S&P Capital IQ

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Swiss Re Ltd SWX:SREN

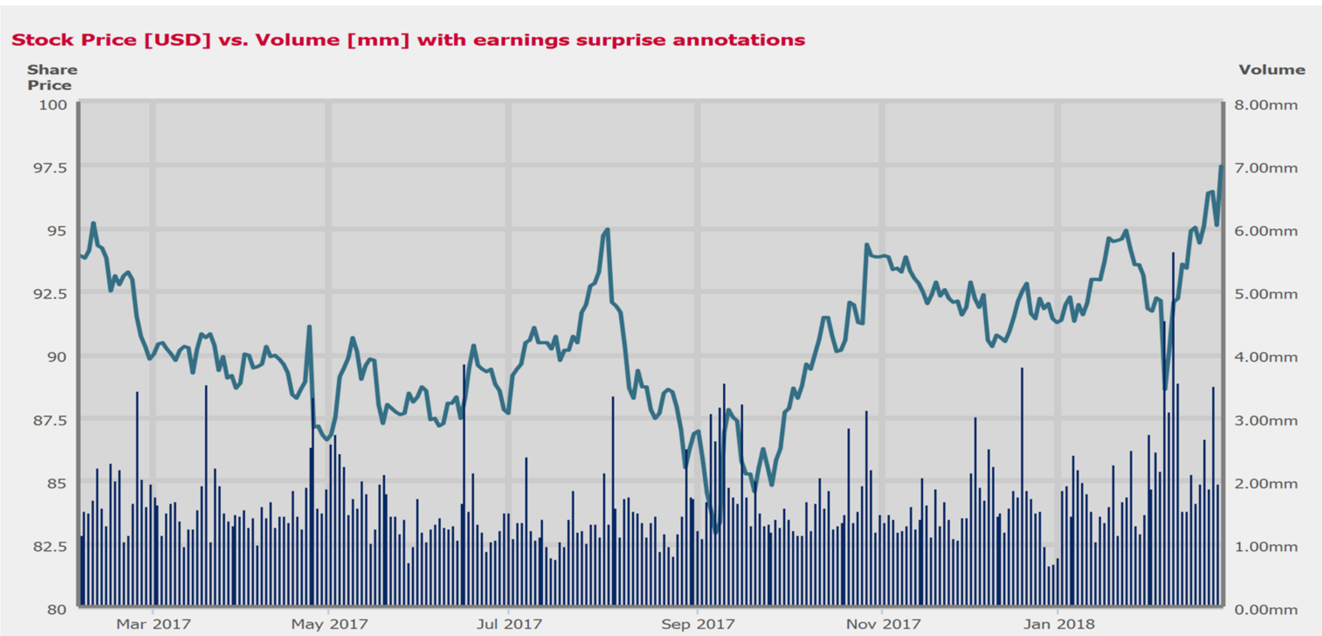
FQ1 2018 Earnings Call Transcripts

Friday, May 04, 2018 12:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2018-	-FQ2 2018-	-FY 2018-	-FY 2019-
	CONSENSUS	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	2.20	2.20	8.62	9.54
Revenue (mm)	6431.53	7960.41	34485.09	35642.32

Currency: USD
Consensus as of May-04-2018 10:00 AM GMT



- EPS NORMALIZED -

	CONSENSUS
FQ1 2017	1.87
FQ2 2017	2.18
FQ3 2017	(5.24)
FQ4 2017	1.59

Call Participants

EXECUTIVES

John Robert Dacey
Group Chief Financial Officer

Patrick Raaflaub
Group Chief Risk Officer

Philippe Brahin
Head Investor Relations and Head Governmental Affairs & Sustainability

Unknown Executive

ANALYSTS

Andrew James Ritchie
Autonomous Research LLP

Frank Kopfinger
Deutsche Bank AG, Research Division

Ivan Bokhmat
Barclays Bank PLC, Research Division

Jonathan Peter Phillip Urwin
UBS Investment Bank, Research Division

Kamran Hossain
RBC Capital Markets, LLC, Research Division

Stefan Schürmann
Bank Vontobel AG, Research Division

Thomas Fossard
HSBC, Research Division

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

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

William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

Presentation

Operator

Good morning, or good afternoon. Welcome to the Swiss Re's First Quarter 2018 Results Conference Call. Please note that today's conference call is being recorded.

