a wave, not just through the course of next year but also beyond that as we achieve the larger $1 billion target that we have for expenses. Reserve releases. So why are we much lower than peers? I mean, it's -- without an in-depth knowledge of where the peers were, where the peers are and the immediate drivers. We've tried to be relatively transparent in what we expect. We gave guidance a bit more than a year ago that we expected to be broadly in the range of 1 to 2, and generally, we have been. I mean, a bit of weaving up and down. Given the way that we reserve, and assuming that our reserves are adequate in which we completely believe, the reserving process we think will unwind a prudent margin that we add in the pricing process and hence, the guidance that you hear from us.

Martin Senn
Former Chief Executive Officer

Thomas, Martin Senn speaking. Just wanted to add to the first part on the question. And this is very important because with the rollout of the current strategic priorities, one key action is definitely looking for the turnarounds. South Africa, Middle East, Latin America, Brazil in particular, the motor business, and one very specific, still high on our priority list follow up is the continuous improvement potential in South Africa, the Middle East and LatAm, and we believe, and as we have made good progress, particularly South Africa Middle East that there's still about 0.5 percentage points improvement potential, which is going to be one of the priorities still for the next 18 months.

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

And the pruning of the portfolio that you mentioned, so basically you would expect to come as quickly through as by year-end already?

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

I mean, it's in flight already, Thomas. I expect you'll see impacts by the year-end.

Operator

The next question is from Farooq Hanif, Citigroup.

Farooq Hanif
Citigroup Inc, Research Division

Clearly, you talk regularly about volatility in Global Corporates and sometimes you get it like you do in Q2, but this is obviously something you can't control easy with reinsurance, because the nature of how losses are distributed. But can you give us a sense of what you think normal volatility is in large losses? You've got a 2- to 3-point combined ratio improvement target, but how much of that just could be swallowed up because of misfortune? And the second question I have is, on your 10% hurdle for use of $3 billion surplus capital or any acquisitions you may or may not make, I mean, do you still give yourself the same time frame for 2016 for that? Or will you give yourself an extra 1 or 2 years’ worth of leeway?

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

So, Farooq, I'll start, and I guess, Martin may add to this. So on the volatility, ordinarily, we look at the total volatility of the property portfolio. I mean, we haven't in the past broken out the large loss piece. And in fact, you probably remember that we added large loss into the attrition, I think, about 15 months ago to try and simplify some of the explanations. But of course, given the size of the impact that we've had in this quarter, we have to break out again. I can't immediately give you a clear sense of large loss tolerance for volatility. I mean, we have clear earnings volatility tolerance for all sources of claim. I don't have a piece that would break out the large loss. I mean, we'll have to look at that and I'll have to come back to you. On the time frame for the reinvestment or the return, the time frame remains exactly the same.

Farooq Hanif
Citigroup Inc, Research Division

So just coming back on the large losses, I mean, would I be correct in thinking that you're not thinking of changing anything in the way you reinsure your book to help this, because it's just bad luck. Is that correct?

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

I mean, part of the challenge of a call like this is that, I mean, I guess everyone scratches their head and ask me why do you end up here? You get compared to peers and I think there's a risk that maybe you get pushed to do things that are uneconomic. We annually review the reinsurance program. We'll go through that process as we come up to the year-end. I think, given what we see in terms of volatility, given what we believe to be the underlying drivers, I mean it wouldn't actually help us achieve our goals if we've been able to buy a much more significant reinsurance program. I mean, end of the year, we look at the reinsurance again, but at this stage, we have no plans to change the stance on reinsurance.

Operator

The next question is from Nick Holmes, Societe Generale.

Nick Holmes
Societe Generale Cross Asset Research

Two questions. The first is on expenses. You're saying that the higher expense ratio is mainly due to mix effects and the Brazilian warranty business? But when I look at each geography, there don't seem to be a general expense ratio drift. I mean, I'm looking at U.K., Germany, Switzerland, Italy. They've all got worse in the first half. My question is really what's causing that and when do you expect it to stabilize? I mean, George, I think you said we won't see improvement until beginning of next year, and I just wondered if you could elaborate a bit on that. And then second question is on German Life. Can you remind us where you are with the ZZR? Presumably, you still have to add to it, and my question is just is there still a cost to shareholders from making additions? I mean, it's a bit of an opaque subject, I think.

