S&P Global
Market Intelligence

Swiss Re Ltd SWX:SREN

FQ2 2010 Earnings Call Transcripts

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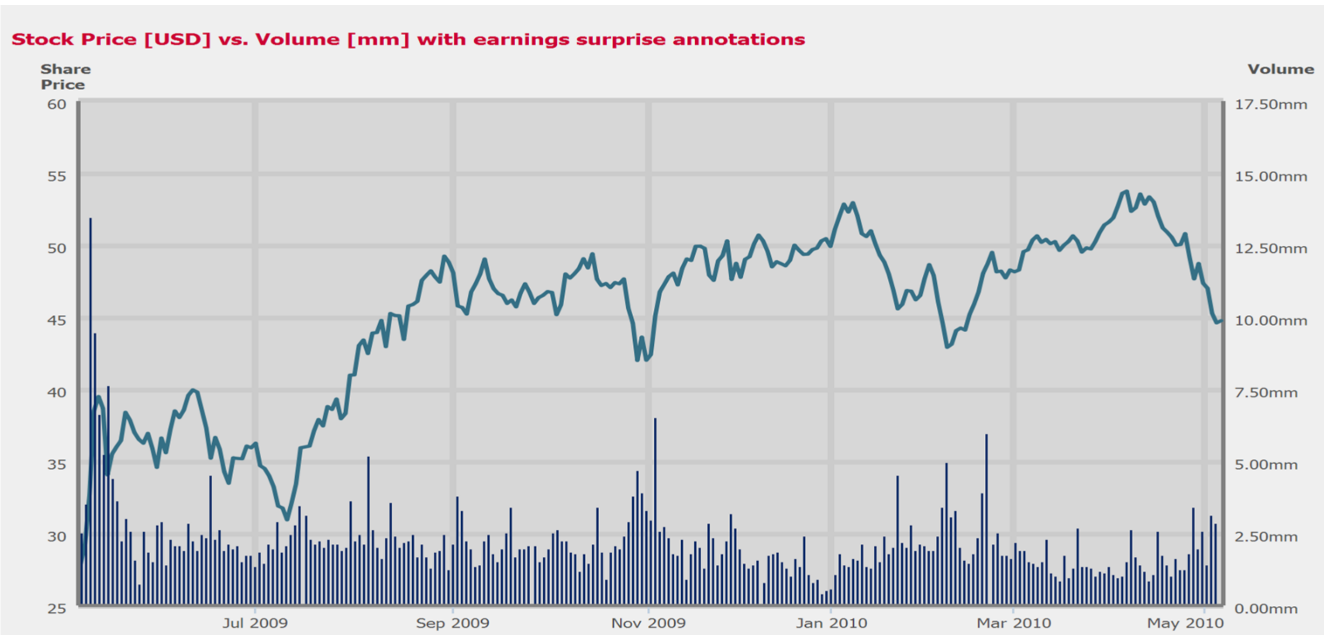
S&P Global Market Intelligence Estimates

	-FQ2 2010-		-FY 2010-	-FY 2011-
	ACTUAL	CONSENSUS	CONSENSUS	CONSENSUS
Revenue (mm)	5159.75	5500.94	24022.93	24133.09

Currency: USD
Consensus as of Aug-04-2010 9:09 AM GMT



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EXECUTIVES

George Quinn
Group Chief Financial Officer

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Susan Holliday

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Morgan Stanley

Michael Huttner
JP Morgan

Spencer Horgan
Deutsche Bank

William Hawkins
KBW

William Morgan
Goldman Sachs

Presentation

Operator

Good day and welcome to the Swiss Re's second quarter 2010 results conference call. Today's conference is being recorded. At this time, I would like to turn conference over to Ms. Susan Holliday. Please go ahead.

Susan Holliday

Thank you, and good afternoon and good morning, everybody. The kind of running order for this afternoon will be that George Quinn, the CFO, will take us through the results for Q2 2010. And then Stefan Lippe, the CFO [ph], will make some comments about the July renewals and the outlook for the company. And after that, we'll have time for Q&A.

So, with that, I'd like to hand over to George.

George Quinn
Group Chief Financial Officer

Yes. Susan, thanks. It's not often that Susan makes a mistake in the introduction, but Stefan is the CEO. Thank you again. And good afternoon or good morning to you, depending where you are. I'm going to start on slide four of the presentation. So we've reported Q2 net income of $812 million, which is - which compares to a loss of $342 million in the same quarter last year. This translates into an ROE of 13.4% on an annualized basis for the quarter.

We also saw continued growth in book value. It's now up to $27 billion in shareholders' equity, or about a bit more than 78 Swiss francs per ordinary share. Measured in Swiss francs, the book value per share has risen by about 9% over the course of the quarter.

We continue to maintain a high level of excess capital, and we reported today that we estimate that the Group is holding more than 10 billion above the minimum AA requirement at the end of Q2. It's fallen over the course of the quarter through a combination of the dollar movement in the quarter, the impact of interest rates, and also changes to the model that's been applied. It's comfortably more than it is needed to deal with the Group's key priorities over the next year, in particular the redemption of the convertible. Just a reminder, on a pro forma basis, were we to redeem it today at the premium, the Group would still sit with a substantial excess above the target level that we had discussed last year.

P&C's underlying performance was good, but the headline result is impacted by higher than expected losses, and I'll come on to that in a second.

Life & Health shows a substantial improvement over last year, but it's not particularly meaningful comparison given the result in the second quarter of 2009. Life & Health does continue to be impacted by the low interest rate environment, and in particular the way that we allocate investment income to this segment. I'll go into that more in a bit later in the presentation.