At this time, I'd like to turn the conference over to John Dacey, group CFO. Please go ahead.

John Robert Dacey
Group Chief Financial Officer

Thank you very much. Good afternoon, and good morning to those of you in the Americas, and welcome to the first quarter 2018 results conference call.

I'm here with Patrick Raaflaub, our chief -- our Group Chief Risk Officer; and Philippe Brahin, the Head of Investor Relations.

And if you indulge me, I'd like to start with a brief overview of the key figures which we published this morning. Swiss Re reported a net income of USD 457 million for the first quarter. This number reflects the negative impact of the change in the U.S. GAAP accounting rules for equity investments held in our investment portfolio.

On a pre-tax basis, the impact was 280 million; on a post-tax basis, 221 million. And in the press release we issued today, you see that the alternative number estimated with the previous accounting regime was 678 million.

Going through the performance of the individual business segments, we're pleased with the performance of the Reinsurance units, our 2 largest businesses. P&C Re maintained underwriting discipline, while expanding and improving, but we think still challenging price environment. We delivered USD 347 million, which translates to an ROE of 13.5%. These numbers are not adjusted in any way for the previous accounting of U.S. GAAP but instead reflect the 2018 performance.

In terms of renewals, treaty premiums have increased 7% year-to-date, with the price improvements of 2%, a continuation of what we saw from the January 1 renewals.

Life & Health Re continues on its solid performance track record, delivering a net income of USD 201 million and an ROE of 11.5%. Corporate Solutions net income was USD 41 million in the first quarter of 2018. This result continues to reflect the impact of business written in previous underwriting years where a soft market environment prevailed. Commercial insurance rates as well as terms and conditions have started to improve after last year's sizable nat cat losses.

Life Capital delivered an exceptional gross cash generation of USD 705 million, reflecting the proceeds from the minority stake sold to MS&AD, as well as benefiting from the finalization of the 2017 Solvency II calculation. The net income of the unit was impacted by the negative investment market performance in the U.K. of Q1.

And I mentioned the overall group results, the Asset Management performance was clearly impacted by the U.S. GAAP guidance on the treatment of equities. The reported ROI of 2.2% was in fact, on an adjusted basis, estimated to be 3.2% for the quarter if we applied the accounting rules of the last year.

The fixed income running yield of 2.8% was stable and in line with the expectations, which we have previously communicated.

Finally, given our strong capital position, we've announced the launch of the share buyback program without caveats or constraints which was authorized by the AGM 2 weeks ago. We will begin repurchases on Monday, May 7, as we receive -- we have received all the necessary approvals.

And with that, I'll hand it back to our Head of Investor Relations, Philippe, who will introduce the Q&A session.

Philippe Brahin
Head Investor Relations and Head Governmental Affairs & Sustainability

Thanks, John, and good day, to all of you also from my side.

So as we did at Q1 and 9-month last year, we will only comment today on the key figures we reported in our press release and provide you with a qualitative assessment on underlying trends. Also, I wanted to mention that we published our 2017 financial condition report at the end of last week, and we are very pleased to have our group CRO with us today, as John mentioned, in case you have questions on the FCR or any risk topics.
And as usual, please [Operator Instructions] So with that, operator, could we please have the first question?

Question and Answer

Operator

The first question is from Andrew Ritchie of Autonomous.

Andrew James Ritchie
Autonomous Research LLP

In your opening comments, John, and I think in the press conference this morning, you still described the pricing environment as still challenging, I think, were your words. Can you give us any additional color on that? Has it become more challenging? It looks like there was a kind of flat evolution with April renewals, which I guess is not surprising. So any more color would be useful on that. Second question, Life Capital. It's a bit of black box this one to try and work out sort of the GAAP earnings. Is there any sort of things we should consider that particularly depressed the result? You talked about the effect of markets, which obviously lowered unit-linked fee income. Can you give us any flavor as to the amount there? Or the strain -- the net strain that you're still seeing from the L&G savings business? Or net strain coming out of the front books, which I guess is still negative? Just any color on the medium term run rate GAAP earnings for Life Capital will be useful.

