S&P Capital IQ

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FY Nine Months 2016 Earnings Call Transcripts

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S&P Capital IQ Estimates

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Vinit Malhotra

Presentation

Operator

Ladies and gentlemen, good morning or good afternoon. Welcome to the results for the 9 months to September 30, 2016, conference call. I'm Selina, your Conference 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. Richard Burden, Head of Investor Relations & Rating Agency Management. Please go ahead, sir.

Richard Burden

Thank you. Good morning and good afternoon, everybody, and welcome to Zurich Insurance Group's Third Quarter Results Q&A Call. On the call today is our CFO, George Quinn. [Operator Instructions]

And I'll now hand over to George to make a few introductory remarks before taking your questions.

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

Thanks, Richard, and good morning and good afternoon to everyone on the call. Thank you for joining us.

So before we start the Q&A, I'd like to make a few comments on the results. I'm pleased to report that today's results showed that the management actions that we've taken to date are leading to an improvement in results, with contributions coming from all of our 3 main segments. The GI combined ratio continues to improve on a 9-month basis with the accident year loss ratio ex cat down roughly 2 percentage points compared to the full year '15 results. The Q3 discrete ratio is slightly higher than expected, mainly driven by higher large loss in the quarter. We continue with our reunderwriting actions, and we're satisfied that we're delivering the expected underlying improvement with more to come.

For Q4, we expect the combined ratio to be in the range of 97%, 98%, which means that the full year '16 combined ratio would be slightly above 98%. It's important to note that the achievement of a 97%, 98% combined ratio is not the limit of our ambition for the combined ratio.

The lower underwriting result was offset by investment income, which is up 3% in local currency compared to the prior year, and as in the second quarter, this results from higher dividend income and equities and principally higher yields on inflation linked bonds in Latin America that back our business in the region. And I guess the point I really want to make is that this has not been achieved by taking on additional asset risk.

The group's capitalization is strong with the estimated Z-ECM ratio above the midpoint target range at 113% as of the end of the third quarter.

Lastly, we're working hard to position Zurich for the future and to shape a clear and simple group strategy for 2017 and beyond. I will give you an update next week at our Investor Day on November 17 in London with focus on the strategic direction, technical excellence, financial targets and dividend policy.
Thank you very much for listening, and we'll now start the Q&A.

Question and Answer

Operator

[Operator Instructions] The first question is from Mr. Daniel Bischof from Baader-Helvea.

Daniel Bischof
Baader-Helvea Equity Research

2 points, 2 questions on my side. The first one, just on your last comment on the attritional loss ratio for 66.6% in Q3. So if you strip out the RCIS impact and the large loss, so the 2 events in Germany and the U.K., you probably would still slightly be above 65%. Was this the level where you would expect the attritional loss ratio to be? Or if not, I mean, what was the deviation? And do you plan some additional corrective measure to take here? And the second one, on the reserve situation, just a clarification, I mean, the 1.8% reserve release, how is this split into the major segments? And related to that, this Q3, you mentioned that the claims frequency in the truck business or the commercial auto business are somewhat higher than expected. Is that something that worries you?

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

Thank you, Daniel. First of all, on the attritional performance, I mean, if you look at the overall results for the quarter, it was slightly higher than we expected it to be. We're happy though that the action that we've taken through the end of last year and the steps that we've taken in the first half of this year are having the impact that we expected. I guess, the challenge we've had this quarter -- and you saw in the opposite direction last quarter, is that, unfortunately, income has not been linear. I think you can strip out a number of components to come back to a view that we would have achieved something in the 97%, 98% range. But I mean for us, I mean, what's the most important is where are we headed, what have we delivered. And if we look to the impact of the reunderwriting that we've done and the impact that, that would have had on the portfolio, I mean, our conclusion is that we're achieving the goals that we've set out. There will still be some volatility. If we look to Q2, we would have had an underlying combined ratio somewhere in the 96s. I mean that was clearly partly due to good luck, and we expressed that at the time. I mean, this quarter, we have loss volatility in the opposite side. We've looked in detail at what drives it, and we're satisfied that it's not driven by something that we haven't yet tackled. We continue to work on reunderwriting. So that's a process that will continue through the course of this year into next. There are certainly areas of the portfolio which are not yet achieving the profitability that we want. And you can see it particularly in some areas of global corporate. And that means that this process for us will continue into 2017, but we're happy that the trends that we're seeing on the attritional are the ones that we expected to see from a performance perspective. On the commercial auto, so commercial auto generally continues to be a difficult market. I mean, we are seeing what at least on the surface appears to be significant rate. But the underlying loss cost inflation, driven by a combination of frequency and severity, is still higher, we believe, than the price action that we're seeing in the market. So that's a line that is not yet improving at the pace that we would like to see. And from a capital allocation perspective, I mean, we are acting accordingly.

Daniel Bischof
Baader-Helvea Equity Research

And your 1.8% reserve release, is this more or less evenly split through GC, NAC and Europe?

