S&P Global
Market Intelligence

Zurich Insurance Group AG SWX:ZURN

FY 2022 Earnings Call Transcripts

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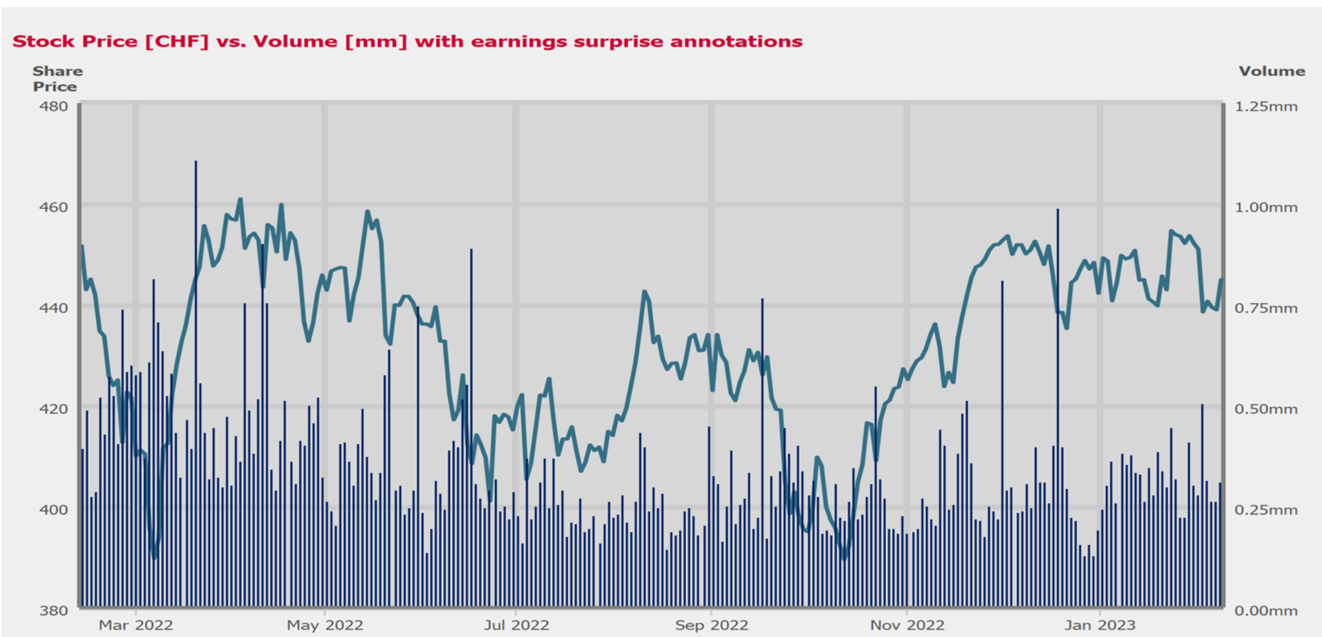
S&P Global Market Intelligence Estimates

	-FQ2 2022-			-FQ3 2022-	-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	8.55	NA	NA	7.49	28.79	NA
Revenue (mm)	NA	NA	NA	NA	53910.06	NA

Currency: CHF
Consensus as of Feb-09-2023 7:24 AM GMT



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Andrew Sinclair
BofA Securities, Research Division

Andrew Ritchie

Ashik Musaddi
Morgan Stanley, Research Division

Dominic Alexander O'Mahony
BNP Paribas Exane, Research Division

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

William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

William Fraser Hardcastle
UBS Investment Bank, Research Division

Presentation

Operator

Ladies and gentlemen, welcome to the Zurich Insurance Group Annual Results 2022 Conference Call. I am George, the Chorus Call operator. [Operator Instructions] 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. Jon Hocking, Head of Investor Relations and Rating Agency Management. Please go ahead.

Jonathan Michael Hocking
Head of Investor Relations & Rating Agency Management

Thank you. Good afternoon, everybody, and welcome to Zurich Insurance Group's Full Year 2022 Results Q&A Call. On the call today is our group CEO, Mario Greco, our group CFO, George Quinn. Before I hand over to Mario for some introductory remarks, just as a reminder for the Q&A, we kindly ask you to keep to two questions each. Mario?

Mario Greco
Group CEO & Member of the Executive Committee

Thank you, Jon. So good afternoon, everybody, and many thanks for joining us today. Before George and I started asking -- answering your question, please allow me to give you a few remarks on this year results. This morning, we reported our highest business operating profit since 2007. And also that we exceeded all our financial targets for the second consecutive 3-year period.

This is despite several tough years where we have had to deal with many unexpected challenges. We remain agile. We focus on our goals. We continue to execute against our consistent strategy to transform Zurich into simpler and to a more innovative and to a customer-centric organization. I'd like to thank all of my colleagues, our customers, our partners for this remarkable achievement. We ended the most recent cycle with the BOPAT ROE at 15.7%.

That indicates the strength of the underlying business performance improvement and significantly exceeds our target of greater than 14%. The combination of robust profitability, strength of capital position and predictability of cash remittances allowed the Board to recommend a 9% increase in the dividend to CHF 24, which will correspond to a compound annual growth rate in the dividend of 6% in the most recent 3-year cycle.

In U.S. dollar terms to compound annual dividend growth will be 8%. As we set out back in November, we will continue to focus on customer needs, transforming Zurich into a leaner and more agile ensure that's planned for the future. Results continue to be seen in our growing customers' number and loyalty with more than 2.1 million net new customers added during 2022, and an increased retention rate of 82%.