Asset Management's produced an excellent result in the quarter, which drives not only the asset management result but also drives the Group items figure. I'll mention that a bit later. The return on investments, on a GAAP basis, was 5.8%, and the total return was 13.2%. I've commented already today, and for reasons that are probably obvious, we don't see these as sustainable returns going into the remainder of the year. But I will comment on the running yield when we get to asset management.

On Legacy, we've made further good progress, but we have reported a small loss. But the team has completed most of the key de-risking targets for Legacy.

I'll now switch to slide seven. Premiums earned are down 21% in the quarter. And this is mainly driven by the renewal in January. And I think the reasons for that shift are well known to you. The reduction in written premium predicted by the renewal was about 15%.

In addition, this quarter, and this is a difference in this quarter, we've adjusted the earnings pattern that we apply to premiums with natural catastrophe exposure. This has an additional effect of reducing the earned premium by about 6% in the second quarter 2010.

In operating income you see a fall mainly driven by the claims that we had previously announced in the quarter, so, for example, the impact of our estimate for Deepwater Horizon of $200 million and the change that we announced in the Chile earthquake estimate of $130 million. These numbers are unchanged from the figures we've given earlier in Q2. Obviously, both of these losses also impact the combined ratio, where we've suffered excess nat cat losses. But here the impact is only about 2 points more than we would normally expect in the quarter, and the remainder of the loss in excess of expectations essentially comes from Deepwater. And you can pick any of the items that contribute to the excess loss on the liability side, but this is obviously the most significant.

Underlying, we believe we're tracking in line. And Deepwater on its own would be about 8 points. But we still think that we are in line, if not slightly better, than the guidance that we gave earlier in the year around the combined ratio.

Investment income for the segment also declined, as interest rates fell and reserves ran off. But the expense ratio is stable, despite the fall in earned premium, and that's of course at least partly driven by the efforts that we've made on the efficiency side.

The lines of business, on slide eight. I've covered most of the key points that are in the text here already. I'll comment only on a couple of the other unusual movements in the quarter. Motor was affected by a phenomenon that we've discussed in earlier quarters. We have a pre-2008 premium update, and this negatively impacts the motor combined ratio because of the ADC. If you cast your mind back to last year, or if you heard it last year, we have had positive impacts from premium updates that have been positive in the past because of the ADC. Obviously, as time progresses, the impact of this type of adjustment should decay [ph] to zero. Individually, it's not actually very significant, but it does have an impact on the motor combined ratio.

Credit is abnormally low in the quarter. It's mainly due because we have a prior-year impact that Swiss Re actually retains, but it's also due to the restructuring of the portfolio that we conducted at the January 1 renewal. That's been very beneficial for the expected combined ratio.

Life & Health is on the next slide, slide nine. Again, just to repeat what I said earlier, we've reported substantially improved results compared to the same quarter last year. And if you dig in a bit, headline operating revenues were down 7%. The main driver, in fact, that has more than a 7% impact, is the life retro deal that we reported back in January.

Foreign exchange also had an impact, and if we adjust for both of these, business grew by about 7%. And this is across all of the businesses, so traditional life, traditional health, and in fact Admin Re.

We have a sharp rise in operating income, in comparison to the prior year. And obviously the prior year is substantially impacted by some very significant individual items. For example, we made the VA adjustment in this quarter last year, and we had the benefit from the arbitration win in the same quarter last year.

The overall result, though, is lower than we would expect. This is partly due to lower investment returns. The declining risk-free rate influences the amount of investment income that we allocate to Life & Health. If this continues, it will continue to put pressure on the Life & Health result.

But in this quarter, it's also combined with a number of individually smaller items such as updates from clients or model changes, but all of these were negative. It's partially offset by the positive impact of VA. The underlying result is higher, but the low-yield environment may continue to put pressure on this segment.

I'll turn to slide 10, and this is Asset Management. So Asset Management has produced excellent GAAP earnings. You can see it on slide 10. The Ro\OI at 5.8% and the total return at 13.2% are both way above expectations. Probably the most significant change from a substance perspective in the quarter is that we've done what we said we would do on hedging. We've essentially completed the adjustment of the hedging program in the quarter, which results in about a $6.5 billion reduction in the notional protection in the quarter. I think the CR01 is a better guide to the amount of exposure we have, but I think most people are more familiar with the notionals. Both are independent.

The hedging that remains mainly relates to individual securities. So the good news is that this should eliminate this issue as a major source of volatility going forward. We made a relatively immaterial gain on hedging in the quarter.

Impairments are also substantially down. We have 75 million in the quarter. But overall, just to recap on this, I would not expect to see necessarily a repeat of this result in Q3, and I would expect the ROI to come down.

The running yield is a better forward-looking indicator, and this increased slightly to 4.3% as we reduced the short-duration asset position. We reduced it by about a third, and the resulting asset duration is within about 90% of the liability duration.

Legacy is on slide 11. On Legacy, I think we've made good progress in the quarter. There's some very important achievements that you can see listed here. So we've now achieved the sale of all of the remaining assets from the former structured CDS positions during the quarter. In doing so, though, we incurred a loss of $27 million, we did also execute on a further commutation within Financial Guarantee Re, which resulted in a further $1 billion reduction during the second quarter.

Other than this, we have had impairment, a bit more than $40 million in the quarter. And taken together, the efforts that we've made in de-risking, together with the impairment, have led to a loss of $54 million in Legacy.

Group items is on slide 12. And so Group items are actually captured in some of the ROI comments I made earlier, but because the impact is so large, we thought it is important to highlight these. I think that many of you are aware of the movements that we can have in Group items, although I certainly appreciate that it's very difficult to forecast. There are two particular items I'd draw your attention to. One is that we've benefited in the quarter from mark-to-market gains on assets which we're using to hedge some of the foreign exchange risk. The foreign exchange hedge is effective, but we have also, this quarter, brought in the non-foreign exchange mark-to-market into the income statement. And we've also benefited from a foreign exchange effect. So foreign exchange and the realized gains that Asset Management has made is reported here. And the currency pair movements against the dollar, particularly the Euro and Sterling, have been particularly beneficial this quarter, but this is fully reflected in the ROI.