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

So there's a slide in the pack that breaks it out by the different businesses. And if you look at each of them, I mean, some are slightly stronger, some slightly weaker. I mean, from a line of business perspective, to go back to your earlier question, I mean, generally, it's -- I mean, the mix is more positive coming from the shorter-tail end of things. And to the extent that we have any significant negatives, which of course are much smaller, I mean, they tend to be in the more long-tail lines, and that's the general driver of the PYD in the quarter.

Operator

The next question comes from Mrs. Nadine van der Meulen from Morgan Stanley.

Nadine Adrienne Marion van der Meulen
Morgan Stanley, Research Division

I was wondering with regards to the combined ratio expectation for the full year, you said that, that could come out slightly above 98%. Could you give a split between the expected loss ratio there and the expense ratio given that you have been guiding towards 31% for the expense ratio previously? And the second question is on the sales volumes. They were a bit pressured as expected I suppose. But particularly in global corporate, also NAC and EMEA. Could you comment on how you see this develop for each region? And in light of that also, maybe comment on the rate, expected rate developments in the different regions.

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

Thanks, Nadine. So on full year expectations, I wouldn't change the guidance I gave you earlier in the year. So from an expense perspective, I mean, we expect to end the year, I mean, broadly in line with where we were last year. And that will be a combination of an absolute expense cut, which I think is visible in the 9 months financial statement. So we've made significant progress, but that's partly offset by the impact of volumes, which I'm going to come onto next. And from a loss perspective, again, no change to, I mean, what we had expected to see there, albeit with the qualification I gave a second ago in the introduction. On the sales volume side, I mean, in general, in the year-to-date, we're still seeing reductions in GWP that are consistent with what we had anticipated will be needed to achieve the profitability that we had targeted for the year. From a rate perspective, if you look at the different markets and the information we've disclosed today, I mean, what you'll see is that in general, we see, I mean, a pretty solid rate across all the markets. I mean, one area that stands out as being slightly weaker is global corporate. I mean, that's a very competitive market. And in particular, property in the U.S. is a market where pricing is very competitive. I think from a trend or from an outlook view, sales volumes through Q4, I don't expect to be very different from year-to-date. So again, we'll continue the reunderwriting process that we started. We'll focus on making sure that we achieve the required profit, and that should leave us with a reduction in GWP for the year ex the RCIS acquisition but still in the mid-single-digits range. From a rate outlook, I don't really expect the trends that you see already in Q3 to change, and my guess is that global corporate will continue to be very competitive, and we'll still achieve higher rate outcomes on the remainder of the book. That would be, I think, better than the overall market performance currently.

Operator

The next question is from Dhruv Gahlaut from HSBC.

Dhruv Gahlaut
HSBC, Research Division

I've got 2 of them. Firstly, going back to Slide 7, where you've given the retention rate tiers, could you quantify what percentage of business is sitting in Tier 4? And what is the combined ratio of that business at the end of 9 months? Secondly, for the group as a whole, how does the claim inflation compare with the rate you've put in of 2% at the 9-month stage?

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

So on the tiering picture, so Tier 4, I mean, it varies quarter-to-quarter. I think in general, the low end tends to be around the 10%, 12%, and the high end tends to be in the 17%, 18% range. So overall for the year, it's something in the kind of mid-teen type level. Can you remember what your second question was, Dhruv?

Dhruv Gahlaut
HSBC, Research Division

And also on -- could you quantify what the combined ratio was for that Tier 4 at 9 months?

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

No, I can't. I don't have that in front of me.

Dhruv Gahlaut
HSBC, Research Division

Correct. Second was claim inflation versus price inflation on the overall book.

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

So I think, I mean, again, it varies market-by-market. So I think the claim inflation we will see in the U.S. is running at a level that's pretty close to the rate that we're achieving. So the margin improvement is currently quite modest, particularly around the global corporate side of things. You see an outcome that from a rate perspective is slightly positive, but claim inflation is still currently probably slightly north of that. And the other markets where the impact is stronger, I mean, claim inflation is not that strong. So I mean across the portfolio, we're seeing much stronger impact of rate outside of North America. For the portfolio overall, we still see a positive impact between the rate that we achieved and the claim inflation that was in effect.

Operator

The next question comes from Mr. Peter Eliot from Kepler Cheuvreux.

Peter Eliot
Kepler Cheuvreux, Research Division

I wanted to come back on the premium growth first of all. I know you're sort of saying that was in line with expectations. But I guess I was quite surprised by the big fall that we saw in Q3 and the sort of swing. I mean, I appreciate you saying you exited the Australian business, et cetera. But even in NAC, we've seen a huge swing from sort of plus 7% in Q2 to minus 4% in Q3. So I was wondering if you could just talk about sort of the historic developments. And the second question, I was wondering if you could talk about the moving parts in the SST ratio. Appreciate you can insert a Q3 figure, but I was, again, I guess a little bit surprised by the extent of the fall from the full year. And I was just wondering if you could split out some of the moving parts or maybe give us a Q2 number in terms of timing.