Now let me turn quickly to our business segments and start as usual with the Property & Casualty. Property & Casualty today reports an excellent combined ratio of 94.3% in and record premium levels. Gross written premiums grew by 14% on a like-for-like basis with strong growth achieved in both commercial insurance and retail business. Lower catastrophic losses and the benefits of earned rate in commercial were offset by the impact of inflation in retail motor and business mix shift towards crop in commercial.

While we expect rate increases in commercial insurance to moderate from the 8% seen in 2022, we expect to see further margin expansion in 2023. In retail and SME, given the rate increases that we have already actioned in 2023, we should see results starting to improve. In key European retail markets, like Switzerland and Germany, where January renewals are important, we are seeing encouraging signs.

Life. 2022 was another year of significant progress for our Life business. We achieved the highest profit ever despite unfavorable currency movements due to the U.S. dollar appreciation and announced complete sale of the Italy Life back book, which boosted the SST ratio by 9 points in the fourth quarter. We also announced the sale of the Life back book in Germany. That is on track to be completed in the second half of this year.

Together, these transactions further reduce balance sheet volatility and enhance our already industry-leading capital-light business model. We remain focused on profitable growth in our target segments of protection and unit linked with 2023, bringing new distribution opportunities in both Italy and Germany, markets where we remain committed despite our portfolio optimization activities.

Farmers. Now 2022 was a strong year for farmers against a challenging backdrop for U.S. personal lines insurance. Gross written premiums at the former exchanges increased by 9%, driven by the inclusion of the MetLife business for the full year and accelerating levels of rates across lines of businesses. Overall, the Farmers segment BOP increased by 18% over the prior year period, also helped by lower covered claims in the Life unit.

Given the challenging market environment, the farmer's team, led by the new CEO, Raul Vargas, are laser focused on improving the underwriting performance of the exchanges, which, in turn will help rebuild the surplus. As you will have also seen this morning in order to support the exchanges effective December 31, 2022, farmer has tactically increased its participation in the Farmers Exchanges online's quota share treaty.

Sustainability. Now sustainability continues to be a key focus for Zurich, and we look forward to discussing our initiatives with you in more detail at our dedicated ESG at Zurich webcast, which will be held on the 30th of March. Looking into the future, finally.

We remain absolutely committed to deliver the strategic ambition and the financial targets that we set out in Zurich back in November for the next 3-year cycle. The new plan looks for us to grow EPS at a combined rate of 8% to 2025, while further increasing the BOPAT ROE in excess of 20%. We also expect to achieve a further step up in cash remittances.
The package as a world should allow us to reverse shareholders with continued attractive growth in our dividend. Thank you very much for listening. And George and I are now ready to take all your questions.

Question and Answer

Operator

[Operator Instructions] The first question comes from the line of Andrew Sinclair from Bank of America.

Andrew Sinclair
BofA Securities, Research Division

Two for me, please. Firstly is on the reinsurance program. And I just really wondered if you can talk through the changes here in a little bit more detail, both in terms of cost of program and in terms of what it means for earnings volatility protection from the group. And I suppose how much is actually renewed on 1st of January versus how much is still to renew through the year? That's my first question.

And then my second question is just looking at Slide 27 of the pack, the Commercial Lines accident year combined ratio ex-CATs and ex-COVID is flat year-on-year at 88.2. Just really wondered if you can give us an idea of what that would be ex-crop as well. How much improvement would have seen, I guess, I'd expect to see a bit of improvement given pricing momentum and given we saw a 1.7 points improvement year-on-year in H1. So just what are we seeing really ex-crop?

George Quinn
Group CFO & Member of the Executive Committee

Andy, it's George. So on the reinsurance program, first, we've made two changes. So two changes to the CAT piece of the program. So I think as I suggested prior to the end of the year, we haven't renewed the CAT aggregate. We couldn't find a reasonable economic proposition. So in the end, we've kept that -- I mean that believe or not at the expected outcome is actually a small improvement to the expected result, but at the expense of slightly more volatility.

So I mean it's a relatively immaterial change the volatility could be plus/minus $100 million, $150 million. Having said that, what we're doing on the -- to reduce CAT capacity on the incoming side, I think that's more significant than that. And if you look at the more recent estimates on the events like Ian or Elliott, I expect that the efforts that we're undertaking to CAT exposure on the incoming side are probably more significant than the small negative impacts from giving up the CAT aggregate.

At the same time, we've added a bit more coverage at the top of the program. So it's not a replacement for the CAT aggregate. And it's more -- I was thinking about -- in particular events we haven't seen yet. So things like quake and where are covers exhaust and particularly in the context of very significant events.

So having looked at that with some support from some advisers, we concluded that we wanted to have a bit more coverage up top. I mean overall for us, I mean, we've seen a relatively modest change in the reinsurance program. I mean most of what we've done is non-CAT at January 1 with the exception of the two things I mentioned. And they're not really that significantly impacted by the current market conditions. I mean probably the key date for us is April 1. That's when we renew the U.S. tour. So I mean, you guys already have seen the impact to some of the U.S. companies that renewed January 1. I mean as you would expect -- the argument that we advanced to our reinsurers is that, again, the actions that we're taking on the incoming side of CAT means that there's already a fairly significant reduction in exposure, and we would expect that to be part of the consideration when we look at the renewal of our U.S. CAT on April 1.

So still to renew that piece. But so far, no significant impact. And certainly, no impact in excess of what we assumed when we put the targets together back in November.

Andrew Sinclair
BofA Securities, Research Division

Any solvency impact as well, George?