Shareholders' equity is on slide 13. Here you see a summary of the main movements in the quarter. The largest and most significant is the net change in unrealized gains and losses. We have an increase of 1.3 billion. I think you'll recognize that, from an economic perspective, this is not particularly capital relevant in an economic context, and in fact exists mainly because we don't mark the liabilities to market under the accounting model.

Government bonds are the principal beneficiary, but corporate bonds and securitized products also saw substantial rises in value as the impact of interest rates more than offset the spread widening that we saw in the quarter. Otherwise, the largest item was net income, partially offset by the impact of FX translation, which is due to the change in the dollar, or the strength of the dollar in the quarter.

Overall, I think it's an excellent quarter, not so much as a result of the overall headline figure, but more when you focus on the changes that we have made, either on Legacy or in Asset Management, and the foundation this creates for us to achieve our goal of a 12% return on equity over the cycle.

With that, I'm going to hand you over to Stefan.

Stefan Lippe

Thank you, George. Good morning, good afternoon to all of you. George has just talked to you about our achievements in the second quarter. I am now going to say a few words on the July renewals, and then give you an outlook.

For the past two years, Swiss Re has positioned its Property & Casualty portfolio for the softening market. This has meant allocating our capital in a very disciplined way to the segments that are most likely to perform. The July renewals have again confirmed that our approach to actively manage the cycle and steer the portfolio is the right one. What did we mean by active cycle management and portfolio steering?

Let me illustrate this with the concrete measures we have taken. I am now on page 15.

We continue to allocate capital to more attractive non-proportional business, while reducing proportional exposures. Non-proportional accounts make us less vulnerable when rates are cut in the primary market, increase our exposure to property business, generating higher returns, and continue to slightly reduce our exposures on the casualty side, especially there where the business has not adjusted to the lower interest rate environment.

Let's take a look at the chart. Two elements here are key to understand Swiss Re's July renewals. The premium volume in our treaty portfolio has remained more or less flat, at $1.9 billion. As in previous renewal rounds, we took the conscious decision to step out of business that did not meet our underwriting standards, and again forced onto the segments of non-proportional business that we believe are most attractive.

As a result, the quality of our renewed business, the profitability, was maintained despite the fact that there was an underlying softening in the market.

I will now turn to page 16. The overall claims experience in 2010 has, in minimum up to now, been too small to trigger a real turnaround in the market. We estimate that overall market pricing has slightly declined, by 3%, during the July renewals. Any rate increases were more or less confined to local markets, or to loss-affected programs like the drilling activities driven by the Deepwater Horizon disaster in the Gulf of Mexico, or the Chile earthquake, and also Australian storm covers.

The long-term price adequacy for Swiss Re, year to date, so including all renewals season we have seen in 2010, is estimated to be 3 points higher compared to last year, thanks to our portfolio shifts, meaning the market went down and we even could improve our quality in the same period.

Now I would like to come to the summary and outlook, and I'm on slide 17. In the second quarter we produced a strong result, despite the above-average Property & Casualty claims. Looking ahead, our P&C book is well positioned for a soft market. We will not chase only top line growth, but really stay true to bottom line profit.

Life & Health will benefit from the recovery in the global economy. I am proud to highlight the excellent returns George already mentioned as far as investment activities are concerned. And I think this was an excellent achievement in this quite volatile and very low-yield financial market environment.

I am also delighted to recap that, once again, we have made good progress in derisking our Legacy portfolio, and we expect this work to be completed by the end of this year.

If I summarize, we are well on track to achieve our 12% return on equity target over the cycle. Adding up all we have talked about today, I hope you'll see that our ambition to be the leading player in the wholesale reinsurance industry is a realistic goal.

We have all the necessary elements in place to succeed, the capital strength, the expertise and a proven capacity for innovation. I will certainly do all in my power to ensure that we combine our skills and the current market condition to make this possible.

Thank you for your time and attention, and I hand back to Susan for the Q&A.

Susan Holliday

Thank you very much, George and Stefan. Now we have time for some questions. If I could remind everybody please to stick to two questions each, that would be great. And operator, could we please take the first question?

Question and Answer

Operator

Thank you. (Operator Instructions). And we take the first question from Michael Huttner from JP Morgan. Your line is open.

Michael Huttner
JP Morgan

Thank you very much. I'm honored. Thank you very much. I have two questions. The first one is on George said the life profitability could remain impacted if - due to low interest rates. And I wondered if you can give me a feel, give us a feel. I remember in the past a figure of maybe $900 million for the operating profit on the life book, and I wonder if - with the low interest rates, how much this could change, in your view? And the second is on the combined ratio. You're saying thanks to renewals and underlying combined ratio, not the renewals, underlying combined ratio, it's a little bit better than the guidance you've given. Can you remind us of the guidance, and also of what it would look like after the renewals we've just had? Thanks a lot.

George Quinn
Group Chief Financial Officer

So, on the first one, Michael, on the life profitability, I think that you'd probably all recognize that I've given a pretty dreadful performance of giving you a feel for the Life & Health result up till now. I think when we talked last quarter I talked about $240 million and one thing I should point out is that I normalized the investment result when I did that calculation, and I overstated the underlying earnings, I mean, if I look at what we've got today, we've got 140 as the headline. If I back out the positives and negatives, for the portfolio we've got with current interest rates, we'd probably be a bit beneath 200.