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

So on the first one, Peter, on premium growth, you need to be a bit careful with NAC because NAC has quite a bit of captive business, and that's what drove some of the increase that you saw in Q2. So I think actually the year-to-date view is a better indicator of where we stand from an overall GWP impact. I mean, Australia has a relatively small effect, but I think NAC is the biggest distorting factor between Q2 and Q3. And a large part of that is explained by captive timing between Q2 and Q3. Overall, year-to-date, premium growth is roughly where we expect, mid-single-digit level. And again, no reason to expect we're going to see a significant deviation from that. On the SST, the main reason for the higher sensitivity is the way that SST treats interest rates, both from a discount rate perspective but particularly from a market value margin calculation perspective. SST adds it to the target capital requirement, and of course, that makes it much, much more sensitive to interest rate. I mean, there are other smaller differences but that explains the vast majority of the difference between the 2 numbers.

Peter Eliot
Kepler Cheuvreux, Research Division

Okay. And if I could just follow-up on that last point, I guess, we're going to see that change now. It's going to be moved from the capital requirement to the available new capital. So I don't know if you -- are you able to give us any sort of sensitivity of how big that positive impact will be?

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

If you bear with me, Peter, and come back for the Investor Day next week, I'll deal more on SST and Z-ECM and Solvency II generally. So we'll include a section there that addresses that particular issue and a few more that are relevant for comparing SST and Z-ECM to other capital measures.

Operator

The next question is from Mr. Vinit Malhotra from Mediobanca.

Vinit Malhotra

Just on the global corporate. I mean, I'm looking at Slide 10 and, obviously, thanks for this additional disclosure today. But there's been a lot of volume cut for 3 quarters now. Pricing is not minus at least. It's okay, zero or one. I mean what do you think needs to be done -- or maybe we wait for Investor Day, but what do you think is -- is it just random large losses? Is it -- what do you think is driving such a high 84 kind of AY LR in this segment? And what do you think needs to be done? So that's the first question. And the second question is -- again, you might discuss it next week, but the interest rate sensitivity for Z-ECM has increased a lot compared to the previous disclosure. Is there some model changes that we should be wary of?

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

Thanks, Vinit. So first of all, on global corporate. So if you drill into the quarter, I mean, I think there are 2 big themes. One is, I mean, the market in general is very competitive. So it's been much harder, despite the reductions that we've pushed through on the volume side, to achieve quite the rate outcomes that we were looking for. And the global corporate cost is particularly exposed to one of the markets that's particularly soft, which is U.S. property. And I think if I look at our U.S. property book and our planning for next year, it's a difficult line of business to underwrite at a profit currently. I mean, you need to take relatively ambitious assumptions around nat cat incidents that really feel happy about our North American property exposure currently. So global corporate has the same issues of the market there. I mean, we have some issues in our portfolio in general. The steps that we took at the beginning of the year around reunderwriting, around the use of reinsurance, I mean, that will start to have a bigger impact on the business as we move on. Global corporate has a particular challenge in the quarter though. So they have 2 areas which are European that have been slightly problematic for them. So one was med mal in Spain and the other is financial lines in Europe. And on both of those, we've moved loss picks for the year, and that's why you see this very high combined ratio for global corporate for the quarter. I mean, having said all of that though, I mean, I think we're doing all of the things that we expected to do. We're not looking for volume outcomes. We're looking for profitability. That's what the team continued to do. And in fact, if I look at all the different parts of the portfolio, I mean, global corporate and in fact commercial and its new organization structure, it's one of the areas that we clearly need much more attention and reunderwriting as we go through 2017.

Vinit Malhotra

And just pardon me, the almost $1.2 billion in NAP, is there a disclosure on how much is U.S. property, any guesstimate or -- in global corporate, sorry?

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

So global corporate's North American property book after reinsurance is, I think, between $300 million and $400 million. We'll check and come back afterwards but it's that type of order.

Vinit Malhotra

In the quarter?

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

No, in the year. The gross number is much higher. That's one of the areas where we put a fairly significant quota share contract in place at the end of last year. On interest rate sensitivity, I mean, we changed the disclosures earlier in the year to try and bring in the nonfinancial market elements. Before -- certainly up to the end of last year, our interest rate sensitivities were typically parallel shift and focused more on interest rate driven impacts on AFR. And what we tried to do going through this year is to update that for the second order effect that we've signed and typically on the liability side to make the disclosure more meaningful. It doesn't change our actual sensitivity but I think it's a fair disclosure so we're trying to improve it.

Operator

The next question is from Mr. Andrew Ritchie from Autonomous.