George Quinn
Group CFO & Member of the Executive Committee

I mean, they'd be tiny -- I mean if you look at what we pay for CAT cover overall, I mean a 10% rise in -- I mean, what we pay is something like 10 bps on a combined ratio. So I mean you need massive changes. They have massive impacts on the group's numbers, and we just don't see that. And we're not dependent on reinsurance in that way.

So commercial year-over-year. So if you look at crop, so I mean crop has actually had -- had a decent year. It's slightly higher than we would have assumed in our plan. So maybe we are about 100 bps higher overall. There's a small issue of first half, second half comparison. There's a bigger issue of 2022 versus 2021. So last year, it was actually a pretty good year for crop. If you look at the gap between last year's outcome and this year, you've got about a 200 basis points difference. If you allow for the fact that crop is -- I mean somewhere about 12 -- somewhere 10% to 15% of premium volume across all the commercial. You're going to end up with somewhere in the mid-double-digit basis point impact. So if we take the 88.2, we would be in the high 87, once you adjust for crop. So not a bad year for crop, but certainly a weaker one than we had last year and a weaker one than we expected.

Mario Greco
Group CEO & Member of the Executive Committee

And the number on the page you mentioned is -- includes crop.

George Quinn
Group CFO & Member of the Executive Committee

It does. Yes.

Mario Greco
Group CEO & Member of the Executive Committee

Just to be completely clear on that.

Operator

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

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

Well done for beating all your records. I had two questions. The first one is on cash remittances. I was actually hoping for more. It seems a tiny improvement -- I know I'm being really -- I mean probably wrongheaded or something, but 4.4 billion rising to 4.6 billion doesn't sound like a record year in many of your business lines. I just wondered if you could give some color on what drives the cash remittances. And the other thing is also a very general question. 265% something, what are you going -- you base in this every morning, I mean I would love it. But what are you going to do with all this money? I saw on the tape and maybe I misread, but buybacks are not your big things, so that's fair enough. But I just wanted a few -- and I know you did have a Capital Markets Day and you kind of addressed this, but 265 is extraordinary.

George Quinn
Group CFO & Member of the Executive Committee

Thank you, Michael. So on cash remittances, first. I'm a bit like you. I always want more [indiscernible] as well. If you look at last [indiscernible] I mean, I think the outcome overall is really good. So we've certainly landed where we wanted to land. I think there were upsides that we have not yet taken on the cash side. So if you look around some of our businesses, and some of you who have been on this call for longer will know that we've certainly got one business that just seems to have a slight structural issue around been able to remit all of its earnings in the form of cash after one of our more significant businesses. And it means that periodically, we go looking for a special dividend from that business. That's something we're still working on. That offers upside to 2024 and 2023, I hope. I think on the -- I mean it's not a big negative.

But one of the small challenge is actually in a rising interest rate environment is that some of the local statutory balance sheets on the life side can end up being a bit long. And therefore, this can exit a little bit of pressure on life cash remittance. But I mean, overall, I mean, we're really happy with the outcome.

We've still got a number of pockets or pocket and they're not small pockets. We got a number of pockets that we need to address and increase the cash remittance going forward. So there's room for more, but I think we're pretty happy with what we achieved last year. On the capital topic. So I mean, you're absolutely right. It's a huge number. It doesn't yet include obviously the impact of Germany, which is still to come. I mean -- but again, I think you've probably read on the wires commentary that was entirely consistent with what we said back in at the Investor Day in November. As everyone knows, we've got a buyback that's underway to address the expected dilution from the sale of the German business. There's a bit more to go in that. We were not quite halfway through that by the beginning of February.

I mean beyond that, our preference would be to deploy it on growth. I mean, we've talked before on these calls about the dynamics of SST and the extent to which organic growth drives it. I mean it's nice to have the option, given what we expect in terms of growth over the course of the next 3 years. I don't expect it to be that capital intensive. So that, again, gives the business, lead them to look at other ways to deploy capital, again, to support growth, to deliver more in terms of earnings and deliver more in terms of dividend. So our preference beyond what we're doing at the moment is growth.

Operator

The next question comes from the line of Andrew Ritchie from Autonomous.

Andrew Ritchie

First question, just on the underlying accident loss ratio 60.8 in the full year. I just want to understand if there's anything I should do to that as a starting point. I think it looks like crop was running at around 96. So there's a small adjustment down if I assume, crop is mid-90s normally. Is there anything else? I mean, for example, was there a particularly maybe a conservative booking on some more inflation-exposed classes in the second half? Or -- and I guess maybe was there any particular negative one-offs on retail.

So really, it's just to understand, is that the right starting point, obviously, adjusting maybe 50 bps for crop. The second question on farmers. I'm just trying to understand why is 8.5%, the additional quota share the right number. I mean it looks like you're just replacing a third-party reinsurer who's come off, is, therefore, 35% surplus. Do you think that's fine from this point for farmers and you're confident there's organic capital generation from here? Or do you still think there's more capital actions that need to take place rather than just waiting for the earnings to come through?

George Quinn
Group CFO & Member of the Executive Committee

Thanks, Andrew. So on the underlying I think crop would be the obvious thing, I think on the loss picks around what we booked, I mean we haven't deliberately been any more conservative than the commentary I gave already at the half year. So we maintained the stance we had around things like GL and Commercial Auto, so we didn't change direction on those topics. I mean the only one -- I mean it's a small number, but it's quite hard to judge, and that's first half, second half on commercial.