And if we continue at these interest rate levels, and particularly if we also continue with these market levels, for example, in the UK, we will see further pressure as we roll off the old years at higher interest rates and replace them with new years at lower ones.

I think if I - I can't predict when the interest rates are going to move up, but if we see it remain at this level, then we will see further pressure in further quarters. That's the best I can do on that for the time being.

On the combined ratio, the guidance I gave earlier was I said, I think back in probably in February, at the full year, that based on the renewal we were anticipating a 93% combined ratio. I think, based on what we know in more detail, having kind of loaded the stuff into the systems and having seen April and July, it's probably slightly better than that. I would - not materially, but probably slightly better than the 93%.

Now, from a GAAP perspective, it's pretty obvious that we wouldn't assume that the second half of the year would compensate for the first half. So if we have results as expected, you could blend [ph] the 93 and the year-to-date combined ratio to make a rough stab at what the combined ratio might be for the full year.

Michael Huttner
JP Morgan

Thank you very much.

Susan Holliday

Okay. Thank you very much. Could we take the next question, please?

Operator

We take the next question from Spencer Horgan from Deutsche Bank. Please go ahead.

Spencer Horgan
Deutsche Bank

Thank you very much. Just two things, please. Firstly, with the excess capital above the AA, I assume we've sort of seen a similar movement under Swiss solvency test review, and I just wondered if you could sort of dare to give us a hint as to where that currently stands at the end of June. Obviously, on the Investor Day, you said above 300%. Is it still above or 300%? And then, secondly, you briefly mentioned, I think, that you're going to change the phasing of earnings of catastrophe-related premiums across the year. I guess, qualitatively, it's obvious how you do that. But I just wondered if you could give us some quantitative help in terms of how much premiums are involved and roughly what the phasing would be across the four quarters, maybe in rough percentage terms. Thanks very much.

George Quinn
Group Chief Financial Officer

Okay, so, on the first one, the impact on SST is a bit less than the impact on S&P. If you look at the components of the S&P change, we've got interest rates which would be probably similar in both. You've got FX, which would be similar in both. But then you also have S&P changes in the quarter, which don't exist at all in SST. So I would guess that the impact on SST is somewhere between two-thirds and three-quarters of the movement that you're seeing on the rating agency version. I don't have the precise number for the half-year, but the SST would be well above 200%. I think we reported at the end of - we reported the internal capital adequacy at the end of 2009 was about, from memory, about 240, a bit less than the - I think it's probably come up. It's probably come down slightly again in Q2. It's probably roughly around where it was, maybe slightly lower. I wouldn't expect to see a significant change.

On the nat cat premium side, the nat cat impact in this quarter is 6%, and there's two pieces to that. So there's the change that we're making this year compared to the change that was in last year, because of course we refine these one a fairly regular basis. So the full spreading impact will not be the full 6%. Again, I haven't got the full figure in front of me, but I guess it's going to be something like three-quarters of it, and probably most of it will move into Q3, maybe some smaller impact on Q4 and Q1.

Spencer Horgan
Deutsche Bank

Okay. Thanks.

Susan Holliday

Okay. Thank you. Can we take the next question, please?

Operator

William Morgan from Goldman Sachs has the next question. Please go ahead.

William Morgan
Goldman Sachs

Hi. I just have one question, please. It kind of relates to what you've been saying about the Life Re business, because I guess it wasn't that long ago that I think you were pointing to around a 300 million quarterly run rate. That seems to have come down now by about a third or so in recent quarters. I mean, given this very low interest rate environment and the effect it's clearly having on your results, what is your optimism, really, for being able to achieve a 12% ROE in the near term, so let's talk about the next one to two years?

I think you have mentioned in the past some potential business opportunities that will come, going forward, from Solvency II, etc., but I guess this is to some extent at best speculative. So when you're thinking about your capital and the way you use it, what are you thinking in terms of the potential for capital reallocation, longer term? Is that necessary in order to make your return goals for the foreseeable future? Thanks.

George Quinn
Group Chief Financial Officer

Thanks, Will. Yes. So, on the Life Re, in my own modest defense, I did mention the 300 when interest rates were much higher, although I appreciate that it has come down quite a bit since then. On the ROE target, if interest rates remain at these very low levels and we remain in this relatively weak part of the cycle, it's going to be a huge struggle to achieve a 12% ROE. But we didn't set the target for any particular quarter, or for this particular phase of the cycle. It's designed to be an over-the-cycle target.

And so I'd expect that, in due course, we would see some improvement both on the asset side and on the insurance side. The near-term versus over the cycle, beyond this I think, when I announced the ROE target, I tried to at least guide people that 2010 would continue to be a year of transition. So we didn't have significant expectations we'd achieve 12% ROE, but we did want to remind investors that we take seriously our responsibility to try and return a reasonable amount on the capital they've provided to us.

2011, it’s not here yet, but I would say that - of course we will have one technical GAAP issue that everyone needs to be aware of, we firmly expect that we’re going to have the retention of the CTCI and the premium that we pay on the CTCI will run through earnings next year. So people love to look through that what they’re measuring the ROE. But of course our ability to achieve it will be at least partly dependant on some improvement in the asset market, although no significant shift in our asset allocation. And hopefully (inaudible) a more positive environment on the business front.

William Morgan
Goldman Sachs

The question I was going to ask, actually the question is more philosophical one. Clearly I can understand that in this environment it’s very hard to make 12% ROE. But obviously if you’re also committing to trying to at least achieve as best you can in the near term, that might prompt you to actually return capital perhaps more quickly than if you are perhaps going to keep your private life when and if the cycle eventually return. I just wondered how you kind of balance keeping your powder dry versus trying to maximize returns near term when thinking about capital allocation.