John Robert Dacey
Group Chief Financial Officer

Andrew, thank you for that, and I appreciate to some degree the frustration of trying to model out Life Capital. There are a lot of moving parts here. Let me start with the first question you had on the price environment. I think the April renewals, which are dominated, frankly, by our business in Japan, didn't bring a lot of new information to us. We're -- as I said, we continued to be able to get the rates that we saw in the January 1, a net increase of 2% with the LTPA of 103%. Our overall sense is, we will see more in June and July with the renewals in the U.S. market with the loss affected portfolios. And our expectations are that prices should continue to deliver an inflection based on the actual performance and actually the insufficient pricing that we saw through 2017. So I guess I'd say we'd have more to tell you on the half year results in terms of real color there.

Andrew James Ritchie
Autonomous Research LLP

You're referring to the fact there's not enough price yet?

John Robert Dacey
Group Chief Financial Officer

I think, our expectation -- and we have mentioned this at the full year results was, with the $140 billion of losses in 2017, the market should have reacted a little stronger than it did. Now part of this is both a supply issue as well as demand issue. We are seeing people interested in additional and broader covers on the Reinsurance buying. So the demand, I think, is there at the moment. Supply is meeting that demand, and I suggest that Swiss Re continues to be one of the leaders in trying to push for adequate pricing across the board. We're comfortable with what the business we're writing and the prices we're achieving, but obviously it's constraining our growth compared to some other -- some of our competitors.

With respect to Life Capital, I'd say that probably -- I can give you a little bit of color. The L&G portfolio integration is going to not deliver any material earnings to this business for the next quarters. Instead, there are some costs, not large, but real costs in bringing this portfolio onboard. I think as the U.K. equity markets were down about 8% in the first quarter, that has had a impact on the fee income for the unit-linked businesses that we have within Reinsurance. So that's been a net negative for the quarter. I think thirdly, the open book business of iptiQ, in particular, does have a growth strain. And you see that we were able to grow our premiums in that segment strongly in the first quarter. There was one significant transaction with iptiQ in Europe, which accounts for a substantial part of that. But net-net, there was a new business strain that is there. So I think those 3 factors together have dampened the profitability for the quarter. And we would expect if markets behave a little better, that we can show some improvement in these numbers, obviously off the pretty low starting point, in the following quarters.

Operator

The next question is from Kamran Hossain from RBC.

Kamran Hossain
RBC Capital Markets, LLC, Research Division

Just one question for me. Clearly, P&C Reinsurance has had a pretty good start to the year and some decent improvement in the combined ratio there. In Corporate Solutions, I guess things are a little bit flat year-on-year in terms of profitability. Could you give us an indication on rate increases at Corporate Solutions, or if you can't give a number, whether the rate increases for Corporate Solutions are above those seen for Reinsurance.

John Robert Dacey
Group Chief Financial Officer

Sure, so I think in the Investor Day, Agostino, our CEO of Corporate Solutions, gave an indication that he was expecting a 5% increase on average across the board for his business for the year. I think to date, we've been a little shy of that, but we still see that as a reasonable objective for the full year, and we'll see if we can reach that during the course of the year. I do think, importantly, in the Corporate Solutions business, since we don't have the big January 1 renewals, but rather the portfolio goes through a normal-year cycle, you've not seen much of the post-2017 book actually come on board yet. And so a little different than Reinsurance where the premiums on 1 1 came in -- this is going to take a little more time for us to get that combined ratio down as a result of better pricing in the current environment.

Operator

The next question is from William Hawkins from KBW.

William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

First of all, you have the big gross cash generation in Life Capital. Has that already affected the outlook that you gave us at the Investor Day of 2.3 billion to 2.5 billion over the 2016 to '18 period? And if so, roughly by how much? I'm just trying to get a feel for what's been the scale of those one-offs. And then secondly, I know that you guys care a lot more about EVM than you do U.S. GAAP, and there's a lot of stuff going on this year with big contracts and volatile capital markets and the rest of it. So I just wondered if you could give us, given that you care more about those numbers, give us any kind of indication of how the EVM performance has gone year-to-date? Any notable factors?