Andrew James Ritchie
Autonomous Research LLP

I just wondered if you could come back on reinsurance. I recall there was a purchase specifically to do with large losses last year, you bought at the end of last year. And you are running up to the aggregate deductible on that. I think you were below that at the end of Q2. I mean, maybe remind us where you are. I'm struggling to see the benefit so far of what you've done given we've had another quarter now impacted by large losses. So is there now more benefit because of where you are? Is there a consideration that maybe you still need to think again about how much you buy? Just remind us, if there is a benefit, what it is and what your results would look like without that. And then the second question is just following up. It sounds like then there was an element of loss pick true-up in global corporate. I mean, that's unfortunate because we saw that several times last year. Was it just on those lines you've identified, med mal in Spain, financial lines in Europe? There was no true-up in commercial auto? And what was the impact of that true-up on the loss ratio in global corporate?

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

So in the reinsurance side of things, just to recap the changes that we made to reinsurance at the end of last year. I mean, the 2 most significant things we've done is we have an annual aggregate in place across the entire group to cover large loss, and we also have a number of quota share programs in place, in particular, one that covers North American corporate business. I mean, we have had benefits from some of the quota share we've put in place. It doesn't change the ratios, but it certainly has impacted some of the individual line-size exposures that we would have had, had we gone without it. On the large loss side, the charge on the large loss side is that the second quarter was relatively strong from a large loss perspective. So that means we haven't attached that contract. From what we would see through the end of the year, I still would not expect us to attach the contract. And it would require, I mean, a really poor quarter for that to be the case. So at this stage, I'll repeat something I think I said earlier in the year, I mean, we think the steps we've taken from an underwriting perspective will address the large loss issue, in fact have to some degree already this year. I wouldn't want to hope for a large loss experience in Q4 that would be significant enough to attach the reinsurance program. I think there, our underwriting should take care of it.

Andrew James Ritchie
Autonomous Research LLP

And then no other earn-through benefits from the reinsurance program to date?

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

Well, I mean, other than the various programs we've put in place, I mean, not just across property in North America but against various sublines in the book where we have had benefits, the annual aggregate itself hasn't delivered benefits because we have a much better performance on large loss. On the loss pick true-up, I only highlighted that to explain the level of combined ratio for global corporate for the quarter. I mean, I don't think it's particularly significant in the scheme of the group. And of course, I haven't highlighted the loss pick adjustments in other lines that would have gone in the opposite direction. I was really trying to pick out what the challenges were for global corporate.

Andrew James Ritchie
Autonomous Research LLP

And just to confirm on commercial auto, there obviously was a big true-up last year, you haven't had the true-up this year?

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

So global corporates and the construction liability line that was the source of the Q3 problem have not changed.

Operator

We have a question from Mr. Paul De'Ath from RBC.

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

A couple of questions please. I'll move slightly away from the standard lines of the P&C business. Firstly, just on Farmers and looking at the underwriting performance, they're still obviously struggling slightly in motor. How do you see that impacting the growth trajectory of the top line in Farmers and obviously therefore the impact on FMS? And then secondly, just thinking about the political changes in the U.S., have you had any change of heart at all in terms of your hedging of cash flows in order to pay the dividend, given that there might be potentially more volatility going on in the near future?

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

Thank you, especially for the second question. On the Farmers side of things, as you can see from the quarter, Farmers is -- it's on the same track that you've seen earlier in the year. The exchanges are still trying to address the profitability of the motor line, and the steps that they take to do that, which will be around pushing rate, of course, will generate more fees for us because of our relationship with the exchange. So I mean, we see the necessary steps that the exchange is taking to address the underperformance in auto is actually beneficial for Zürich and Zürich's relationship with the exchange. From a growth perspective, I think if you look at the quarter, the in-force count dipped slightly. I think that the -- obviously, there's a limit to how far you can push some of these rate topics without having any impact on policy count. I mean, the Farmers is -- the exchanges have had to manage that balance, and I think they've done that very effectively. But I guess, the key point here is we expect to see the exchange take more rates, and that will drive more fee income. On the political changes, I mean, in general, I've got to stay away from that topic. The -- I mean, from a corporate finance perspective for us, obviously, we pay attention to currency moves. I don't see anything either recently or currently in the outlook that would cause us to change our view of how we should approach, how we deal with some of the foreign currency basket issues that we face as a group. I mean in general, I think it's much better for investors if we take a very longer-term view and allow some of the currency volatility to balance out. Of course, if situations became more extreme, I mean, we'd have a look at it. But I mean as of today, I was looking at the cross rates, I note today that the dollar is stronger against the Swiss franc than it was on Monday. Going more than that, I have nothing to say on the political topic for the time being.

Operator

The next question comes from Sami Taipalus from Berenberg.

Sami Taipalus
Berenberg, Research Division

The first one is just coming back on the top line but looking slightly longer term this time into 2017. And if I kind of square up what you're saying about the competitive market and that you're perhaps running slightly behind on the underlying loss ratio improvements, is there actually any chance that you could grow your top line next year? Or should we sort of write that off? And the second question is on the competitive environment in the U.K. and Germany commercial lines, could you just give a bit more color on that please? Because you made a few remarks about that in your comments.

