S&P Global
Market Intelligence

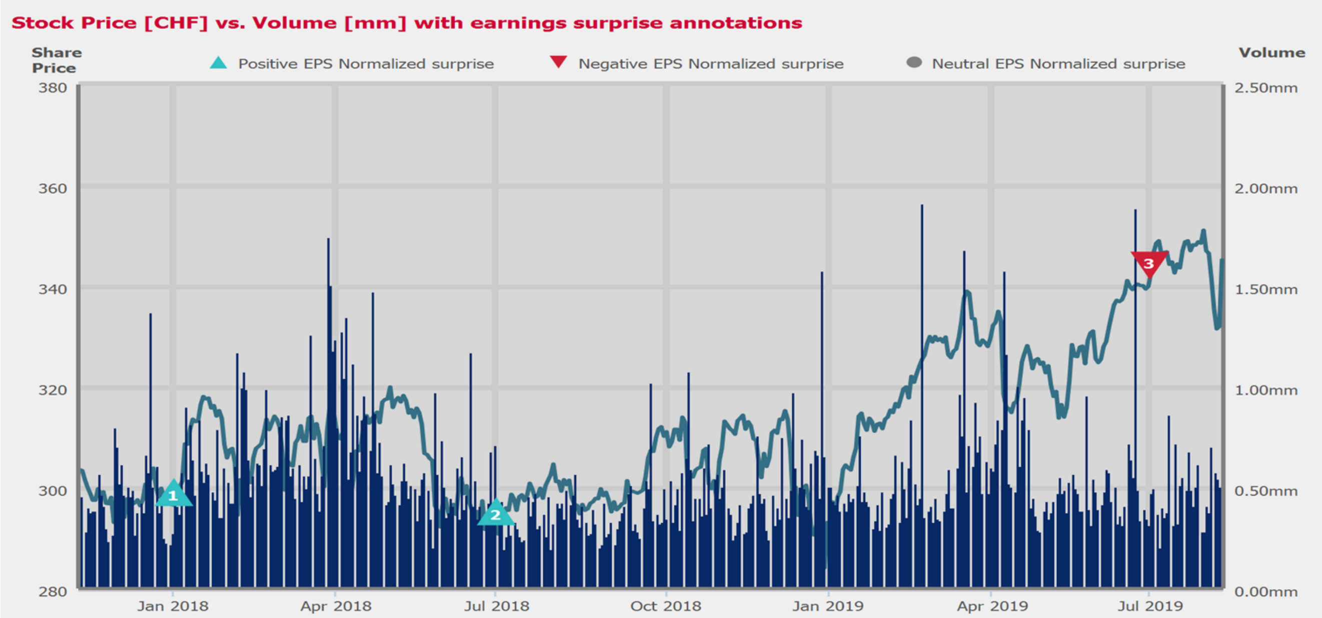
Zurich Insurance Group AG SWX:ZURN
FH1 2019 Earnings Call Transcripts

Thursday, August 08, 2019 11:00 AM GMT

S&P Global Market Intelligence Estimates

	-FH1 2019-	-FH2 2019-	-FY 2019-	-FY 2020-
	CONSENSUS	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	14.90	14.93	27.12	29.62
Revenue (mm)	26510.48	-	48763.20	50059.45

Currency: CHF
Consensus as of Aug-08-2019 8:43 AM GMT



	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FH2 2017	7.02	9.67	1 37.75 %
FH1 2018	11.50	11.57	2 0.61 %
FH2 2018	-	-	-
FH1 2019	14.90	13.67	3 (8.26 %)

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Head Investor Relations & Rating Agency Management

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Autonomous Research LLP

Farooq Hanif
Crédit Suisse AG, Research Division

James Austin Shuck
Citigroup Inc, Research Division

Johnny Vo
Goldman Sachs Group Inc., Research Division

Jonathan Michael Hocking
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Vinit Malhotra
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William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

Presentation

Operator

Ladies and gentlemen, welcome to the Zurich Insurance Group Half Year Results 2019 Conference Call. I'm Sandra, the Chorus Call operator. [Operator Instructions] The conference is being recorded. The presentation will be followed by a Q&A session. [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 and Rating Agency Management. Please go ahead, sir.