John Robert Dacey
Group Chief Financial Officer

So I think, on the second question, I can give you an answer which you may not be looking for, which is -- but won't be surprised, we really don't release any quarterly indications on EVM. And I don't expect that we'll start doing that anytime soon. But as you rightly point out, there was a little bit of noise in these U.S. GAAP numbers. It's frustrating to us. I'm hoping that in future quarters, this impact of the -- having to write through the unrealized losses or, in some cases, gains equity portfolio won't have this kind of an impact. On the gross cash generation, you're right, 705 brings us awful close to the -- finalizing the 3-year target after 2 years and 1 quarter. I'd say we would expect later this year to be able to provide you with more guidance on future years' delivery of cash. But we're not at this point of time changing what we've got that's out there currently.

Operator

The next question is from Jonny Urwin from UBS.

Jonathan Peter Phillip Urwin

UBS Investment Bank, Research Division

So firstly, how big do you think the premium base in Corporate Solutions needs to get to give you the sort of desired scale that you're looking for? That's the first question just in the context of the 30% growth we've seen today. And secondly, you know there were small positive reserve releases in P&C Re in the first quarter. Can you give us some color on how that developed in property versus casualty and did you release anything on [him] or California wildfires yet?

John Robert Dacey
Group Chief Financial Officer

Yes. So let me take the second question first. We've -- on P&C Re, had a, as we said, a modest positive prior-year development. I can say that the -- it was also modestly positive in our casualty book of business. And so that's the -- was one of the areas where people seemed very concerned in the Investor Relations day and I was pleased to see that the reserves there continued to demonstrate their resilience. No specifics on [him] or in California wildfires. I think, we're probably able to say more about that development later this year. On how big does CorSo have to be, we're obviously continuing the growth you see year-on-year. There's actually a fairly strong growth in Corporate Solutions. I can attribute that to 3 specific areas: one, the U.S. Accident & Health business where we'd acquired a company 2 years ago has continued the strong source of growth. Similarly, some specialty lines in our European markets have delivered a nice premium uptick in 2018. And third, the joint venture with Bradesco in Brazil has come online. And so those 3 plus a little bit of the tailwind from foreign exchange are responsible for this growth here in the first quarter. We've not done a material expansion either of our property book or casualty book, not because we don't earn interest in doing so, but simply because the price environment has probably put some constraints on our ability to grow strongly there. The overall size, I'd say, we're keen to be, over time, a major player in the commercial insurance space. How big you have to be? It's a little bit of a moving target as some people continue to consolidate. But I think the expectation is we would continue our bolt-on acquisitions, continue the investments and the primary lead and expect at some point of time to be materially larger than we are today.

Operator

The next question is from Thomas Fossard from HSBC.

Thomas Fossard
HSBC, Research Division

Two questions on my side, one for John and one for Patrick. The question for John is on the P&C Re side for 92% combined ratio Q1. Can you put that in a context of the full year guidance of 99%? I mean, any material deviation from the full year guidance U.S. provided reserve full year number? And the question for Patrick is, looking at the SSCR report, I must admit I've been quite surprised to see how high was the SST ratio of the Reinsurance division to 52%. How should we take this number or read this number, as actually you mentioned in the past that significant amount of the excess capital should be upstream at the old [color rather than that be] holding in the entity or operating entity level. So I mean, is 250, 230 that was the level in 2017, is the right -- about the right level of comfort you need to keep at the Reinsurance level?

Philippe Brahin
Head Investor Relations and Head Governmental Affairs & Sustainability

Thanks, Thomas. Maybe we start with John.

John Robert Dacey
Group Chief Financial Officer

Sure, so in the 92% combined ratio, I think we were in a fairly benign quarter with respect to large losses. In Reinsurance, we consider a large loss something in excess of USD 20 million. And we had neither any nat cat nor any man-made loss coming into the category of large losses for Q1 for Reinsurance. That said, there were a whole lot of small and medium losses that accumulated, which kept the combined ratio at

92%. There's nothing we see that would lead us to change our full year guidance at 99%, and so we're comfortable that -- sorry, that, that estimate is a good estimate to hold onto.

Philippe Brahin
Head Investor Relations and Head Governmental Affairs & Sustainability

Maybe, Patrick?