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

All right. Thanks, Sami. So it's the top line, and I think from a -- and if I take a longer-term view, once we've completed reunderwriting, I mean, we'll grow at rates similar to the market GDP rates in the markets where we operate. I mean, we don't have an imperative to need to grow. We're not trying to achieve a particular expense ratio outcome. We're far more focused on expense levels from an absolute perspective. So I mean, it's really market conditions that will determine whether or not the company finds business that's sufficiently attractive to grow next year. Having said all of that, I think today as I look at things, given the market conditions, given the market competitiveness and some of the reunderwriting that we still have to do, I don't expect us to grow. I don't expect us to shrink in the rate we have this year, but I don't expect us to grow next year. Competitive environment, U.K. and Germany. Maybe I would pick out the U.K. as slightly more competitive than Germany given the price and rate trends that we see. I mean, in general, U.K. is quite closer to the U.S. in terms of current market trends. Germany, we still as a market where certainly if we select the portfolio correctly, I mean, we could generate attractive returns and drive some margin improvements through the portfolio.

Operator

We have a question from Mr. Michael Huttner from JPMorgan.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

I had 2 questions on the PYD, I think it was Q1 or maybe Q2, or I remember, May. As 2 competitors highlighted, that there was a difference between the region average of PYD, of the loss profit, and what you showed at the group level. And I think you've got the same in Q3, is that right? And I just wondered, are you effectively adding more to reserves? And is this a voluntary thing? Or is this a required thing? I'm guessing 2.9 is the country or the region runoff profit and the 1.8 was the group level. And then on the -- you gave this 97%, 98% range and I really thank you for that, for Q4, I find it very comforting. But given that you were maybe not quite so confident, but yet you still expressed a range for the full year, and now you'll be a little bit above that. Where is your confidence coming from Q4? I think Andrew Ritchie kind of made -- in your answer, you made the point it wasn't from the aggregate loss ratio, loss cover. I just wondered is there a moving part we're not seeing? Or have we -- are we kind of account for the fees and some large losses? I just want to understand a little bit of the thinking here.

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

Michael, so on the first one, we highlighted both and -- Q1 and in Q2, that there was a difference between the, let's call it the regionally reported PYD and the group PYD, because we made a choice to take a more prudent view from an overall group perspective. I said at the end of Q2 that we would look to try and make sure that we push that down into the businesses. We've done more of that in Q3, but we haven't completely eliminated it. So the group, again, has taken a slightly more prudent view than the average of the positions presented by the geographic regions. I mean, over time, I expect to eliminate that difference and to the extent that the group has a view, for that to be recognized locally. I mean, I think I've said explicitly before that, I mean, one of the things we'd like to do over time, one is demonstrate consistency around PYD over a longer period than simply the 3 quarters we've seen this year. So that's something we would continue to focus on through Q4, Q1 and throughout the course of 2017. And at the same time, to the extent that the local environment permits me, to be more prudent overall from a reserve perspective.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

And that's about $300 million year-to-date, this difference?

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

Approximately.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Yes, but we can find out...

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

On the 97%, 98% range, I think you were quite kind to me. So I mean, I'm always confident at Q2 and I'm...

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

It's not kindness, you're doing a really tough job, it's not kindness. I appreciate what you do, sorry, sorry, I'm not being [indiscernible], but what you do is really hard. So it's not kindness, it's just recognition.

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

So my confidence about our ability to achieve 97%, 98%, hasn't changed. I guess what's happened is that the path hasn't been as linear as I guess I would have hoped. I mean, we are doing the things that we have indicated to take some of the volatility out of the system. It will not remove all of it, though. So I mean, I can't make a cast-iron commitment that in any given quarter, we'll see a particular outcome. But if I look at the drivers of our underlying performance, if I look at the action that we've taken and I look back at the impact that, that would have had in Q3 had we had that in force for the entire time, I'm happy with the trends that we see. I mean, we are going to get there, but we will be subject to some volatility, even when we've completely reunderwritten the book, whether that's by the end of this year or the end of next year. But the underlying position, I think, is the most important to me. I can see the improvement and that will show up in the financial performance.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Just very quickly, quarter-to-date, we're more like Q2, we're light, right?

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

So you'll have to come back in February, when we talk about Q4.

Operator

The next question comes from Mr. Nick Holmes from Societe Generale.

Nick Holmes
Societe Generale Cross Asset Research

A couple of questions. The first is on the U.S. business. Do you think that the recent rise in bond yields is going to put more pressure on U.S. commercial pricing? And kind of can you give us your thoughts on the outlook for pricing? Because obviously, it has been under pressure this year, but it's performed, I think, a bit better than most people thought. Second is on the Z-ECM ratio, wondered if you could update us on your capital policy here. I mean, the ratio is looking stronger. And I wondered what the surplus capital position is that you see within the group, if any?