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

So on the expense, maybe to just broaden the explanation, you picked out some of the bigger driver. So the impact of the extended warranty deal in Brazil, we have the impact of the comparison with the pension post-event pact [ph] in the prior year. But I think in the transcript, we've also flagged the fact that there are other expense increases, especially around some of the growth initiatives we've been running, which is why I think you see some of the expense increases in some of the countries that you've just mentioned. So why does it take to the beginning of next year to turn around the expense picture? One, on the extended warranty transaction in Brazil, that contribution is driven by the fact that we're amortizing upfront cost, but with no margin yet being earned. That will start in a more significant way in Q4, and of course, we'll start to have that benefit where the revenue starts to actually match some of the expense. The pension piece, you're aware of last year's about 0.4 points on the expense ratio. And mix, we have a better crop first half versus second half, that also has a small impact. And then again, the investments that we have been making and we continued in Q2, that position us for growth in some markets and clearly to improve customer experience in some of the key product areas. So the turnaround for us will be a combination of the extended warranty premium earning in with the margin. And on top of that, all the additional steps that we're currently working across the firm. And in fact you may see in the quarter that we've incurred almost like -- a bit more than $70 million of restructuring charge, as we start to take the steps to reach service centers, start to inform staff of the changes we're about to make. You can imagine that to do that in controlled manner -- without introducing undue risk into the process, there needs to be a reasonable transition period, and that's why it takes until the beginning of next year. On the ZZR topic, I gave an update at the end of last year where I indicated the total impact we anticipated from ZZR, I've given indication that if we did nothing, given what interest rates were at the end of last year, we'd anticipate seeing $100 million to $150 million impact from ZZR, which is shareholder relevant from about 2018 through 2021 while we would build the ZZR reserve up to the level acquired and applied by the -- I guess, the smooth average impact of the interest rate. Obviously, as interest rates rise, it's beneficial so that reduces the impact. But if you look at the last 6 months, we've been down a lot, we've been up a bit. At this stage, I wouldn't change the guidance I've given you at the year end. To understand, there's some discussion in Germany about how the safety ZZR should be applied across the industry. There may or may not be changes, but in the absence of changes, the year-end guidance that I gave would be the best point to watch from.

Nick Holmes
Societe Generale Cross Asset Research

Okay. That's very clear. Just one very quick follow-up. On expenses, would you say that you are happy with where you are at the moment? Or -- I mean, with the progress that you're making -- obviously, you're not happy with the expense ratio, but with the progress you're making, is everything going as you would expect and everything on plan?

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

So on the expense side, yes.

Operator

The next question is from Michael Huttner, JP Morgan.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Just so 1 -- 2 questions. On the cash remittance, the over $3.5 billion and the new higher target of $10 billion versus $9 billion before, can you say a little bit where it's coming from? Or what I'm not quite sure, is this a dividend from the rate -- from the non-Life to General Insurance year 2014 payable in 2015, with a few expectation of the current business trends? And then the other question, to lighten things up a little bit. Could you talk a little bit about the nice thing, which is the improvement in Life and maybe where you see that going?

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

Thank you, Michael. So on the cash, first of all, you remember last year that we reported 3.7 for the year, 0.5 of which was really one-off. This year, we indicated more than 3.5, and therefore in total, we now expect to see more than 10 for the 3-year period. Typically, the cash that we receive in the current year is a reflection of the statutory declarations of the results of the prior year. So what you're really seeing here is cash flows up from the subsidiaries that by and large, but not exclusively, will relate to statutory earnings from 2014. Drivers of this -- why do we continue to see outperformance, there'll still be some one-offs we anticipate this year as the impact of the sale of the immediate UT portfolio in the U.K. which, of course, will be positive. We have another sale of an asset management business in the U.K., which will also provide us with other small positive. And again, we would expect, and you see a bit in the free capital generation slide, to maintain a very high rate of conversion of earnings into cash. And given our outlook, I don't see that, that's going to significantly change over the course of this year or next.