So if you look at the half, second half, it's about 100 bps higher. I mean it looks as though that's just the kind of natural fluctuation of the book, given that we can still see underlying improvement on the loss reserve fix versus lost cost trends. So maybe on commercial, the answer is somewhere in between H1 and H2, but I mean it's going to be a small impact to the end. So I think crop -- and assuming we take the CAT, the equation, and we adjust for the COVID topic in the prior year, which is also quite small that, I think, gives you a reasonable indication of what the underlying is.

Andrew Ritchie

And there's no reason to think crop isn't still a mid-90s business?

George Quinn
Group CFO & Member of the Executive Committee

Yes. No. So our view hasn't changed. We planned it somewhere around the 94 level. So it's a bit more than 100 basis points higher than we would expect currently. I mean last year, we were at about 92 we've been lower than that, and we've been higher than that over the course of the last 5 years. On Farmers, so yes, we have increased the participation on the quota share. Obviously, the market is a bit more challenged for the exchange currently. I mean I think in the end, I think our view, and I think the view of the exchanges, too, is that in the end, this is not a surplus issue. This is a profitability challenge that they need to solve. And by solving that profitability challenge, all the other things that's connected to the exchange that would -- including the surplus, which would be questions at 35, they go away at that point.

So I think our view is that there's no need, unless, there was -- so maybe I'll explain what the exchange is doing, and then I'll come on to the more positive side of it. So obviously, the entire U.S. auto market has a bit of an issue. There's lots of rates being pushed through at the moment. You've seen already in today's release what we see in terms of what the exchanges have been doing. The exchanges have a bit of a challenge as anyone would, that's got more of a concentration in California because that's a bit slow on rate approval. But I mean, having said all of that, I mean we can see the -- I mean we, obviously, see trends on a shorter time horizon than the ones that we publish. We start to see some improvement, although it's still got a long way to go on the exchange.

And therefore, us supporting the exchange to the capital level that they are targeting, I don't think it needs more than that. If, on the other hand, and I think I said this at the Investor Day already -- I mean if the exchange gets to the point where they're in line with our profitability targets and to put it in context, in somewhere around 101 is kind of neutral. You need somewhere closer to 98 for the growth. If there was a really attractive opportunity for growth and exchange need to support for that, then, obviously, that would be something we would consider because of the benefits that would bring us. But we're not at that point today.

Andrew Ritchie

And just to be clear, does the exchanges renew its CAT program at midyear?

George Quinn
Group CFO & Member of the Executive Committee

So the exchange has a staggered CAT renewal. So you'll see that get renewed over the course of several years. So they're not completely exposed to the impact of a single year.

Operator

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

Peter Eliot
Kepler Cheuvreux, Research Division

Two for me, please. First one was on the outlook. I guess I was just a bit surprised that you refrained from giving many of your usual outlook items. And I know we've got IFRS 17, but even given the change in framework, I'm sort of thinking year-on-year comps are probably still relevant for premium growth, investment income, et cetera. So I'm just wondering if you could sort of elaborate on your thoughts there? And in particular, whether there's any help you can give us on the Life outlook.

Second one, noncore, just really what you did say in the outlook, it sort of sounds like you're possibly expecting further reserve strengthening given the comment less negative. So just wanted to check whether that's the right understanding. If I can be very sneaky and just ask a clarification on the answer you just gave to Andrew as well on the commercial, George. Because you said H2 commercial is about 100 basis points higher than H1, which is natural fluctuation. I'm just thinking -- I mean, given the margin expansion that's flowing through, I would have expected that to be lower. So the delta is more than 100 basis points, but maybe if you could just clarify those dynamics would be very helpful.

George Quinn
Group CFO & Member of the Executive Committee

So on your sneaky question, you're absolutely right. So I guess I would characterize as slightly more than 100 basis points. You would expect to see more. On the first two questions, so I think the challenge on outlook, it's got nothing to do with our clarity or visibility of where we're headed. And in fact, of course, that's incorporated in what we said back in November, is just that we could be dealing with different metrics, even if the substance is the same. We've got changes to headline things like revenue coming away we're going to have a different treatment of combined ratio. So there's a whole series of things, I think we need to restate for people, which is the mathematical and mechanical part of the process.

And we'll have that all in front of you come Q1 and I think that's just an easier point at which to get a bit more detail around where we're headed from an IFRS 17 perspective. So we avoided doing it today not because of a lack of clarity on where the business is headed. It was really that we'd be talking a slightly strange language, I think, for most people who are not yet familiar with it. I think on the life topic, I mean, again, we'll cover in more depth when we get to Q1, so that you guys can prepare for the first half.

But I mean there is a relatively simple logic. I mean, in the current models, the insurance companies apply under IFRS. You've got a combination of a book of business that's pretty locked in, generally price stable. There's a consistency to that, that flows into the new system, albeit in a different way. So volatility has also dampened, but the dynamics around that piece, I don't really expect to be vastly different from what you've seen today. And I guess that most people are setting up to try and make sure that they've got the right risk adjustment to make sure that we don't get unexpected amounts of volatility from CSM amortization. On the -- I mean the thing that is different -- it's different now. I think over time, it converges.

So again, a pretty consistent characteristic of Life businesses is the impact of management actions. I guess it's analogous to PYD on the P&C side. That part will get smoothed. So eventually, once you've smoothed enough of it, you'll get a similar impact to what you see today, but you don't have it in the starting point. So I think the way to think of this is there's an underlying coal component that I think behaves in a similar, but not identical way to IFRS 4 and it will take time to build the same effect from management action as you have an IFRS 4. But I mean having said that, one of the comments we made back in -- one the comments I made back, I think, already in September was that if you look at the group overall from an earnings trajectory, I'm not expecting a significant change. You may see some change, relatively modest changes between the segments.