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

So on the U.S., in fact, I was asked a similar question on CNBC this morning. I think if you look at all the markets, the U.S. is the only one that stands out with a relatively modest rise in bond yields. I mean, retrace that partly yesterday. I think it would be a mistake, certainly for us, and my view as for the market in general, to start to assume that there's an upward track in bond yields and somehow we can anticipate that from a pricing perspective. And the point I made this morning was that I think everyone needs to continue to focus on adapting to this relatively low yield environment. And if something else comes, I mean, probably could, we will enjoy that when it appears. I don't think the bond yield topic, I mean, it's certainly, from my perspective, hasn't really had enough time to impact the pricing environment. Pricing in the U.S., very competitive market, lots of well-capitalized competitors, everyone trying to make sure they hang on to the parts of the portfolio that they like and competing for when things do emerge into the marketplace. So even though the trend is not as negative from a pricing perspective as it was last year, I mean, I think still the best you can say is that the -- I mean, maybe we're approaching a bottom if you look at the trends, but the incremental is still slightly negative, market-wise. Z-ECM...

Nick Holmes
Societe Generale Cross Asset Research

Sorry, George, so you would expect pricing to start to stabilize next year, is that what you're saying?

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

So the short answer is probably not, I think. I think it's -- I don't really want to get into the position where I'm trying to call a ton in the market. I mean, the stance that we're trying to take is, I mean, if you look at current trends, both from a financial market perspective and from a pricing and loss cost perspective, you should typically assume that those continue, because that market currently is something that's generally out of your control, so we're not planning for that currently. Z-ECM ration and capital generally, so all I can really say there is, I mean, we feel very comfortable with our overall capitalization. As you point out, the Z-ECM ratio is slightly above the midpoint, but I mean, that hasn't triggered some reconsideration by us of whether there's a significant element of excess capital that we'd like to try and find something, alternatively to do with it. I mean, our focus is around the operational improvement requirement of the firm, and I would say that we feel quite comfortable with our current capitalization and wouldn't necessarily look to change it.

Operator

We have a question from Mr. James Shuck from UBS.

James Austin Shuck
UBS Investment Bank, Research Division

George, I have 3 questions, please. Firstly, could you just comment on the German life business, I'm just interested to know whether the low interest rate environment will start leading to progressive DAC write-downs in the fourth quarter and beyond, first question. Secondly, could you just update on the progress with distributing surplus capital from the U.S.? I think there were plans to distribute that capital, and I'm just wondering whether you've actually progressed at all and at what time frame we might expect to see that be distributed? And then finally, just a more conceptual one. I mean, obviously, you've changed your book of business a fair amount in pruning and reunderwriting, et cetera. By implication, you have a fair amount of legacy business that you may or may not want to keep. Just interested to hear about the Rhode Island legislation and whether that could potentially lead you to take a good hard look at some of your closed book or runoff businesses with a view to freeing up capital from them?

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

Yes, James, so on the German life business, if I look carefully at the guarantees, I look at the running yield that we have in the book, I look at the benefit that we have from the, under those gain positions, I don't see anything there that would suggest that we're at any significant risk, I mean, in the medium term of a DAC write-down. I mean, I think the other thing you do see in the German business is that, as we've said before, you will see pressure from ZZR. I mean, that will start during the course of next year with a, I think, a mid-double-digit million dollar impact on life earnings. It will increase, and over the course of, at least our planning horizon, we expect to see a total ZZR impact of about $400 million, which would be between roughly '17 and 2021. But not seeing anything on the DAC side that would suggest a write-down. On U.S. capital, I think probably the best way I can answer that question is to say that, I mean, as you know, our cash plan for the year was partly dependent on a successful outcome from that discussion. I see nothing that would cause me to change my view of what we expect to deliver on cash, which would mean that we'll meet the more than $10 billion of net cash remittance that we guided to, and in particular for this year, we'll achieve at least the cash cover dividend, assuming the dividend is unchanged. On the Rhode Island topic, something we'd been looking at towards this year and last year. I mean, conceivably, it also is the possibility that you can achieve a, I guess, well, for a U.K. individual, it will be a Part VII type outcome. I mean, the legislation is of interest to us. I mean, it takes some preparation of the books of business that it may be applicable to before they'd be ready to potentially transacting on. And of course, there aren't many people who really have experience of buying under this regime yet. I mean, it's something that we're looking at very carefully, and it offers, certainly from a group perspective, a more attractive outcome, potentially because of the finality that it really offers in comparison to the economic finality that a reinsurance solution would typically offer. So Rhode Island is something that we are looking at.

Operator

The next question is from Thomas Seidl from Sanford C. Bernstein.