George Quinn
Group Chief Financial Officer

If you look per capital management which (inaudible) and I would view that let me set the target. It’s absolutely clear that if the market remains - market, I mean, called insurance markets, if they remain at these levels, we’ll have to do more (inaudible) on the money if we have any reasonable expectation of the coming 12 ROE.

Again just to reiterate what I said on the Q1 call, I don’t expect that we’ll do anything of a capital management other than dividend before we get to the redemption. At post-redemption we still have significant excess capital on our hands and we cannot find a way to deploy return levels that would drive us toward the ROE than we have to explore ways to return it shareholders and we know the various techniques that would be used to do that.

William Morgan
Goldman Sachs

Thanks.

Susan Holliday

Okay. Thank you George, could we take the next question please?

Operator

We take the next question from James Quin from Citigroup. Please go ahead.

James Quin
Citigroup

All right. Three questions please. First one is on the deterioration of your assets, George you mentioned you are at 90% of the underlying duration, I think we can now square that with the fact you have got $49 billion of cash and short-term assets on your balance sheet. So I - perhaps if you could help around that, because frankly, most of this problem seems to me a self-inflicted problem, which is the call you made on bond yields as opposed to something structurally wrong with the business. And essentially, from that perspective, it's a voluntary decision.

The second question is on Admin Re. And I think the fact that Admin Re is making no money, I know you mentioned that it's because of the fact that there is investment income which you don't allocate to this unit, but it's not exactly obvious to me that there is a pot of investment income sitting somewhere else in the business which we should include in the Admin Re returns, given that obviously if you look at the Asset Management business investment yield and you net off the allocation there's not much left.

And I suppose the other question here is really, I think, twofold. Firstly, if you've been doing ALM properly, then I don't think you'd be faced with this problem. I don't know if that's true or not. But the other side to this I think is that this business was really (inaudible) to investors as about capital and efficiencies, but it now looks as if it's simply about taking spread risks. And if that's the case, then why do you think investors would like you to allocate more money to this segment, because it's far from obvious, (inaudible) what it's making at the moment, that this is actually the business that we all thought it was? Thank you.

George Quinn
Group Chief Financial Officer

So, on the first one, I don't know what calculation you're trying to do to work out key rate durations, but I see the detail of where the firm sits as far as any mismatch is concerned at the short, the middle and the long end of the curve. My guess is that maybe there are some things that you haven't factored into the analysis.

So, for example, I'll need to have a fairly large amount of Swiss francs on my hands at some point, March or later next year, to deal with the redemption [ph]. And we're not sitting with that and risky assets, currently. We've ring-fenced that in anticipation of what will take place next year and on top of that, of course, we have surplus.

Traditionally, Swiss Re's benchmark for its surplus is cash, again, to avoid that we end up turning into a benchmark investor and that we continue to focus on absolute returns.

Now, of course we could move the surplus largely into risky assets, but that doesn't make sense to me, and I don't really think that that's what investors are pushing us to do at the moment. So I think you're looking at the total asset balance but ignoring the liability, the pure liability component of it, which of course is not equal to 100% of the asset side.

On the Admin Re topic and this issue of how it's been sold in the past and the opportunity that it offers in the future, the - when we look at Admin Re, and when we've looked at it in the past, we've measured the returns against our own economic model. So we look at the traditional way the industry views it, which is IRR, which is the spread model you've described. But we've also looked at it against our own proprietary model, which is the one without spread risk embedded in it.

Now, of course, what's changed in between is that we've in some areas de-risked part of the portfolio, because of a concern that we might take significant losses. That's had negative impacts on the capital requirements, because of the way the statutory models work. And that substantially reduces the expected returns, either on an economic basis or on an IRR basis for the business. But it doesn't change the way we look at any individual transaction going forward.

We have an ROE target, and we normally look at this ROE target, which of course is a non-risk-adjusted GAAP measure, which of course would lead you back to that spread risk model for - well, not only Admin Re but Life & Health in general. But we also look at the economic returns, i.e. the risk-adjusted ones. And we're not going to risk capital in the Admin Re business unless we can get the right returns to take us towards the GAAP target, but also ones that meet the economic hurdles that we impose upon all the businesses, whether it's

Admin Re, Life & Health, or P&C.

James Quin
Citigroup

George, I hear you, but on the cash point, of that 49 billion, you only need (inaudible) to pay back Berkshire Hathaway, so there's still another 46 out there. Now, I don't think anybody's suggesting that you invest all of that in risky assets, but it seems to me that you've opted to take an enormous ALM well, maybe it's not an ALM mismatch, but it's certainly a - to run a very large cash weighting. And that's actually what's causing you most of the pain now. (inaudible)

George Quinn
Group Chief Financial Officer

To be honest with you, that's just wrong. So 3 billion is the smaller piece, but the economic net worth of the firm, which of course is a key component that you take away before you start looking at ALM on an economic basis, we reported that at the end of last year it has been $28 billion. So where would you like that piece to be?

James Quin
Citigroup

No, it's the fact that you've got 49 billion of cash on your balance sheet, and I'm not sure that the 3 billion is much of an explanation as to why you've got 49 out there.

George Quinn
Group Chief Financial Officer

I guess what I was trying to say was, take the three, I agree, that's straightforward and clear. But the (inaudible) surplus is a huge number, and that will be in there too and that's closer to 30 billion.

James Quin
Citigroup

Right, okay. So basically your NAV, then, for want of a better word, that's going to be invested in cash for the foreseeable future?

George Quinn
Group Chief Financial Officer

Well, it won't always be, but our benchmark is cash, so we - obviously, in prior lifetimes we've made the mistake of thinking that we were a benchmark investor, and if you can beat the FTSE or the SMI or the S&P it was a great outcome. But that was a movie that didn't go well. So we apply a cash benchmark for the asset managers, and we apply the same economic approach that if they deviate from that benchmark they get charged the capital costs, which of course is what shareholders will expect us to return to them if we're going to have risky assets on the balance sheet.