Noncore. So I think we just [indiscernible] the commentary. So if you look at what we got in noncore, you got two components that are driving the outcome today. We got something that I think you've seen in the past from us, there's a DI book in there. It's got some market-related features. So there's a [indiscernible] market volatility. I mean, typically, it's been relatively modest. We're talking low tens of millions, positive or negative in any given year.

I think what's different this year, you saw it in the first half, we moved the book of business into noncore with the intention of disposing it during the pandemic -- well, not disposing it during the pandemic, but we had moved it during the pandemic with the intention to dispose of it afterwards. And I think what we discovered there is that the experience that, that book had during the pandemic was not as representative as we would have liked it to be of future claims experience. So it's taken us a couple of bets to correct that this year. But I think at this point, I don't expect to see a [indiscernible] on this topic.

Operator

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

William Fraser Hardcastle
UBS Investment Bank, Research Division

I guess, first of all, just in from that motor on the retail side, could you talk through those geographies that are causing the greater strain in motor inflation? And is this parts or bodily entry related? And I guess, what is it that's changed reasonably significantly 2H versus 1H here? And then an extension to that, but I will let this be the second question. Are you able to give any updates on the outcomes of the major renewals at January for Switzerland and Germany in these retail portfolios?

George Quinn
Group CFO & Member of the Executive Committee

Yes. I'm going to focus the comments on motor retail. I think there are similar issues on commercial. So you could read across, but I think there is one reasonably significant difference. So anyway, more retail. I think the big driver, it continues to be the CPI, the inflation-driven components, which means it's still mainly a health or issues connected to health issue. I mean, we're not as big in some of the other markets where there are BI severity issues.

So for example, if I look at a market we can see data on, which is the U.S. that we don't have a direct exposure to maybe the mix of -- maybe the issues that are driving the market are slightly different to what we see in Europe. And I guess that's probably more a function of the health and legal system there. So Europe, mainly a very traditional challenge and the reason you see deterioration in the second half is just a continuation of what we saw in the first and inability to take rate to offset it. So I mean, to some degree, that's what we expected to see in the second half of the year.

So anyway, that's how we get to the second half of 2022. So what about 2023? So at this stage, we've got very good insight into renewal for Germany and Switzerland as of Jan 1. I mean, for both of those books, we've got a reasonably significant renewal. So we've got a good understanding of where we think it's headed. So I'll take Germany first. I mean the way I would characterize Germany would be that assuming that we see inflation levels that are similar to what we saw last year. Germany has achieved the price increase that will address that. And will start to address part of what we saw last year. I think it's mostly like a multiyear process. Maybe there's a couple of years of rate entries required to get this business where we think it needs to be, but there is a significant step in Germany as of Jan 1. It's what we expected.

So it's not a surprise to us, but it's obviously -- we're very pleased to see it take place in reality rather than forecast. Switzerland is a bit different. So in Switzerland -- I mean -- obviously, hasn't seen the same levels of inflation that we've seen in other European markets. Having said that, by Swiss standards, we've seen some pretty chunky numbers. We're talking 2.5%, 3% rather than 9%, 10% in other markets. And the team here, they've taken a more targeted approach to the renewal. Again, they've put some fairly significant rate through for some key parts of the portfolio, makes a pretty significant proportion of the portfolio overall. And again, expect that also to address what will happen this year plus start to catch up on what we saw in the prior year. However, in both markets, we expect more price action required. But the first steps we've seen on January 1 this year I mean it's a good sign of where the retail market is headed.

Operator

Next question comes from the line of James Shuck from Citi.

James Austin Shuck
Citigroup Inc., Research Division

I just wanted to spend a bit more time on that retail deterioration at the full year, please. So the full year accident year loss ratio in retail, up 1.9 points at full year. And I think you're saying that use of frequency and inflation and some of which you talked about just now, but that's up from the 1.3 points at 1H. At 1H you really called out EMEA expenses and loss ratio actually being better. So I'd just like to focus a bit more on the discrete second half of the year? Because it seems as if the cost save rates and claims inflation seems to have happened the most at that time. And I hear the comments about the outlook going into. But I guess my fear is that you're seeing nominal rate increases, but not rate in excess of claims inflation once we adjust frequency as well.

The second question was just returning to Farmers. So again, on the 8.5% quota share, why is it you've chosen to do work quotas to share? Because Farmers is a volatile business. And 10 points plus or minus on that combined ratio is not an insignificant number to the Zurich Group earnings. So can you just talk us through, a, is that a multiyear quota share? Why you settled on that and why you didn't do other alternatives such as [indiscernible], for example? Perhaps I'm so interested in why it didn't actually require any extra capital in the target capital that you have in the denominator of the SST.

George Quinn
Group CFO & Member of the Executive Committee

Yes. So on the first one. So I mean, to put it -- I don't really want to call a number today in Germany, but it's in double digits, not high double digits, but it's in double digits. So in our opinion, it's enough to deal with nominal frequency and part of the prior year. Not enough, though, to put Germany in a position where we would be satisfied with the return we're getting on that line of business. And the German team themselves identified that in the conversations that we're having with us last September.

So there's definitely more to be done, but we think it not only addresses what we're currently seeing addresses part of what we had last year. So -- and we feel pretty confident about that. On the Farmers question. So yes -- so maybe I'll start from the end. So it's a very good question. So target capital. It will have a relatively small impact on target capital, but it will build as the reserves build. So that's why you're not seeing it yet. But we're talking -- I mean, something that's in the up to mid-single digits impact on SST, so it's pretty small overall.