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

First question is on Page 18, where you show the running yield by asset class. I focus on that. When you look back to '15, you showed, basically a reinvestment rate, 2%. This year, the reinvestment rate is dropping down to 1.7%, yet running yields have been rising over the same time horizon from 2.4 to 2.7. So you frequently mention on the inflation in bonds and LatAm. Is that the only explanation? Or what else is going on? Because otherwise, mechanically, the regular yield on the fixed income portfolio must come down with this type of reinvestment rate. That's the first question. And the second is then you talked about the consistency on reserves. Now when I look at the segmental reserves as quoted on Page 10, the last 3 years, '13 to '15, you had basically 0 reserve position from global corporate and NAC, and yet this year, those 2 segments are the strong deliverers. And I wonder why you find now the reserve [indiscernible] in those 2 segments which caused problems in previous years?

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

So Thomas, on the first one, on the running yields, I mean, I think you and I discussed this already in the Q2 call. The answer would be broadly the same. And in fact, I would agree with your hypothesis that the running yield must come down. There's no way to avoid this. The only way that you could avoid it would be if you chose to take more risk, and that's not something that we intend to do.

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

But why are you having [indiscernible]?

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

Those are the 2 reasons I gave you in Q2. So LatAm and the inflation impact and the impact of foreign exchange, so that's it. On reserving, I mean, you talked about the consistency of reserving. I mean, I guess when we talk about consistency, I wasn't trying to imply that if it was consistently negative, we would continue that into the future. We've made some adjustments to reserving for, in particular, global corporate and NAC. And those 2 topics we discussed last year, that's obviously moved the reserve position overall to a different place. And other than that, I mean, we are happy with the reserve position that we have across the entire group. I would expect over time, not every one equally in every single quarter, but over time, that all of the different businesses contribute to positive PYD. And if you look at the numbers we have for this quarter, that's exactly what you see.

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

On the first one, maybe a follow-up, if you strip out inflation FX, what would be the running yield in fixed income and P&C, please?

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

I don't have the number in my head, I'm afraid.

Operator

We have a question from Mr. Andy Hughes from Macquarie.

Andrew Hughes
Macquarie Research

Couple of questions, if I could. First one is on Slide 7, under Retention By Tier. Just looking at the Tier 4 and comparing that for the half year, so for the half year, it's 62% retention, and then you got 60% retention for the 9 months. And I thought quite a lot of this stuff renewed in the first quarter. So has there been a material change in the Tier 4 retention versus what you have seen in the first half of the year and the third quarter? And I guess, the second question is on global corporate and the comments you made before about the rate changes. I can see the kind of global corporate sort of rate change, it dropped to 0 from 1 in the previous quarter. But if I'm just wondering, is there any way we can adjust this for the impact you discussed with the benefit of reinsurance, because obviously, these are gross premium numbers? So what would be a kind of more recent -- because obviously, if I look at Slide 23, it's hard to see how the kind of combined ratios can improve, given that the rate changes coming through is quite low. I'm just wondering if we can kind of adjust this somehow for the reinsurance that you put in place that you discussed earlier?

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

Andy, so on the Tier 4 topic, if you look at the size of Tier 4, it's slightly larger at the beginning of the year than it is in the remainder of the year. I think we have a continual renewal, which means there's a significant Tier 4 element in pretty much every single quarter. And I think what you're seeing in global corporate is actually is the, in a relatively competitive market, and I guess everyone recognizes they're operating in, and therefore, it's, I mean, I think, pushed for the rates that we're trying to achieve. At least trying to push for a margin improvement that will outperform the market generally. I mean, that's had some negative impact on retention. I don't see a dramatic shift in the retention dynamics between Q1, Q2 or Q3. Global corporate rate change and the impact. You describe that as the benefit of reinsurance. I mean, actually, going back to Andy Ritchie's question earlier, because we're not attaching the annual aggregate, I would estimate that the impact of reinsurance on global corporate would be slightly negative rather than positive currently. I mean, obviously, if we're not recovering under one of the key contracts, that, that will have some negative impact on them. I mean, I don't think it's particularly significant, but I wouldn't quantify the impact of reinsurance through the 9 months as necessarily a positive for global corporate.

Andrew Hughes
Macquarie Research

I was thinking more of the $300 million to $400 million property reinsurance you talked about, rather than the aggregate one, on the property book, which obviously would, on a gross written premium basis, would obviously deflate the numbers.

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

Yes, so the -- I mean, I guess it deflates and slightly distorts the numbers, and there'll be a, a ceiling commission. But I mean, I guess the margin change from that will be really, really small. I mean, I wouldn't expect that, I mean, that would change the overall combined ratio in any significant direction. I mean, that will change dynamics between the OUE ratio and the acquisition cost ratio. I mean, essentially, it just brings the entire book down slightly, reduces the overall contribution of it to the overall performance. But I don't think it will be particularly material.