Martin Senn
Former Chief Executive Officer

Sorry. Hi Michael. Before George goes into the Life questions, let me just clarify a little detail. You mentioned the revised targets. The targets have not changed. It's $9 billion plus by end of '16. What we have done is just give you additional guidance in terms that we have a clear expectation to exceed that target. I just want to be precise that it was not a target revision but guidance on the rest of it [ph].

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

On Life, if you look across the entire book for Life, we have a number of areas of strength, even some unusual areas. Germany Life has a very strong performance in the quarter. I think the stand-out one for me is Zurich Santander. Zurich Santander has growth in local currency of 50% in the quarter. I don't think that's going to be sustainable, but it's the same that the performance there is very powerful. I think the combination was extremely well. And again, going back to what we talked about at Q2 last year of operational leverage around that transaction, growth rates, I think, will stay high, not at the 50% level, lower double-digit range. But a large element of the cost piece there is fixed, so that should continue to help drive Life in the right direction.

Operator

The next question is from Stefan Schurmann, Bank Vontobel.

Stefan Schürmann
Bank Vontobel AG, Research Division

I've 2 questions. The first question on U.S. Global Corporate deal, you mentioned that you have taken steps to improve. It hasn't been a nice quarter. If you can maybe just give a little bit more details on what exactly you're doing, in what subsegments or what large or smaller accounts you're active to take corrective measures. Then the second one just shortly on duration management, can you give us any -- an update here, is there any change compared to last quarter or not?

Martin Senn
Former Chief Executive Officer

If you look at the Global Corporate North America business, I think the -- I think there are 2 issues we're being focused on as we prepare for the quarter. So one is, obviously, it's a source of the large loss volatility. There's a large element of that, that we see as temporary, so it will reverse. However, having said that, when we look at the tiering approach, we're going to add a second step to tiering, which is around the volatility of the accounts. So a bit going back to Farooq's question about your appetite for volatility. We'll address that partly through risk acceptance approach. So if we see clients that have traditionally frequently been a source of volatility, that will push them down in the tiering and will therefore require much higher rate increase at renewal. So that's 1 area. The other area is -- it's a -- we discussed again earlier in the call, commercial auto is a challenge for us. If you breakout just the Global Corporate component of commercial auto, actually we saw good rate increase after the results of last year, which of course were pretty poor. So we have good rate increase in Q1. I think our expectation was that, that would be sustained over a longer period and that would bring the overall combined ratio for commercial auto down from its current low 100s level back into territory where you could make a reasonable proposition that you're earning a good return on capital. Having said that, as I mentioned earlier, Q2, the trend hasn't completely reversed, but the achieved rate increase has dropped. And it's dropped to a level that we don't believe would maintain pace with the loss cost trends in commercial auto given the -- we talked a bit earlier around some of the economic frequency-driven topics and commercial auto is clearly one of the lines that's impacted by that. So that again is another area where we'll push harder for rates, and that will almost certainly meet at the margins we shed some of that volume. Those are 2 of the most obvious examples, Stefan. On duration management, we don't have a particular stance on duration. We're looking to be broadly ALM matched. I think we are slightly long in the scheme of things, but it's not particularly material overall.

Operator

The next question is from James Shuck, UBS.

James Austin Shuck
UBS Investment Bank, Research Division

I have 2 questions, please. Firstly, just I think you're conducting a retail portfolio review, which has been ongoing for some time. I just wanted some kind of update on how that was progressing. In particular, I'm kind of interested in how you actually look at profitability metrics on that basis. For example, you have your buff [ph] ROE target that -- I'm kind of interested in divisional return on risk-adjusted capital within that division piece. And then secondly, the point you made around sort of capital compressing prices somewhat in Commercial Lines. Could you just shed a little bit more light on that? I'm interested in kind of more insight into which lines of business and which territories you're seeing that most impacted.