James Quin
Citigroup

Okay. All right.

Susan Holliday

Okay. Thank you, George. Can we move to the next question, please?

Operator

William Hawkins from KBW has the next question. Please go ahead.

William Hawkins
KBW

Hi. Thanks very much. George, I just wanted to test you on your comment about the de-risking of the Legacy portfolio, how comfortable you are with that. Can I be plugging in zeroes from here? And if the answer's no, can you give an indication of sort of what are the areas that could lead the figure to not be zero?

George Quinn
Group Chief Financial Officer

I didn't - you said plugging something. I didn't catch plugging what, though. Plugging's a bad word.

William Hawkins
KBW

Sorry. In terms of the Legacy Division, if you said you've almost done the de-risking, does that mean I can assume no more losses from here, that the result will effectively be zero? And if the answer's not, can you just give an indication of what are the risky areas that you still need to work through?

George Quinn
Group Chief Financial Officer

So, on the P&L point first, the - I think that we'll move away from the segment reporting, I think when we're happy that there isn't any significant or material exposure. We're not going to get to a precise zero. But what I don't want to have is that the quarter after we change the disclosure, that all of a sudden I'm explaining why treasury has a large movement because of Legacy. I think that the - if you look at the components of Legacy that are left, from an unprotected exposure there's still a small chunk to securitize, but that will run off very rapidly. I think that the thing that we're still focused on, the thing we devote most of our time currently to, is something we've talked about previously on these calls, and that's on the credit correlation book, which I see more as an operational risk issue.

So without getting into the detail, because it would be market sensitive, we're exploring options to establish a long-term solution for the credit correlation book. And I think we'll probably have that done by Q3. I think if we've got that done, then I think I'd be happy that absent some very unexpected, very significant market turbulence, that we'd be at a point that zero would be a good enough average guess for Legacy. But we will have some volatility still in Legacy in the future.

Susan Holliday

Okay. Thank you, George. Could we move to the next question, please?

Operator

Brian Shea from Bank of America/Merrill Lynch has the next question. Please go ahead.

Brian Shea
Bank of America/Merrill Lynch

Hi, good afternoon. I have two questions, please. First of all, on reserve movements, in the past, George, you've shied away from talking about what's happening on a gross basis. But I think you did promise to update us once you got close to that border. I forget if it's 2 billion or 3 billion at which - that border which reserve releases began once again to accrue to Swiss Re. And I just wondered if you could comment are we getting close to that border yet? That's question number one.

And then the second one is, when you were giving all the investment yield metrics, I think you suggested that the 4.4% running yield on fixed income was probably the best metric to look at as a (inaudible) that could recur. 4.4% still seems awfully high to me, though, in the current environment. And I just wondered if you - if I heard that correctly. Perhaps you could actually say at what yield are you investing new money at the moment? Thank you.

George Quinn
Group Chief Financial Officer

So, on the reserve movements, the - I did promise to update if we came close to the borders. So, just to remind people how this thing works, we've essentially paid 2 billion for 5 billion of protection. The accounting is asymmetric, but I think you guys probably know that, and if you don't you can explore it at your leisure. So on the way down, to the extent that we have positive development, we cede [ph] that directly to the ADC for the first two. So we'd have to be close to 2 billion of positive development before I would start to give you more guidance. And I think that I wouldn't do more than I did, but I think in response to Will Hawkins' question. I think it was on the full year, maybe it was on Q1. And all I would venture for the time being is that we have positive development that we're ceding to the contract, but we're still a good distance away from any of the borders.

On the investment yield, the - it obviously depends which asset class we're reinvesting in. If I look at the major changes in the quarter, I'll go back probably to the discussion I had with James earlier, we've made a reasonably substantial reduction in the short-duration position in the quarter. So even though we're probably not investing at 4.4 overall, it does push the running yield of the portfolio up.

We also - something I mentioned to the media earlier today, one of the decisions we took in the quarter was to move out of TEPS [ph]. We made a decision back in, I think it was August of 2008, but because of our concern of inflation exposure on the liability side, that TEPS looked like the best, albeit relatively imperfect, solution to that problem.

The ADC that we have has changed that dynamic and so we have spent some considerable period looking at the inflation risks, and we came to the conclusion earlier this year that we're actually happy with the protection that we get out of the ADC and therefore the TEPS position is no longer required. So, again, we've traded out of that. And you'd probably have a similar dynamic to the short duration move.

And then, finally, we have probably towards the end of the quarter - and so it probably hasn't had a particularly significant impact yet, and it won't because it's a small allocation change that we have looked to add some corporate bond exposure. It's not a huge amount. But I guess if you look at the main portfolio that we would carry that and it would probably be the US, and US high grade, I don't know, somewhere 4.5-ish, that type of level. So you've seen a fairly small move, but those are probably the three main drivers.

Brian Shea
Bank of America/Merrill Lynch

Okay. So do you - it's very hard to make this math work, but even if you are investing at less than 4.5, 4.4%, do you feel that that's a good sort of yield that you can be showing going forward?

George Quinn
Group Chief Financial Officer

I'm not sure I understand the question, Brian. So even if we were investing it lower than 4.4, that 4.4's a good yield? Is that what you were asking?

Brian Shea
Bank of America/Merrill Lynch

Yes, is that standard can be posted going forward?

George Quinn
Group Chief Financial Officer

Yeah, so the - I'm not making - the 4.4 wasn't a forever commitment.

Brian Shea
Bank of America/Merrill Lynch

Yeah.

George Quinn
Group Chief Financial Officer

So the 4.4 is where we are. Obviously, if yields stay low, so if we're still at 290-something on the US 10-year, this number will come down, but it will come down for the entire world.