Andrew Hughes
Macquarie Research

Okay. Is there an obvious way I'm missing as to why this business is kind of just going to improve with a very low rate change? I mean, is it really the benefit of the mix we haven't seen so far that will start to come through next year?

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

Well, I think in the case of property, it will not improve because of rate change, it will improve because you write less of it.

Operator

Your next question is from Calvin Turner from InsuranceERM.

Unknown Analyst

I just have 2 questions, if I may. One is on the life benefit from the assumption changes on persistency. I wondered how long you look at in terms of dates or periods to change that, whether it's just the last, the previous 3 months before Q3? And I'm talking about the $30 million benefit on that assumption. And then second one, just on the point of reinvestment versus running yield, the point that was made earlier. You said that the foreign exchange in LatAm was the reason. I just wondered if there was any increase in illiquid credit? And whether that was part to do with the reason for the improvement in income as well?

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

So on the first one, I mean, typically when you're looking at experience updates, you look at, you split the portfolio into cohorts and you look at the cohort back to inception. So the periods over which you'll review it will vary and it would be very unusual that anything will be as short as, say, the last 3 months, when you're typically looking at 1, 2, 3 or even more years of experience before you make a decision on whether you move persistency. On the yield side of things, so I mean, the yield that we have in there for fixed income is typically the market instrument-based one. So when we calculate that, we exclude, I guess, things like mortgages and loans, which typically are on the less liquid end of the calculation. And so I wouldn't expect that to have an impact on that.

Unknown Analyst

So there's not been an increase in illiquid credit investments in the quarter?

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

So I'm not aware of a significant shift into illiquids in the quarter.

Operator

[Operator Instructions] The next question comes from Mr. Ralph Hebgen from KBW.

Ralph Hebgen
Keefe, Bruyette & Woods Limited, Research Division

Ralph Hebgen from KBW. Just going back to the global corporate line, where I know we've discussed this at some length. It just looks as if the accident year loss ratio in the 3Q inject quite a material element of volatility into how these things run from quarter-to-quarter. So George, last quarter, you gave us quite a helpful commentary around large losses and where the large loss experience you had, ran relative to your expectations on your budgets. In 2Q '16, there was a positive element. I was just wondering whether you could give us a similar commentary, perhaps at group level and also specifically focusing on global corporate? So that's the first one. And the second one is coming back to what Andrew was talking about. I do wonder, I may look at this too naively, but it looks also to me as if you're not seeing an obvious benefit from the excess of loss reinsurance program that you had. Are you thinking, is it actually appropriate for you to think about perhaps lowering the attachment point so that you would get a positive impact on the volatility, which is arguably still present in the book? And question number three is on life insurance. I saw, just at the high level, that's very strong in the quarter in terms of business operating profit. Are there any special drivers behind that? And where would you say your guidance is now running? You said it's like $300 million to $350 million per quarter. Is that still what you're happy to repeat? Or is it at the upper or lower level of that range?

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

So on the loss experienced in the quarter, I tried to avoid getting into explaining how it would have been good if it hadn't been for the claims that we had in the quarter. Some volatility is going to be expected. I mean, I think one of the reasons I feel more comfort this quarter compared to some of the experience that I guess you guys shared with me last year, I mean, I think we have much better information as to what we are changing, the impact of those changes on the book and our ability to project that forward. I mean, that's something that drives some of the confidence around our expectation of the improvement. And I guess Q3 is a reminder to all of us, in particular me, that it won't necessarily be a linear process. If you look at the loss experienced from a large perspective, our cover at group level, and if we adjust for -- if we adjust the actual experience from what we would have had, had we made all of the changes and impacted the entire book, it would be better by 50 to 100 basis points. But of course, the most important issue is that we have to deliver it rather than talk about it. But I mean, overall, I'm happy with the trends I see in GI. On the excess of loss on the annual aggregate contract, I mean, you're absolutely right, we so far have had no benefit from the contract. If I could write a contract that would allow me to define the attachment points at the end of the year, I would absolutely choose that one. So I guess we chose one based on the experience that we've had over, I mean, the last several years. And the aim wasn't to put something in place that we felt certain we would attach during the course of the year, but it was designed to give us confidence that for any reason we have a repeat of last year's experience, you and we wouldn't suffer the same financial impact. In the event the year has turned out quite different so far, we have made more progress more quickly, and in particular, we benefited in Q2 from a relatively light quarter from large losses. So that today would lead me to expect, as I said, I think, in response to Andy's question earlier, that the impact of the reinsurance will be negative. I mean, we will review the entire program and look at whether there are ways in which we should adapt or change it to make it more effective. I mean, we put the contract in place for a particular reason. That particular reason hasn't emerged in the year to-date, and I think that's actually good news rather than bad news. On life insurance, I think the only thing I would highlight for you in terms of one-off, in response to, I think Calvin's [ph] question was about the impact of the assumption changes, we're not going to have them every single quarter. And in this quarter, they were about $33 million of positive impact on the result.

Operator

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