Richard Burden
Head Investor Relations & Rating Agency Management

Good morning, good afternoon, and welcome to Zurich Insurance Group's first half 2019 Q&A call. On the call today is our group CEO, Mario Greco; and our Group CFO, George Quinn. Before we start with your Q&A. Mario will make a few introductory remarks to the results. Now when we come to the Q&A, as always, we just ask you to keep to 2 questions in the first around, and if we have time afterwards we'll come for a second pass.

Over to you, Mario.

Mario Greco
Group CEO & Member of the Executive Committee

Thank you, Richard. Good afternoon to all of you, and thank you very much for being on the call, especially since we are in the middle of August, almost. Before we get into the Q&A, let me try to provide a few remarks about our performance and where we stand today. In '16, as you remember, we set ourself ambitious targets. And we launch a new bold strategy. The first half results show that the strategy has delivered. And we're on track to exceed all of our targets. Our BOP has reached the highest level in the past decade, and our BOPAT ROE of 15% shows the significant value that we are creating for our shareholders. The performance of our Property & Casualty business has been very strong with the business showing growth in gross premiums and improved underwriting performance, with still very low volatility. The strong improvement in the accident year combined ratio before natural catastrophes clearly shows that the actions that we have taken to change the mix of the business and to improve the quality of the portfolio were the right ones. This is especially the case in our commercial business, where discipline and focus has driven significant improvement in profitability in contrast to what many have reported.

Looking forward, we see further opportunities to improve the results. And we see the current upturn in U.S. pricing as supportive of the future performance of our business. Our life business has continued to perform well in the first half, with underlying growth continuing and with headline results held back only by the strengthening of the U.S. dollar. The high quality of our life portfolio and our long-term focus on protection in unit-linked savings positions, position us as well to manage the ongoing challenge caused by the low yield environment.

BOP farmers are both our own business and the policyholder on the Farmers Exchanges have continued to grow successfully in the first half of the year. Particularly, the Exchanges have continued to build successfully out their presence in the Eastern United States and they also expanded Toggle, their innovative offering for millennials to over 20 new states. Our balance sheet remains extremely strong with our solvency above the top end of the target range despite the impact of falling yields and the absence of the dampening mechanisms available to peers reporting under Solvency II. Over the first half of 2019, we continued to develop our strategy, and we strengthened our business through the addition of new partnerships and new and innovative product offerings across a wide range of our businesses. Our innovation has also gained external recognition. The group had won a number of awards over the first half of the year. And this is, of course, quite relevant for all of us. These results and developments give me great confidence for the future of the group and our positioning for the next phase of our development, which I look forward to presenting to you later this year.

Thank you for listening and now ready to take your Q&A. And George and I will respond to all your questions. Back to you.

Question and Answer

Operator

[Operator Instructions] The first question comes from Jon Hocking, Morgan Stanley.

Jonathan Michael Hocking
Morgan Stanley, Research Division

Two questions, please. Could you comment on what you're seeing in terms of large loss trends? And if it's anything that [indiscernible] of an underlying pattern there? This is the first question. And then secondly, in terms of the trends we're seeing in U.S. pricing, are any of those sufficient yet to change your appetite for particular lines of business over and above others that you've been maybe some of the things you've been deemphasizing?

George Quinn
Group CFO & Member of the Executive Committee

Jon, it's George. You'll probably remember last year that we resisted the temptation to get too deep into large loss topics because often we hear that as a reason why businesses haven't achieved the targets they've been given. I mean I think the good news for us is that we haven't had that commentary internally. I think though if we do break down the numbers, I mean, the outcomes that you see in the first half of this year aren't driven by an absence of large loss. We see more of the improvement driven at the smaller end of the spectrum, so we are still seeing large loss. In fact, if anything, slightly higher than our current expectation. On your other question on U.S. pricing. Maybe it's good to just mention where we see U.S. pricing so that we'll all be on the same page. I mean, if you remember, the commentary from Q1, I talked it was the fact that, I mean, overall, for North America, I gave quite a bit of detail. We were slightly north of 2, slightly north of 4 rather ex workers' comp, we were right at 6, if that's a particular measure you like. Overall, things are stronger in Q2. We see things getting quite close to 7% for all lines of business. So with that change of appetite, I mean, I think for us, it was actually rational how we set targets. I mean so for the business, where they see the right levels of return, they can rate the business, for sure. And I'm sure that this will take some business at the margins that previously we would not have written and it will took into places where we would rate it. I think on portfolio that for me is a different topic. I mean we are trying to shape the portfolio. I think that topic will continue, but certainly, the improved profitability in the market overall will increase the opportunity for us in commercial.