Brian Shea
Bank of America/Merrill Lynch

Yeah, okay. Thank you.

Susan Holliday

Thank you. Operator, can we take the next question, please?

Operator

Andrew Ritchie from Autonomous Research has the next question. Please go ahead.

Andrew Ritchie
Autonomous Research

Hi there. Two very short questions. First of all, on the movement in excess capital, could you just give us a bit more color? You mentioned there's a model change impact, obviously the interest rate impact and FX impact. If you could just give us any sense of the relative quantum of those three elements, that would be useful. And secondly, in the Life profit, sorry to go back to this again, just trying to understand if there's any other sort of noise factors that you could give us color on in the second quarter. Was there, for example, an issue with the mark-to-market of, for example, Berkshire Hathaway CDS, given they are - (inaudible) a lot of business with them the beginning of the year?

George Quinn
Group Chief Financial Officer

I was listening carefully to the second. I've managed to forget what the first one -

Susan Holliday

The first one was about movement in excess capital.

George Quinn
Group Chief Financial Officer

Oh, sorry. The size of the relative, roughly speaking, Andrew they - these are the three largest. They probably explain about three-quarters or more of the total movement and they're not quite even, but they're not far away from it. So, about one-third each would be the way to think of it.

Andrew Ritchie
Autonomous Research

Those interest rates, FX and model change?

George Quinn
Group Chief Financial Officer

Correct. On the Life profit topic, there is impact, CVA, DVA, so there is a mark-to-market impact because of the spreads of people that we've bought protection from. But equally, in the quarter we've got again that fabulous impact that comes from the deterioration of our own CVAs over the quarter.

So you probably end up roughly back in a similar kind of place. The overall VA piece is positive, if you look at the underlying components, the problem is, I can't pick out a big theme for you. I look at a long list of individual movements.

Andrew Ritchie
Autonomous Research

Maybe just to understand, because obviously, given your duration and then giving what you've said in answer to the previous question about the relative stability and running yield, do you think there's an allocation issue here in terms of the underlying economic running yield of the Life business is not declining as much as you're effectively allocating it. Is that the correct treatment, do you think? Or do you think you should look at that?

George Quinn
Group Chief Financial Officer

We've been discussing it. The problem we have here is that we've changed the investment income allocation, I don't know, probably three times since I've been CFO, and I haven't been CFO that long. And it's been changed several times before that. We never seem to find precisely the right answer. And I think we've found an approach that is okay, but might be slightly punitive to Life & Health and may exacerbate -

Andrew Ritchie
Autonomous Research

But it's going to overestimate the negative impact on the way down and overestimate any recovery on the way up.

George Quinn
Group Chief Financial Officer

Yeah, if the markets very, very volatile, I would agree. We'll have a look at it. I'm not going to promise a further change, but we will have a look at it.

Susan Holliday

Can I just - before we move to the next, can I just clarify something? The retrocession transaction in Life & Health that we entered into with Berkshire earlier on this year is a reinsurance transaction, and therefore it's not fair valued, and it has - so it has nothing to do with credit spreads.

George Quinn
Group Chief Financial Officer

No, but I assume that Andrew was talking about a different part of the Life & Health book. Andrew, you speak for yourself.

Andrew Ritchie
Autonomous Research

Well, I thought there was an impact from the deal with Berkshire, as in if their spreads widened you would have a negative mark-to-market for your Life result.

George Quinn
Group Chief Financial Officer

In which case, I answered the wrong question with the right answer. So Susan is right that on the retrocession deal, reinsurance accounting generally benefits from the fact that you're not expected to include the impact of spreads. Spread only appears in the fair value world. So where we've got fair value protection, i.e. derivative protection, it will impact the value of that.

Andrew Ritchie
Autonomous Research

And on that basis, there was some, okay, you said it is always offset by your own credit spreads. All right.

George Quinn
Group Chief Financial Officer

Correct.

Susan Holliday

Okay. Thank you. Let's move to the next question, please.

Operator

Jean-Francois Tremblay from RBS has the next question. Please go ahead.

Jean-Francois Tremblay
RBS

Hey good afternoon. I have two questions. First of all, regarding the outlook for Life Reinsurance, I'm looking for a guide post, essentially. We used to talk about potentially 300 million in run rate. Now we're down to 200 million. Yes, there's been a change in interest rates. But what can you say around the duration of your liabilities, assets, in that part of the business, to help us better understand to what extent a change in interest rate is rapidly or gradually reflected in those results? That's question number one.

And question number two is regarding the P&C business. In your presentation, you highlight the fact that your price adequacy is 3 percentage points better this year, year to date, than last year. How would you quantify that price adequacy? So can you put some additional numbers around that? Or do you think you'd guide 60, 50% on the price adequacy? So, it would be quite helpful in better understanding the profitability of your book overall.

George Quinn
Group Chief Financial Officer

So, on the first one, the duration of the liabilities on the Life side is eight years. On the second one, I'm not going to quantify the absolute number for price adequacy. You can imagine that, maybe you can't, but the - if you can take my word for it, the overall adequacy for P&C is above the level required for that business to return the target return on the capital allocated to it. So P&C, even though I guess we have that soft market issue currently, the business is actually performing pretty well.

Jean-Francois Tremblay
RBS

Okay. On the Life side, so - assuming you've got this eight-year duration of liabilities, but with such a long duration of liabilities one would not expect, obviously, to see such a rapid change in underlying earnings as a result of the change in interest rates.

George Quinn
Group Chief Financial Officer

Which I think is right, which I think was at the heart of Andrew's prior question.

Jean-Francois Tremblay
RBS

Regarding the other parts in the allocation?