On the why this and not something else? So I guess if you cast your mind back to 2015, which was probably the last time we were a very significant participant on the quota share. I mean some of you will remember that we actually had some pretty significant amounts of capital up against that. I mean, again, I think many of you are aware that the sure of that contract has changed significantly over the years because of discussions between the exchanges and the reinsurers and the particular form of that contract that works for both exchange and for the reinsurers, I mean the nature of the risk of the contractors is a bit different, it was before.

And therefore, the amount of capital required would be more modest than it was in 2015. It would also be reflected in the fact that the potential volatility would be more modest than it has been previously. In particular, CAT is capped and CAT is now more dealt with through the CAT covers that the exchanges plays. So I think from an overall Zurich perspective, I mean, this is probably the simplest, the most straightforward. And certainly, Zurich will benefit from the way the exchange and its reinsurers have changed the structure of the contract over the course of the last several years. And I think that combination is really why we've done -- what you've seen us do is a simple and straightforward way of addressing the challenge that they currently face and gives them some time to deal with that plans around the improvement in the combined ratio.

Operator

The next question comes from the line of Kamran Hossain from JPMorgan.

Kamran M. Hossain
JPMorgan Chase & Co, Research Division

Two questions. The first one is on -- just back on the Farmers quota share. Could you maybe talk about the profitability assumptions you've made in, I guess, the increase there? Is it 101%, as you mentioned, is kind of the target level? Or was there something else there? The second question on the commercial line cycle. Could you talk about the impact that the reinsurance market changes in terms of price structure, et cetera, is likely to have in that market. I think at the Investor Day in November, you said you expect the cycle to probably tail off in -- by the time we get halfway through 2023. Do you still think that will be the case with all the changes in the reinsurance market?

George Quinn
Group CFO & Member of the Executive Committee

So the -- I mean, I want to avoid that I end up giving out the plan for the exchanges on the combined ratio. I think probably the best way to look at this would be that -- I mean we've significantly increased our participation in the quota share, but we are still a small minority compared to the others, and the others are there because they expect to make money. So maybe if you combine that with the comments I gave earlier around where the neutral point sits, that gives you some sense of what the market anticipates from the exchanges.

On the second comment on the -- or the second question on rate. So I think if you go back to the comments I made earlier around the -- I mean the more differentiated view of what's happening on rate at the moment. So if you look at -- I mean, what we see in the market towards the end of last year, I mean, somewhat predictably property is the one that maybe sees the -- maintains a fairly strong trend. And in fact, if you look at our numbers from a North American perspective, we would see property rate ticking up at the end of last year.

So that may be partly connected to reinsurance, maybe partly connected to the continuing concerns around risk of inflation at that point. I mean difficult to attribute it entirely, but you certainly see the line of business that it probably impacts the most and the strongest position. I mean, I think -- I mean, in general, one of the things -- I think as we look out through the remainder of this phase of the commercial cycle, it's going to get very differentiated. I think I mentioned this earlier. And if you look at the different lines, things like property, motor, I mean, they're still in very good shape. SSGL also in good shape. Workers' Comp specialty, they're around the same positions they were at before.

So I mean slightly negative, fairly flat towards the end of last year. And you've got primary GL somewhere in the middle of all of that. I mean the more negative one is financial lines, in particular D&O. So that is softening currently. It's probably the part of the market that saw the biggest run up. It's not the biggest part of our book. So we're not as exposed to it, but that part of the business or that part of the market is showing a different price characteristic to most of the other lines at this point.

Operator

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

William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

George, is there any evidence that you point to for building prudence into your current accident year loss picks? I mean normally, that's very much what would be expected at this stage in the hot market. But when you've been discussing the flat commercial lines combined ratio or the underlying loss ratio, I haven't really kind of heard you emphasize that potentially quite positive point. So could you talk a little bit about prudence and how it may or may not be changing in the loss picks?

And then secondly, please, on Slide 21. So we've now got a 6% rate increase across the book. Can you tell us a comparable inflation figure that we should be netting off against that? And just to make sure I'm gauging it correctly, I think this time last year, that 6% was 7%. So if you could remind me what the inflation equivalent would have been a year ago as well, please?

George Quinn
Group CFO & Member of the Executive Committee

Sorry, I didn't understand the second part of the question. You said the 6% was...

William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

6% [indiscernible] What's the inflation. Could you just remind me the inflation equivalent a year ago.

George Quinn
Group CFO & Member of the Executive Committee

All right. So on prudence, apologies, I should have spent more time on that topic. The -- so I mean, again, to take you back to the -- some of the reserving decisions we make at the end of Q2, end of the first half. I mean, we touched a number of, again, probably the more social inflation exposed lines of business, not necessarily because we saw experience that was a source of concern, as a precautionary step. So I think I might have mentioned earlier, primary GL and Commercial Auto with two targets for that, and we haven't changed that stance through the end of the year.

It's also a characteristic part of our reserving process that we don't accept as a basis for reserving, the loss pick chosen by the underwriter, we -- and certainly, for most of the last 2, 3 years have added a margin to that. And that's designed to build up within a range of acceptable levels of prudence, additional assurance that we have less exposure to the risk that we see adverse development on some of the reserve lines. And then finally, if I tell you the usual Workers' Comp story. So I mean, I think you know from the prior conversations that we've had that -- and the -- if you look at rate on Workers' Comp, again, for the end of last year, beginning of this year, flattish, slightly negative.

If you look at loss cost trend or in the mix that we think is relevant for our book, something similar to that. So not vastly different. We've still maintained a relatively long run view on the parameters that we choose to include for the reserving decision. If you chose a shorter-term perspective, so say you took 5 years rather than 10 years, that's a very significant surplus to reserves.