Operator

The next question comes from Peter Eliot, Kepler Cheuvreux.

Peter Eliot
Kepler Cheuvreux, Research Division

The first question is, the obvious one just revisiting that accident year combined ratio ex nat cat. I appreciate, George, you don't want to sort of go too deep or overanalyze that the large losses. But I was wondering if you could just give us your view on sort of how much of that improvement is sustainable? And to the extent that it's come from sort of pricing improvements and portfolio actions. I mean those have been ongoing, should we expect another similar improvement over the next 12 months? Or is that certainly sort of bullish? Secondly, I was wondering if you could just give a bit more clarity on granularity, sorry, on the 8%, is that ECM increase from business profit? Because I guess that's a, what 2.5 points higher than the sum of net income contribution, so that would be great just to understand like the contribution from new business and any other moving parts?

George Quinn
Group CFO & Member of the Executive Committee

So on the first one. So sustainability. So maybe I'll do a very high level first, and then I'll go into some of the factors that will drive what we see now or have gotten what we see now will drive what we see in the future. So the obvious thing that you can isolate in the first half results is the impact of cat. We're about 0.7 points beneath where we would expect to be, given where we price things. And we don't assume that, that is a structural change, so if you adjust for that, we would see the underlying closer to 96%. If you look at what do we expect for the future. So I mean I'd love to be as optimistic as the second part, your first comment implied. I think the -- I mean clearly there's a rate environment out there, it's going to be -- this will continue to be very constructive. I mean I mentioned earlier in this response to Jon's question that we're seeing acceleration of rate into Q2, so just to be clear, inflation, lost cost inflation, Europe and U.S., were, I mean, [indiscernible] most for us in the short term, we're not seeing any significant change. It's slightly higher in the U.S., but I'm talking 10 basis points. So overall, that should start -- the rate net of most cost inflation should also continue to feed into the results. But equally importantly for us, there's a whole shift taking place on terms and conditions, which I think is much harder to see. But actually, I mean, has the promise of something that will benefit us for a period that's longer than simply the typical 12 months that we'll have the contractual relationship than any one of these individual policies, so I mean we see things like attachment points are moving up. Line sizes are coming down and more business through wholesale channels where rate is probably even stronger on commercial, auto in the U.S., significant changes in deductibles with the continuation of the rate. I mean I could go on and on. There's a whole series of factors and features. But I think they are very helpful from a terms and conditions perspective. Be aware that other things will go the other way. So I mean we have crop in the second half. Crop is a higher loss ratio business. This will certainly not be as positive a year for crop as we had last year for the reasons I think you all know about from what you've seen in the first half.

But I mean I think you've had from the guidance that we've given already that -- I mean we've guided you all to expect something around 96%, something combined for this year given the performance in the first half given the expectations we have for the second. We expect to be a bit better than that, so something between 95% and 96%. On the Z-ECM topic, I mean there's always a number of moving parts. So I mean, I guess, you've seen the key features today, so we've got business profit generation of 8%. That's probably close to a couple of points higher than you would normally expect to see from us. Dividend accrual at 4%, we don't go about 7% for the market movements, and that's mainly interest rate driven and then a bunch of smaller stuff explain the rest. I mean there are always differences between the reported IFRS profits and the impact that you see in the economic view, typically, more of those come from areas like life, but the picture can be quite different in terms of -- I mean the almost always immediate recognition of new business value versus the spreading forwards of profit under IFRS. I mean, equally, some of the things that we did to reduce risk around some of the legacy parts of the portfolio. I mean that also has a positive impact. I can't give you a very scientific, very detailed explanation. But I mean, broadly, those are the main drivers.

Operator

The next question comes from Andrew Ritchie of Autonomous.

Andrew James Ritchie
Autonomous Research LLP

A simple one, I think, hopefully, to start with, the one part life contribution, I think, in the notes to the financial accounts it says USD 29 million pro forma for the first half. That seems quite low versus the original expectation. Maybe you could just update us on what's going on there? I guess there's some noise in relation to OnePath. What -- are there any implications of some of the recent legislation that's been passed post the Royal Commission update, for example, I think, Protect Your Super legislation. Does that have any impact on the outperform path?