Patrick Raaflaub
Group Chief Risk Officer

Yes, so we are, as you know, we are not giving specific targets for the business unit or the subsidiary companies. We only communicate the internal or the respectability target of 220 SST for the entire group. For the first time, we obviously in the FCR, you see a little bit more details of how the group -- the components of the group, how they look under the SST format. And there -- you would -- you could expect that, that might fluctuate a little bit in the future, but there is not really much I can say about or more detail I can give you on the Swiss Re Zurich or the business unit Reinsurance SST ratio. So maybe also important to see also from the group perspective that while the SST target is a very important target from a risk quality standpoint, is not the only indicator, not the only measure that we use to steer the group's capitalization. So it's a significant one, but it's not the only one. It also depends, obviously, at any given point in time how much capital is deployed, for example, in financial risk, whether the ratio is above or how significantly it may be above that target or even, as the case may be, slightly below that target.

Operator

The next question is from Frank Kopfinger from Deutsche Bank.

Frank Kopfinger
Deutsche Bank AG, Research Division

I have 2 questions. My first question is on the buyback. As you change the conditionality, could you also comment on how you are going to execute it, whether it would be on a steady basis or you might become more opportunistic on this? And then secondly, also a question on the financial condition report. I realize that on one side, the target -- the risk capital for the P&C increased by around about 10%. As on the other side, mainly all peak risks, they declined. So could you bridge this development for us?

John Robert Dacey
Group Chief Financial Officer

Sure, I'll take the first question on the buyback. We'll delegate the operational activities of buying the shares to a bank here in Switzerland, [but we'll have] the responsibility of the target. Finish date would be in February of next year. And absent any additional insights, we would expect that they would spread this out reasonably evenly over the course of the year. If they see the opportunity in a particular week or month to do a little more because of softness in our share price, that's up to them, not directed by us.

Philippe Brahin
Head Investor Relations and Head Governmental Affairs & Sustainability

All right. Patrick, well...

Patrick Raaflaub
Group Chief Risk Officer

On your second question, the major reason for this seeming discrepancy is that reserve risk went up because of the nat cat events of the last year. And that increased the target capital, because obviously, there is some reserve uncertainty for which we have to hold capital according to our model.

Operator

The next question is from Thomas Seidl from Bernstein.

Thomas Seidl

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

First one on CorSo, I was quite surprised to see the strong growth given your comment on rather low price increase. You now explain this is from the 3 segments, U.S. A&H, specialty in Europe and the joint venture. Could you expand a little bit more what exactly you're writing, especially the U.S. Accident & Health? I think it's about 200 million in total. And the second question on the P&C Re business, if I strip out the price increase, premium is flat year-on-year despite your price signal pointing to 103% adequacy. So not too bad in historic terms. Does it mean basically you need to maintain this top line just to keep this price level. And hence, if prices do not change at the mid-year, we should expect a flat top line for Swiss Re in the P&C Re business?

John Robert Dacey
Group Chief Financial Officer

So on the first one, with CorSo, as I said, the growth came in these 3 areas -- I'm sorry, I apologize, I missed the...

Unknown Executive

Accident & Health.

John Robert Dacey
Group Chief Financial Officer

I'm sorry, within the Accident & Health. If you remember 2 years ago, we bought a business, a smallish business in the U.S. called IHC. This is employee stop-loss. So employers -- or companies which are clients of CorSo run their own Accident & Health programs for their employees. We come in on the back end of that and assume what is essentially tail risks for these programs. And that's a business which has been profitable and which we've been able to grow our market share in the U.S. market. Year-on-year, the first quarter was actually a very nice and strong growth. On the P&C Re, we will continue to hold the line on what we think are appropriate price levels; and if that provides the opportunity for growth and on our treaty book through the year, we're up 7%, we'll take that. And if for some reason the prices are being undercut by other providers but our [indiscernible] are prepared to work with and we don't feel the need to grow this business at unreasonable price levels.

Operator

The next question is from Vinit Malhotra from Mediobanca.

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

So one question on Life Re, please and one on Corporate Solutions. On the Life Re, I noted with interest, sir, that there's not much mention of U.S. mortality pick up. We have seen some very sharp increases from flu-related deaths, for example, and from one of your peers had a lot of comments on that. And could you just comment a bit about what you're seeing in your book, maybe it didn't bother you, maybe the frequency was not enough to be a problem, but just a comment would help, please. Second thing is just on Corporate Solutions profitability. There's 100-odd combined ratio without any BYD problems, which we have seen in recent data from Corporate Solutions. It means, and as you have written in your press release, that some business from previous underwriting years was harming. What is this failure? Do you think this previous year business would continue beyond maybe this year to affect numbers on a trend year basis?