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

So on the retail portfolio review, maybe I'll start and maybe Martin I can explain some of the metrics that we use as we evaluate the portfolio. And the one thing I can't do, James, is give you a sense of where we are on process against each of the different components. Maybe just to recap, what we said at the Investor Day, we've looked at the entire retail footprint. We've put it through a series of decision points that we described at the Investor Day, and we've concluded where do we believe we should grow either from a particularly customer segment perspective or from a broader market perspective. Where do we believe we have niche and we don't have many niches in the portfolio, and then we have everything else. And everything else, there's a minimum return on capital requirement for businesses to pass the first test. We look at it from 2 perspectives: one is the end return of capital for our business and the second is the market -- the expectation of what the market will deliver over the medium term. When we look at what we have in the, I guess what I'd term the rest, so the bucket that doesn't fit into the group that we're either actively looking to expand either organically or inorganically or doesn't fall into niche, we have a mixture of things in there, many of which don't pass reasonable test for return on capital. There actually are some things in there that actually produces decent returns on capital. As we look at it today, it's now obvious that we've the best owners of some of those businesses in the long-term. Now obviously as we prioritize the action that we're about to take here, we'll prioritize dealing with the underperformers, but there are parts of the portfolio where I think the -- our ability to grow it within our strategic priorities is maybe less than perhaps for others. So you'll see a mix of things from us over the course of the next year, some of which are clearly underperformers and some of which are simply a bit long-term strategic fit.

Martin Senn
Former Chief Executive Officer

Just from my side, the retail footprint question, I mean, I think we have spoken about that at length on the main Investor Day, and we showed you at the time and how we evaluate our retail footprint that was also a decision. In respect, this process is very much ongoing. After the sale of the Russian retail business deal in 27 markets lead us on in a few markets, which started obviously, I would say, guide us in a direction that we have to address the issue, and we're in the midst of this evaluation. Our large PIF positions account for about 2/3 of the retail GWP and AP for both GI and the GL, respectively. If there is a bit more to say and to be much more specific and concrete, we will obviously come back to all investors and all our stakeholders.

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

On the capital topic and the capital impact in pricing, I mean, it's not a particularly unique thought. So -- I mean again, the -- starting from the reinsurance, it's the emergence of all kinds of forms of capital that has expanded supplies, but pressure on pricing that's pushed through as the primary companies are benefited from lower reinsurance rates, and that's particularly impacted property, I mean, to put a number on it -- I mean, for example, in the U.S., maybe one of the larger territories -- I mean, we see rates on U.S. property falling about 4% in the first half, and that we see as a continuation of, I guess, the facts such as described.

James Austin Shuck
UBS Investment Bank, Research Division

And is it -- I mean, is it fair to say that some of the trends from -- that you're seeing in the U.S., they -- is it starting to spread beyond the U.S. and into Europe and particularly on the Commercial line side?

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

I'm not sure I can draw that conclusion. I think the -- I mean, the cycle in Europe looks as though it lags a bit. I mean, there's a possibility that it starts to feed in, that when you look through our portfolio, I mean, U.S. property is the only one that stands out with a number that's as dramatic as the one I just gave you. I mean, everything else is either flat to positive or around that type of level. I mean, U.S. property is the one that the stand out and has stood out for some time.

Operator

The next question is from Vinit Malhotra from Mediobanca.

Vinit Malhotra

Vinit from Mediobanca. Just -- so if I can just ask, George, on the Z-ECM level, because in the 1Q, the comment was -- in the 1Q result, the comment was that at 1Q, it was in the upper half of the 100 to 120, and it's coming a little bit more than one would have been anticipated. Has there been any changes in any kind of market risk or any other treatment in the models or anything else that you think we should think about? And the second question is -- I mean all these years, do you -- one of the topics that was supposed to help was the use of analytics and predictive analytics, which you've also pointed to in the transcript as now running in 21 countries and you see what a successful example. And so where do you think the GC bit went wrong? Was the analytics still ramping up or was it relied too much on, or any feedback there would be great.