The second question is, sorry to return to this topic of loss trends. I guess, you are, I think, actually, the only global commercial lines insurance in the first half that's actually achieved an underlying attritional improvement year-on-year across the U.S. and Europe because everyone else has reflected issues of particularly social inflation rather than classical loss cost inflation to do with litigiousness, et cetera. What additional work have you done in the first half in the U.S., in particular, on looking at issues of social inflation in general liability, commercial auto, professional lines where there's been many of your peers adjusting a real step change in claims trends?

George Quinn
Group CFO & Member of the Executive Committee

The first one, so frankly I was actually down in Sydney last week. I met with the team to go through the completion balance sheet and also to look at the planning for next year. So maybe I'll start with the headline summary. At this stage, we anticipate an outcome for 2020, that's at or around the level that we indicated in the presentation that we published when we announced the one past deal back in December of 2017. And from memory, that was around USD 200 million, so that's still our expectation today. Of course, where we're starting from is a bit different, certainly from a position that was the position then. Certainly, the DI issues in the local market. I mean we see it in our own book on the Zurich side. The key thing here is, I think, when we talk about the strategic reasons for the one class transaction, we point at a number of market features and factors that we liked. I won't get into all of them on this call, but I think we've talked about the fact, I mean we've acted in the past in Australia to address weaknesses or shortcomings, and we continue to be confident that we can do the same in this portfolio and drive the outcome that we committed to when we announced the transaction. I mean there's a whole bunch of issues. I mentioned DI, you mentioned Protect Your Super, I mean Protect Your Super is absolutely a topic that will impact those that are more exposed to group. And I think, as you probably remember, from the -- you may remember from the December conversation of 18 months ago, OnePath is a bit less exposed on the group side of the market. Having said that, Protect Your Super will also have some knock on impact on retail. We don't expect that to be so significant, but there is a impact as trustees get pushed to make sure that you don't have duplicate cover or are not in a forced purchased position that will mainly impact -- but it will have some impact on retail. So for us, overall, the first 6 months of this year are not representative for a whole bunch of reasons. We're still confident we can drive the level that we committed to. The other thing to watch is, it will be a bit lumpy next year because we have to take some action around the portfolio. And of course, some of that benefit will flow once the action has taken place, so there'll be a tendency next year for that number to be a bit more back-end loaded than front end.

Loss trends. So the -- I mean it's -- I think I gave an answer to Peter, some of the things that -- I mean we see from a market perspective taking place. I think an overview, I think without being too arrogant is that these are not things that we started in the first 6 months, but we see -- maybe because of the general pressure on the market, there's more people following the changes that we've made. So I mean we look carefully at the trends around losses. I don't see in the data that we have, some of the things that you've heard and the commentary from the others. And I guess probably the main driver of that is that if you look at the last 3 years and you look for other ways in which we don't correlate with the market, probably the presence of growth is the obvious difference. You've seen us act relatively early in the cycle to deal with the challenges that we have. They started with some of the large loss topics that we talked about in 2015, Mario's pushed to get to reinvigorate underwriting and our willingness to give up market share, where the returns just didn't justify the capital allocation. And I think one of the things that we're happiest about today is the fact that you can really see the benefits of that in the commercial performance. So I can't analyze for you in detail, again, why we're not seeing this step change in social inflation that other people point to.

Mario Greco
Group CEO & Member of the Executive Committee

By the way, I think we have seen it. The point is that since we shrunk, the impact on us is reduced, and it doesn't make it as feasible as it was for the others. But we have been shrinking now since 3 years ago. And so it's -- everything is much more manageable for us than probably, it is for others to grow this because we see the same trends. But the impact is completely different.

Operator

The next question comes from James Shuck, Citigroup

James Austin Shuck
Citigroup Inc, Research Division

My 2 questions. I just wanted to return to the point around the attritional loss ratio at H1. So it's ex the PYD and ex D -- the nat cat. If I look at kind of previous half year periods, there doesn't appear to be any seasonality around that number? I mean I appreciate kind of second half of the year, there's more nat cat, but it doesn't seem to have been the case in the past and perhaps you've grown in crop a little bit more, so maybe the impact could be a little bit more of a drag this year. But I'm just trying to get a feel for really the 61.8% attritional in H1, even if that goes up a little bit in H2. Am I right in kind of interpreting that the improvement in rate and what you're experiencing on the plain side?

And the point you made about terms and conditions, then that is a pretty reasonable starting point from which we should expect it to continue to improve as we look forward. I guess there's a kind of related point around the net earned premium growth that you talk about in the presentation because you're guiding now towards a small reduction for full year. That was obviously down 5% at H1, so small reduction that to me implies that maybe we should be up a little bit in the second half of the year. I'm not sure whether that's FX-related or not. Clearly, that might have an impact on the attritional loss ratio as it runs through as well. So any help on that would be great.