George Quinn
Group Chief Financial Officer

Yes, so - excuse me. This is a strategic point to lose my voice, but the - all right, we'll have a look at it and we'll come back. I think that we'll try to get something that's stable and more predictable. We didn't anticipate a fall in interest rates of this kind of magnitude. But we'll see if this is something in the model that we hadn't anticipated. And if we find something that's relevant, we'll come back to you.

Jean-Francois Tremblay
RBS

Thank you.

Susan Holliday

Okay, can we take the next question, please?

Operator

Marcus Rivaldi from Morgan Stanley has the next question. Please go ahead.

Marcus Rivaldi
Morgan Stanley

Hi good afternoon. Quick couple questions, please. First, could you give us some more color, please, on your July renewals performance, and particularly comments around the casualty market? It's interesting your comments are almost directly opposed to a major competitor with their views on growth in casualty at the renewal season, rather than yours pulling back slightly.

And secondly, given you (inaudible) up, George, as being a particular area of concern about the credit correlation book, I think notional at full year, and this is a Swiss franc number, I think we were about 34 billion notional down from sort of peaks of over 120. Could you give us a sense of - update on where that is today, please? Thanks.

Stefan Lippe

Yeah, Stefan Lippe speaking. So, in the renewal season, we have to see that the July renewal is mainly driven by the property renewal in the US, the nat cat renewal, and some of the Australian business which is showing up in July. So, compared to past years, the reduction in our business or what we haven't done in Casualty was very, very low. So there was not big shift in between Property & Casualty. It was rather than on the Property side to pick the better parts in the programs. So you can say that the shift from Casualty - out of Casualty to Property was rather very benign. It was existent, but rather benign. And you have seen the top line was at the end of the day even stable, even if it was a little bit more in non-proportional business, which usually has less top line than proportional.

And perhaps one point, perhaps also in answer to a question (inaudible) asked, to this yield. If the yield in the financial market is going up, this will of course change also what we underwrite, because for us the underwriting is not driven by combined ratio only. We take the economic return on Casualty & Property. So if yields would go up in the market, even at same combined ratios, Casualty business suddenly is getting economically better, which might mean that we grow in Casualty more significantly than in Property. It might even mean that the combined ratio goes up but overall, including the risk-free yield we allocate to the business, it makes a lot more sense from the economical point of side.

So it's not independent path, the yield development in the market and the combined ratios. And gives you perhaps an indication what you have to expect, if yields might return, concerning our appetite on the Casualty business.

George Quinn
Group Chief Financial Officer

Marcus, without being terribly specific on the credit correlation point, again, because we're active in the markets at the moment, I mean, active trying to find a solution, just to make sure there's no misunderstanding.

There's actually a lot of disclosure in the footnotes to the financials and there are tables on notionals, fair values and maximum potential payouts. As you can imagine, given the nature of the products, credit correlation would account for the bulk of that disclosure, at least for the credit piece of it. So that part's a good guide to where credit correlation stands.

Marcus Rivaldi
Morgan Stanley

Okay.

Susan Holliday

Okay, thank you, George.

Marcus Rivaldi
Morgan Stanley

Can I just have a quick follow-ups, on the renewals? Just that 8% pending, would you expect all of that to renew, or would you expect only a portion of that remaining 8% to ultimately convert into renewed premium?

Stefan Lippe

Usually what we put in pending is the expected value we assume to be then done at the end of the day, and looking backwards it's usually very good estimates.

Marcus Rivaldi
Morgan Stanley

Okay. Thank you.

Susan Holliday

Okay. Thank you. So, operator, we'll take one more question, please.

Operator

Our last question comes from Fabrizio Croce from Kepler. Please go ahead.

Fabrizio Croce
Kepler

Hello. I have very easy one, actually, there are two. One is about the direct return in H1, and how it compares against H1 last year? So it's actually two figures. And the second one, if you could give some detail on your investment portfolio, which means how is your attitude, I mean, we are in a low interest rate environment, and so how is your attitude changing towards real estate, inflation-linked bonds? And if there are changes there or you are still very conservative on those asset classes?

George Quinn
Group Chief Financial Officer

On the first one, Fabrizio, I apologize, but I haven't done any real preparation on half one versus half one. But there is in the Q1 report, again in the footnotes, there are six-month summaries. Again, if there's a specific thing you can't find there, you can ring Investor Relations and they'll try and help answer the question. So, apologies for that.

On the investment portfolio, we're not planning any substantial shift. I've described some of the relatively modest changes we've made in terms of asset class in the quarter. At the Investor Day, we had talked about the fact that we may add a modest amount of corporate bonds. We may also do something similar on equities. But by historical standards, these would be very, very small allocations to those asset classes. So you wouldn't - I don't expect that you would see any significant or sudden shift in the investment portfolio.

Fabrizio Croce
Kepler

Sorry, a follow-up in terms of duration. Are you planning a lengthening, a shortening, or what are you doing, exactly, on duration?

George Quinn
Group Chief Financial Officer

In the quarter, you've seen us reduce the level of short duration. So we have lengthened the asset duration to come back closer to the liability duration.

Fabrizio Croce
Kepler

Okay. And this will continue during the year, so we will see this until - so this is something which will be continued, or is it now finished? Are you at the level satisfying to you?

George Quinn
Group Chief Financial Officer

I think under normal circumstances we would look to be matched. So being away from matched, either up or down, would normally be a temporary phenomenon.

Fabrizio Croce
Kepler

Okay. Thank you very much.

Susan Holliday

Okay. Thank you, George, and thank you very much, everyone on the call, for listening.

If there are any other follow-up questions, please give me or one of my colleagues in Investor Relations a call and otherwise, I'd like to wish you a good afternoon or good morning.

Thank you, operator; that concludes the call.

Operator
This will conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.