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

Thanks, Vinit. So the -- I guess, on the Z-ECM, no model change in the number. So this is simply parameter update. And I guess the upper half of the range, I guess, is turned out to be a bit conservative. So you'd imagine that -- I mean, I didn't know it to be 120 when we gave upper half of the range. I thought it was going to be slightly lower than that. But that's -- I mean, the calculation is purely based on parameter updates. There's no model change. On the use of analytics, I don't think I've pointed a lack of analytics that's driven the issue at Global Corporate. As I said earlier, large loss is the predominant driver of the issue there. There's a bit of weakness on the liability side I described earlier, but the standout factor is the impact of large loss and the impact on attritional in the quarter. And again, we see both of these as natural volatility that can occur, and it's something that we accept with the business model that we have. So we retained probably more risks than most of our peers. We don't conclude there's an analytics problem or there's an underwriting issue. And again, I mentioned earlier that what we have done to value the losses that we've seen to try and draw conclusions as to whether there's some flaw in our underwriting process or even in the engineering process [ph]. And from what we see, there's no evidence of that.

Vinit Malhotra

And George, can I just follow up on that, just quickly. So there seems to be a slower GC growth outlook, used to be 3%-odd and now it's 0 to slightly down for the year. So clearly, you seem to be taking an action, but then I'm not clear whether it's something that will naturally improve or you need to take an action, because something has been found to be inadequate or...

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

Again, I think it was -- I apologize I forgot who asked the question earlier, but the question -- I mean, what are you doing about, what do you see there? Things like the Commercial auto side, which is clearly not going to reverse, I mean we have to take action that will impact volume. So hence the guidance I've given you around expectations of top line for the remainder of the year. So I mean, we'll become a bit more cautious around that. On the property side, I think we will evaluate how we tier clients in addition to rate [ph] profitability also on volatility. And I think that's a prudent addition to the way we look at things. I don't see that there's a major analytics problem.

Operator

The next question is from Andy Hughes from Macquarie.

Andrew Hughes
Macquarie Research

So a couple questions. The first one on the Zurich rate tracker. So I'm just wondering if this tiering approach is distorting those numbers in any way? So for example, if you have a client and you put it in the lower-tier bucket, that you don't like, you put rate increases as well [ph], they're going to leave. And you're going to be cutting rates from the topper tier that you're going to keep. Because obviously, the rate tracker has looked quite good in the past relative to market rates and obviously market rates did tick down according to the indices in Q2. But your number is starting to look a bit weak on the index. So I'm just wondering if that's having an impact. And the second bit, I was just trying to get our head around is the outlook for top line, and I guess, this is probably the key thing. The outlook for flat to declining top line, I mean, I'm going to square that with the comments you made about the expense ratio ticking up when volume is full. It sounds like it's more like declining to declining top line and actually that the combined ratio target is much more important than the top line in the General Insurance business. So could you kind of put these things together? And do you see some GDP growth helping that top line? Is that why you think that things are going to be okay?

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

Thanks, Andy. On the rate change, obviously the rate change does reflect the outcome to us. So I mean, it reflects what we're renewing as opposed to the totality of what was there and what may have renewed. So our approach to tiering does impact that. So that's why it will look different from the market overall. I'm not convinced that we have a more negative position in this on the market. And in fact, I mean, over all, I'm not convinced that our perspective on rate or loss cost is significantly different from any other any of our competitors across the key lines. On the outlook top line, my comment was really about Global Corporate. So -- I mean, be careful about extending that to all the other businesses. I think we still have investments in anticipation of growth, and we have growth in a number of other markets. It was really intended to be a Global Corporate-focused comment.

On the GDP, I think GDP will help but not in the timeframe that we're talking about. And my sense is that the benefits from GDP feel to me as though they lag at the moment and the pricing dynamics feels a bit stronger than the GDP risk growth dynamics. So I certainly think that over the next -- the remainder of this year and next year, I don't think GDP growth will be a significant positive.

Andrew Hughes
Macquarie Research

Can I ask a follow-up on the first point, the rate tracker? So I'm just trying to work out how it actually works. So if you did the tiering approach, would you have expected the prices the rating tiering approach to impact this tracker negatively anyway or is this market impacts that are going on? Can you maybe give separate answers of what's market impacts and what's actual rating action being taken by you to rebalance the book?