Second question was around Farmers. The sort of tone of what you're saying with Farmers, it sort of -- it seems to be quite pleased with it. I look at the GWP growth though, it's up 2% on a continuing basis, and that includes the Uber partnership. Policy count is actually down in H1 versus full year and the largely business value, which was kind of meant to be a big push around cross-sell, ATE and new business value is also down, so could you just shed a little bit of light on why you're sort of quite -- a little bit more positive than I am on Farmers performance in the period, please?

George Quinn
Group CFO & Member of the Executive Committee

Thanks, James, so first of all, on the attritional, so no seasonality. And I think that's true in terms of outcomes. I think there are prices that I think as you think about from a planning perspective or a [head counting] perspective that you would expect some -- the 2 most obvious sources of it. You mentioned crop. So certainly in the last couple of years, the second half of the year has been a major beneficiary of -- in fact, I think, the last 3 years, we've done a major beneficiary of significantly better crop performance than planned. And I think I talked about it at end of the year, and I mentioned the fact that as we planned for this year, you were going to see about a 7 point change as we moved back to on a more normal crop outcome. I think crop will be slightly worse than that, given the challenges in the first half and the issues around planting. I don't think it will be a big issue, but the benefit we have from crop that one. That doesn't look likely to emerge in the second half.

I think the other thing is the presence of the -- well the peak nat cat scenarios in the second half. They do cause seasonality, but maybe not the reason you'd expect. I mean, obviously, we have a lot of reinsurance that's running through to cat protection. I mean the nature of that stuff is that if we have significant event, I mean very significant events, we get recoveries and if we have a more normal year, we don't get any. So I mean the reinsurance approach would tend to slightly penalize the second half in most years. So I think, you need to offset those 2 things against the other things that you mentioned on the positive side of the spectrum. So the improvement in rate, the terms and conditions. And I guess you called that a reasonable starting point, I would be far more bullish than reasonable. But the -- on the premium side of things, that's mainly FX that you're picking up, so it's been the headline number that underlying view. Of course, the actual outcome will be determined by -- I mean how the market develops, so though at this stage, might even fool you as what the shift in the second half. You're not going to see a big impact on earnings anyway.

Farmers, so why are we pleased with it. So I think the -- so from a management company first. So the fee-based part of the business. I think they're still going to do exactly what we expected them to do. And exactly, I think we've generally guided all of you guys to expect, so we did expect to see a bit more rates run through this year. We've had a bit more cat on the exchange side, so we don't see a significant shift today on the combined, I mean, if you compare the Farmers' technical profitability today to -- I mean just 18 months, 2 years ago, it's completely different. We do want to see them grow the policy count. We do want to see them expand more. It's a topic of discussion between us and them and how we can support them to achieve that. Let me -- I mean everyone on this call appreciates the value of Farmers and between us and the exchange, we're trying to manage this for the best outcome for both of us. If there's any hint of something that we would like to see improved, it would have been the thing that you commented on last. So on the life side, there's evidently more work to be done there. The things that you pointed to, the strategic priorities for us around cross-sell and the growth, we haven't seen it, we're not giving up on it. We expect the team to deliver it, but we haven't seen it yet.

Mario Greco
Group CEO & Member of the Executive Committee

But let me add something on this. We started a while ago discussing with Farmers and Farmers management, all these issues that you raised, plus some others. Things have started to change. Management has been reinforced. Actions have been changed and taken actions on the agency structure on the project investments on the cost basis. They're launching new products. We see these things. And so we're confident that by doing the right things, then the numbers will come through. I understand that you haven't seen yet the numbers as they should be, but we're confident that they will come, and we see the actions before they track the numbers, right? It takes always a bit of luck to get that, especially when you have an agency model and you have a rating business.

Operator

Next question comes from Kamran Hossain, RBC.

Kamran Hossain
RBC Capital Markets, LLC, Research Division

Just one question for me. Basically, if price momentum continues in the U.S., how does that make you think about reinsurance purchasing because of the actions you've taken over the last few years? Will you still seek to kind of manage volatility or if pricing improved considerably, will you then begin to kind of risk taking a little bit more of that business on your own balance sheet?