John Robert Dacey
Group Chief Financial Officer

Sure, so on the first one, yes, we did notice a little bit of a seasonal impact on the U.S. mortality and also a few severe claims for our Life portfolio. But we don't extrapolate either those to any particular trend issues. And as you see that we were able to endure those bumps in part because of the size of the portfolio and strong performance in other places. So we don't feel -- while the -- there was some issue. It wasn't material enough for us to spend a lot of time talking about it. With respect to CorSo, we believe the reserves are at the correct levels, as you said correctly. There was no negative prior year development. It was effectively flat for the quarter. And our expectation is that the new business that comes on during 2018 will start to trend this number down, not dramatically and not quickly, but 2017 business will continue to be influencing that performance through this year. And by this time of year from now, we expect that the better pricing that we are achieving should help us with a more sustainable combined ratio that starts with a 9.

Operator

The next question is from Ivan Bokhmat from Barclays.

Ivan Bokhmat
Barclays Bank PLC, Research Division

I have a question regarding the earnings volatility from the equity mark-to-market. I appreciate it was a new accounting policy adopted, but I suppose it will become a recurring feature of your results going forward. I was just wondering how you think about managing this volatility in the future.

John Robert Dacey
Group Chief Financial Officer

We'd like to see equity markets go up and so the volatility we manage is a volatility on the upside. But look, I think, we've got about 6.6 billion of investments that are in the bucket, which is going to show this kind of volatility. That's a little about 5.5 -- or maybe 5% of the total investment portfolio. I don't think we want the accounting rules to change our strategic asset allocation, and therefore the best we can probably do is just be transparent. So with every quarter, we're going to provide this comparison that you see here in Q1, which says what the 2018 result for the half year for 3 quarters for the full year would've been under the previous accounting standards so you can do your comparison back to 2017. In 2019, my expectation is that we'll simply provide the movement in the quarter for unrealized gains or losses out of this portfolio. So unfortunately, in the first quarter that we applied this, it is negative and it's substantial. What -- the slide we included in the Investor Day presentation where we flagged that this was coming, I think, demonstrated that for many quarters, at least historically over the last 3 years, the impact tended to be much smaller. And so we hope it'll be a little less of a distraction in those quarters. But we've invested in these equity shares because we think it's an intelligent place for us to allocate the [indiscernible] funds that we get from writing our business, and I don't expect that we'll materially reduce that portfolio for the reasons of volatility.

Operator

The next question is from Stefan Schürmann from Vontobel.

Stefan Schürmann
Bank Vontobel AG, Research Division

I have just 2 small questions. The first one on the cash generation, 705 million in Life Capital. Can you give us some qualitative split of that. How much stems from the Solvency II adjustment; how much from modern; how much from the 5% stake of Mitsui? And then the second one on growth in Life & Health, just giving some insight here how much is coming from the Life and how much from the Health side, if possible?

John Robert Dacey
Group Chief Financial Officer

So on your first one, the gross cash generation, I think, as we said, the 2 major single pieces are the Solvency II finalization for Reinsurance and secondly the investment for MS&AD. I can suggest that the latter of those was approximate -- a little more than $200 million -- actually, I think you can probably do the math to get to $240 million for that number. The Solvency II amount was also substantial in the quarter. And -- but I don't know that we've released the absolute amount. But it's the only other major piece worth noting, I think. The important piece for us is that, that gross cash generation eventually will allow us to consider important dividends coming up from Life Capital into the group, and we look forward as the group CFO to that flow for Swiss Re Group.

Philippe Brahin
Head Investor Relations and Head Governmental Affairs & Sustainability

Regarding the second question, Stefan, I think we -- you should expect the Q1 to reflect a bit what we have seen in terms of split between Life & Health, Life being 60% of the book and health 40%. But we don't provide more detail. You'll have more at H1.

All right, so actually this is the last question, so thanks, Stefan, again for your question. And we come to the end of the Q&A. Thank you to John and Patrick for joining and all of you for joining today. Feel free to reach out to any member of the IR team if you have follow-up questions. And with that, thank you again for your participation.

Operator
Thank you for your participation, ladies and gentlemen. You may now disconnect.