So I think the traditional areas of prudence that you're familiar with in our book continue to be there. We continue to follow the same processes around trying to make sure that we add appropriate prudence to the assumptions that the underwriters make when they write the business. But in terms of our overall philosophy, nothing has changed. So we're doing the same things in the same way.

So on the inflation topic, I mean it varies a lot by line of business. So maybe if I focus on the area where I think it's probably you have most transparency for all of last year. I mean we've talked about the fact that for the U.S. business, we've got a loss cost trends -- sorry, we've got a rate increase that's around 8% across all lines of business. Inflation. So -- and if I exclude exposure changes from that, so I think purely a severity and frequency, excluding, I mean we still see it somewhere around the 5% mark for commercial. The picture in Europe is different. I mean, in the conversation I had earlier with James. I mean, he highlighted the fact that, obviously, retail in Europe, in particular, deteriorated in the second half of the year, which is a sign that loss cost trend is in excess of the pricing that we're achieving here. But that's probably the best guidance I can give you.

William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

5% is the same as what you would have said a year ago for North American commercial. Isn't that strange, shouldn't it almost inevitably be higher?

George Quinn
Group CFO & Member of the Executive Committee

So if you break out where we were in commercial last year and you look at the loss picks we've added to it, it's still around 5%, but we've added a point to commercial auto and a point to primary GL.

Operator

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

Dominic Alexander O'Mahony
BNP Paribas Exane, Research Division

I just got a couple of questions on capital generation. So I'm on Page 45. Just looking at economic profit business growth, -- the first thing I just wanted to check on is the AFR generation 5.0 this year. I think it was 5.5 last year. So that's declining despite the profit in IFRS coming up. Just trying to help -- I wonder if you could help me bridge why one is going down a bit and the other ones going up a bit?

Second question is on the target capital. George, I think earlier, you were saying that you expect the growth to be pretty capital-light. And I think actually the capital were down a little bit in H2 is up 0.5 than H1. On a run rate basis, are you expecting this sort of 0.4 to be roughly flattish. I realize that the quota share will increase in 2023, but is the rough expectation that this will be flattish. And will broadly does this matter for cash remittances or was actually the Swiss Solvency lens not really useful to the key value of your cash remittances.

George Quinn
Group CFO & Member of the Executive Committee

So on the second question first, the -- it's obviously part of what's driving the dynamics that you see on AFR versus target capital is impact of interest rates. So it's a lot of what impacts the first half of the year that impacts it again in the second half of the year. So if we end up in a reasonably -- in a slightly more stable environment, I think it would be flattish. I'm not sure we're going to be in an entirely stable environment. I guess the outlook seems to anticipate that we'll see a bit more rise potentially followed by some reduction at some stage in the future. But if we don't see it at the same pace as we've seen with some of the historic changes we've seen last year, it should be pretty flat.

On SST, I mean, SST is a good guide to the -- I mean, the overall risk appetite perspective, the firm has and how we manage capital from a consolidated perspective. But it doesn't seem much to cash remittance, certainly in short-term periods because, of course, those cash remittance numbers are typically driven by the local statutory requirements. And they can and frequently do deviate significantly from SST. Over time though, again, in a stable environment. So if we keep interest rates relatively stable, given the relatively short duration nature of the book, the two things should be more in sync than perhaps we've seen last year.

On the capital generation topic, 5 AFR versus where we are from a reported profit number. I mean, you can obviously get a number of differences at the margin. I think the -- I mean the way I would look at this I would probably work off of the operating profit number and tax it. The impact of, in particular, gains that appears in the [indiscernible] number can really distort this because, of course, we've got a mark-to-market perspective on AFR. And I think if you work off of the bulk number, you'll get something that's probably a bit closer is my expectation.

Dominic Alexander O'Mahony
BNP Paribas Exane, Research Division

And just so I understand, I mean, given what went up, that the AFR went down, is that just a anomaly to do with rates? Or is that something else?

George Quinn
Group CFO & Member of the Executive Committee

So the -- I mean, rates are going to have an impact on that because of what you saw in the prior year. I mean, partly through the impact of discounting. I mean, that's likely to be the main driver. But I need to look at it in more detail and come back to you with a better answer.

Operator

The next question comes from Ashik Musaddi from Morgan Stanley.

Ashik Musaddi
Morgan Stanley, Research Division

Just a couple of questions I have is first of all, again, sorry, going back to the retail inflation topic, I agree Italy and Spain is relatively small for you, but the combined ratio in both Italy and Spain has gone up significantly in second half versus first half. So could you just give us some color as to what is driving that? Is it just like general auto industry? Or is it anything specific to Zurich here? So that's the first one.

And second one is going back to the capital question again. I mean, clearly, you have a very big solvency ratio at the moment, 265%. But what is your view of excess capital in that? And I would say, excess capital, which is fungible as well, not necessarily just a ratio perspective. If you want to deploy some cash to do M&A, I mean, how much cash you can extract out of that 265%. The reason why I'm asking is, I mean, your leverage looks like more or less full, at least on the current FS score basis. So I just want to understand how much of cash and liquidity you can gather within the business. These two questions.

Mario Greco
Group CEO & Member of the Executive Committee

I need to tell you that we're all smiling here on the other side of the of your question.

George Quinn
Group CFO & Member of the Executive Committee

Yes, because we're probably all thinking was, we're not going to answer the second part.