George Quinn
Group CFO & Member of the Executive Committee

Thanks, Kamran. I'm going to be very careful what I say now. So I mean, obviously, we expect to see the price momentum continue. And if -- I mean, we saw the price momentum start, I mean, before the beginning of this year, and we made some changes already to the reinsurance program at the very start of the year, especially around the property side of things. If you look at the major programs we have in place. I mean we have a cat program. We have no intention to change that. I don't think that's a price-driven topic. That's a risk appetite issue. And even if we saw the stuff becomes fantastically profitable, it's not the kind of risk that we necessarily think we are the best carrier of. The other 2 things, which are for the most significant is we have a very large question on property. I mean we've been clear with the market when we placed that. That that was a risk that we seemed to like less than the market did at large. And on the day that things changed, we would definitely retain more of it, so we certainly have an option around that topic coming to retain more. And then there's another large contract, which again is relatively recent. I think probably, most of you are aware, we have a very large liability core share. That's more like the cat cover, so that was intended to be a long-term commitment is about the shape of the portfolio that we have, there's a capital allocation topic in the end, but more from a longer-term perspective than a short one. And certainly, I mean, if the market continues to support us in the way it has we would not intend to make significant shifts there. But the property topic is certainly one that every -- I know that every time we come through the planning process and we start to approach the renewal, we have pretty intense internal conversations about what should be in that core share and this year will be no different.

Operator

Next question comes from Michael Huttner, JPMorgan.

Michael Igor Huttner

JP Morgan Chase & Co, Research Division

So on cash flow. And by the way, well done, really well done, that's amazing what you achieved. On cash flow. So for the first time in a while, you've given us a figure at the half year. So it implies that there was $1.7 billion in the first half. Can you just explain which of your large entities have still to pay or have paid to give us a feeling for any kind of seasonality here. And the second question, which is really a bit lightweight and apologies for that. Given where markets are today, so interest rates have dropped a little bit more and you seem to -- sorry, I changed my question. You kind of indicated that the business operating profit delivery in terms of solvency is about 2 points ahead where you would normally expect it. And you alluded a little bit to where it came from. Can you say what it looks like for the second half? In other words, are there any changes in that -- in those kind of numbers we've seen all those trends we've seen in the first half?

George Quinn
Group CFO & Member of the Executive Committee

[indiscernible] maybe do the first one first because that's the easiest one. Not anticipating any significant shifts, and I apologize, I think I said 1 to 2 or 2 to 1. It's about 1% above what you would normally see as, so there's no major model shift taking place currently. I don't see one planned, so no reason to expect anything other than the operating profit and the ability of the life business to generate new business value will be the drivers of capital generation in the second half.

On the cash flow, second thing, I will resist the temptation to [indiscernible]. The people who will be helping us in the second half of the year, they already know who they are. I mean we've talked in the past about the fact that if you look at last year, I mean, you see this unusual picture between the life side and the P&C side, where P&C was a bit weaker, life a little bit stronger. I expect life to continue to be strong this year, not only will we see the operating cash generation, but we're still continuing some of those balance sheet optimization topics that we covered back in February. And you'll see more of those in the second half very likely. And the reason for giving numbers today, which is unusual for us, we're simply to underline how close we are to the overall goal, given that probably the conversation switches fairly soon to what does the next 3 years look like.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Before that, you have to decide on the dividend, don't you? The cash is the dividend, for me, that was the underlying question. I beg your pardon I interrupted you.

George Quinn
Group CFO & Member of the Executive Committee

[indiscernible] The only thing to be careful of is that the cash flow is extremely important, but cash has never been a constraint nor honestly a driver of the dividend here. It should be about earnings because that's what sustains sustainability for us. But I mean we have a whole system of the group, which is designed to make sure that we convert earnings into cash in a disciplined and ideally rapid manner, but that's not the key factor when it comes to that dividend decision. They'll get made in February of next year.

Operator

The next question comes from Nick Holmes of Societe Generale.

Nick Holmes
Societe Generale Cross Asset Research

Just a couple of questions. First one is does the fall in bond yields make you more optimistic about P&C pricing? I was very surprised nobody has mentioned it, to be honest because surely, that could be an important contributor to getting to a properly hard market. And then the second question is just coming to the expense ratio, it's still a bit high. Wondered if you could take us through your plans or remind us where you want to go on that?