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

I mean it's hard to do that. I mean, it's the outcome for our portfolio. The -- which will be combination of other than a request for rate increase in the market competition against that offer. I mean, I fairly couldn't just know what the split be, see Andy, and I'm not sure what we can do it, but we'll have a look.

Operator

[Operator Instructions] The next question is from Andrew Broadfield from Barclays.

Andrew Broadfield
Barclays PLC, Research Division

Just one quick question. I apologize if I -- I came a bit late on to the call, but I'm intrigued by the comments around the volatility being part of the metrics that you're now looking at on -- it sounds like on a per risk basis, because I would have thought, and you referred to it a little bit later the core essence of your businesses is to take the volatility out of other people's -- corporates', individuals' lives and absorb it within yourself. Is there a sense that at per risk level that your businesses -- I mean, this seems an extraordinary question -- is your business is not diversified not to absorb a $50 million loss? Are we getting too excited on a quarterly basis, because I thought [ph] that's what precisely what your business there to do? So I'm just intrigued a little bit more to know whether this is just a small thing that's going on or whether this is a core part of transitional change that's going on within the business at a gross risk level.

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

So I mean, it's not a core trend. I mean, you're absolutely right. If we start to force volatility out of the system, there'll be no system pretty quickly. So I mean our proposition to clients is that we protect them from uncertain events, and the challenge we've had this quarter is we've had more of those uncertain events than we normally anticipate to see. I think what we're trying to do on the tiering side, I think it's just to be a bit smarter about it. So apart from peer rates, pay attention to volatility. If we're charging someone who produces relatively stable results over a long period at the same place as someone has the same average answer, but much wetter [ph] volatility, that's part of the wrong approach for us. So I mean -- I don't think you'll see a fundamental change all of a sudden Zurich becomes allergic to volatility. I mean, that wouldn't work for us. But I think on the margin, we can take steps that would reduce some of what you see in Q2.

Operator

The next question is Dhruv Gahlaut, HSBC.

Dhruv Gahlaut
HSBC, Research Division

I've got 2 questions. Firstly, you've talked about the rate evolution on some of the lines. Could you say as in how does the claim inflation compares with rate on a group wide level at this point in the GI book? And secondly, you've taken an impairment of about $30 million. Could you say what this was for?

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

At a rate evolution we would see a lost cost inflation running at or slightly less than the headline rate improvement. So some relatively immaterial margin, which is taking place currently. On the impairment, I don't want to identify the particular asset. I mean, it's part of the Life portfolio, it's a relatively small number overall. We've taken a $30 million goodwill impairment in the period.

Operator

The next question is a follow-up question from Michael Huttner, JPMorgan.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Two points. One your neighbors, Swiss Re, mentioned that they'd like to move to half yearly reporting, which I imagine would deal with the loss of the issues you identified that Q1 is less representative than the half year, what's your stand on that? And then the other issue takes what sounds like more urgent action now that maybe you're contemplating in Q1 or in May, does it mean that there's a risk -- sorry, a chance that you could overshoot in the targets? I mean, George, you've got a huge amount of experience in all these things, so maybe you can kind of a bit on impartial view of that.

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

So the -- the one thing is absolutely clear to me is this wouldn't be the day for us to talk about dispensing half yearly or other quarterly reporting. I mean, I believe in transparency. I think the fact that you and the investors can see what we can see produces is actually a system that helps people improve. So I mean, we can debate the quantity of stuff that we all pump out in your direction and whether we need at all, but I'm actually a believer in relatively frequent, clear information of where we stand. I think it helps you achieve your goals. On the second -- I mean, I appreciate the flattery, but I mean you'll appreciate that my immediate goals is not to overshoot the target, but to deliver it. I mean, as you can see from today, we've got some distance to go yet. But again, we understand what we have to do. We have a plan to deliver it and we have confidence that we will deliver the target that we set in May.

James Quin

Thanks very much. I think that's a very good place to finish the call. That was our last question. Obviously, if you do have any follow-ups, do call us in Investor Relations. Thank you very much for dialing in and goodbye.

Operator

Ladies and gentlemen, this now concludes today's question-and-answer session. Thank you for participating, and wish you a pleasant rest of the day. Goodbye.