Ashik Musaddi
Morgan Stanley, Research Division

I mean obviously, we ask questions at the risk of with this, but yes, worth trying, I would say, for us.

George Quinn

Group CFO & Member of the Executive Committee

Yes. So let me try to be more helpful than just a straight out. I'm not giving you an answer. Let me start with the retail thing. I don't think it's different from the -- I mean, there are some local dynamics in both businesses that are relevant. So for example, in Spain, we have a pretty significant investment program running in the business to try and expand and thus increase our geographic coverage in the market.

In Italy, it's probably more the traditional effects that we're seeing elsewhere driven by loss cost trend. But in both markets, inflation is likely to be the principal driver of what you're seeing in the second half of the year. And it is auto, that's I mean home is not much different actual. If you look at Germany in particular, you don't see a very different outcome on home. So I would pick out both of those lines of business as the prime factors.

So on the SST topic. So I mean, again, given the comments that I made back at the Investor Day around our ambitions around leverage and the fact that -- I mean, we're quite early to delever a bit given that the cost of financing is increasing. I mean, we don't have an awful lot that's maturing over the course of the next year or 2, but it's going to get more expensive to run that we've still got enough cash to allow us that option, if that's what we choose to do. I mean, more generally, I mean, the company obviously has significant flexibility given the way we generate cash across the group. I mean, obviously, I want to avoid I'm going to get into a number that I need to specifically update on a regular basis. but it's a feature of the group that we tend to -- I mean, we have a strong preference for businesses that we can measure not only in terms of the actuary of judgment, but also in terms of the cash they can provide to the group to underpin that actuarial judgment. And that's not something that's going to change.

So I think when you look at -- I mean, certainly, from an earnings perspective, it's pretty clear how much of what we generate, we distribute. So I mean you're getting 75% more or less back on a regular basis. We retain the additional piece and we also retain, of course, any cash we generate in excess of the earnings levels. And I think I mentioned earlier in response to Michael's question, but I mean, we regularly undertake exercises to I guess, I would say, liberate cash that's not needed in the various businesses and bring it back to the mother ship. But I mean as you would expect, with such a significant capital level, we have significant flexibility.

Operator

The last question comes from the line of Vinit Malhotra from Mediobanca.

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

The life side, just I often ask this, George, your life numbers frequently hit the ball out of the path particularly will relate the guidance. And again, it's happened can again, the guidance is very weak. I don't know it was very light, very cautiously thing. I'm just curious about the life part. Is it also there's a shop for NBV, there some assumption changes. Are you not happy with the mix, I mean selling protection. And are you trying to deemphasize protection a little bit in this high tested environment. So that's one on life.

And just very quickly a follow-up is Slide 25, the 60.8 underlying loss ratio. I mean, when I compared to 59.8 ex-COVID last year, is this 1 percentage seems to be mostly explained away by drop and then with also motor, and also effects of pricing. I mean how should we think about this -- sorry, I mean, just to be very clear 60.8% minus one point of crop. Is that how we should think of it and then you apply some margin? Or how should we think of that at this point?

George Quinn
Group CFO & Member of the Executive Committee

So I think the -- to the last part of your question, more or less, yes, would be the approach, I think. So the first part of your question, it would imply a lack of satisfaction with the life business, if I was to agree with any of it. And I don't suffer from that. I mean I think we're really happy with how the Life business performs. We're really happy with the transformation that the Life business is undergoing. So if you think about -- I mean, what the firm -- I mean what our Life businesses achieved against what we were doing alongside supporting the clients I think it's a fantastic outcome.

I mean, again, I think the implied criticism around the life guidance is entirely valid. But that doesn't make me any less happy about the overall income. On the fall in NBV, that's really a 2021 topic in the end. So if you think back to the end of 2021, we talked about the fact that we were positioning AFR for IFRS 17 because of the requirement for a certain level of consistency and best estimate assumptions. So we're trying to make sure that we had the Life AFR and exactly the place that we wanted it, and we've reduced life AFR at that point. That then gets caught up in the new business models that come into production for Jan 1 in the following year.

So part of what you're seeing in the fall and new business margin is really that decision that we made in 2021. There's a secondary impact. I mean with interest rates rising, there's a bit more competition around the unit linked business. So that has a bit of pressure. But I think if you look at the new business margin, even after the change, it's still, we think, pretty good. It's pretty strong.

So from a mix perspective, I mean, given that we make a big song and dance every time we produce a presentation about the mix of our Life business is a sign that we actually really like it. And we've got no intention to deemphasize protection I think. And our philosophy to emphasize underwriting, whether [indiscernible] Life, and therefore, we like protection in Life, where we get the chance to underwrite it in the right way, strong preference to do that. So really happy with Life.

I think the caution on the guidance -- I mean, just going back again to, I think it was Peter's comments, I mean it's got nothing to do with what we expect for the year and just the fact we've got a change metrics coming up in about I was thinking it may be in 3 months. It's quite a bit quicker in 3 months. So I mean you've seen I hope the supplement, at least -- the structure of this up we're going to hand out. So you've got a sense that even if the business is not changing, some of the ways that we describe there are about to. So rather than pump out some IFRS 4 guidance, which -- I mean, I'm sure most of you could probably [indiscernible]. I thought it's just more helpful to give you more general guidance, lean on the fact that we've given you already an outlook as far as our targets from last November are concerns, and then we can have a more detailed conversation when we get to Q1. And we actually have the new structure in front of us.

Operator

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

Jonathan Michael Hocking
Head of Investor Relations & Rating Agency Management

Thank you all for dialing in. If you've got any outstanding questions, please get in touch with the IR team. Thank you very much.

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