George Quinn
Group CFO & Member of the Executive Committee

Thanks, Nick. Yes, it's an important question. I mean if you look at the movement in the markets, even very recently, we're seeing levels that we haven't seen for some time. Although, interesting, if you compare them to the levels that we based the current share targets on, I think what you would have seen is just a reminder, the current share targets were struck based on yields around the middle of 2016. Europe is definitely lower for sure. It's a bit less relevant for us in Europe, given the portfolio is typically about shorter duration in Europe. At U.S., actually, still a touch higher, not sure that can be true by the end of the week, but it's somewhat true very recently. But of course, we have had a benefit in the intervening period from the fact that interest rates have risen. I think the point you make is important. I think it could well be true that this helps sustain the price trend that we see for longer. I think the only caution I would signal is that one of them has given today. The other one we've yet to see. But I think it's certainly helpful and encouraging the market to underrate in a great disciplined fashion.

Nick Holmes
Societe Generale Cross Asset Research

Sorry, and expenses.

George Quinn
Group CFO & Member of the Executive Committee

Expenses, so you'll hear a bit -- well you've probably heard from me before, you need to break apart the expense ratio. We've tried to do in the investor presentation. I think you see the continuation of the fall. And the -- what we refer to as the other underwriting expense or overhead components that dropped, 13.7% down from 14.1%. That's partly offset by 2 factors. One is premium taxes, which, of course, we don't entirely control, but that impact is quite small. And then on the commission topic, I think the interesting thing you see on commission, it's slightly higher and I think you've heard today, and you may have read in the press release that we have some new relationships. We have access to another significant group of clients, this time in Europe actually opposed to elsewhere. So the commission ratio or the commission ratio component, that's driven actually by changes in Europe in the first 6 months. Whereas in the markets that have generally been driving it up in more recent times, typically, Lat Am and Asia Pacific, their contribution is actually smaller but there is a net increase. And that's driven by more of that mass consumer business that is slightly more expensive to acquire, but is typically less volatile, more predictable. And certainly just helps the overall quality of our portfolio. So as you've heard before, it's a tradeoff we're happy to make. And the focus of the expenses has to be in the OUE ratio, and we expect to continue that focus in the second half of this year.

Nick Holmes
Societe Generale Cross Asset Research

Thank you, George. Can you give us any sort of quantification of those numbers? I think OUE is meant to be around about 13% is your sort of unofficial target. Is that still correct and moving the overall expense ratio down to sort of 31% over a period of time?

George Quinn
Group CFO & Member of the Executive Committee

On the 2 things. So we're looking to be able to get down towards 13%. So if you look at where the peer group is, we think that's roughly where they are. I think if you look at what we still have to bring in the second half, I'm not going to have to get all the way from where we are to 13% in one step, but you'll certainly see a further move in the second half of the year. On the commission ratio, for the reasons I gave earlier is a bit -- it's a bit tricky to be really hard and fast on the commission ratio. I mean all things being equal, if we had done none of the portfolio change that you've seen from us over the course of the last couple of years, we would have an overall expense ratio that would be in the high 20s. But we wouldn't have the outcomes that you'd see from an underwriting perspective, so the overall expense ratio, we published [indiscernible] whether we get the opportunity to do more of this. And if we see it at the right -- at the right levels of return, we would do more. But our focus is mainly OUE. And we are expected to bring that down further, probably not all the way to 13% by the end of the year.

Operator

The next question comes from Vinit Malhotra, Mediobanca.

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

George, one question on P&C, one on life, please. On P&C, at the Investor Day last year, we talked about the commercial business in North America targeting I think it was 3 percentage of improvement from HY to 2021, but that was before this whole momentum or tailwind from the pricing and claims efficient came in. Would you say that they are likely to change something there? Are they trying -- will they have a higher, better target? Or does that number already getting somewhere close given that we've seen a big change in commercial. If you could just comment on the commercial U.S. anything you can comment on? And second question on the life side. So there's about, give or take $100 million lower guidance effect for the vehicle of '19 now versus previously guided. Is that -- and I understand from speaking to the IR team, that's mostly FX related. But I mean if I -- very specifically the dollar was also, I mean, all over the place last year, for example. Is there anything else on life that we should note regarding this guidance and any commentary there?

George Quinn
Group CFO & Member of the Executive Committee

Thanks, Vinit. So it's a good point on the first one. So Kathleen and the team have slightly overachieved versus the target we set at the Investor Day. Remember, there's cat in that so there's a -- I mean there is some benefit there, although most of the cat benefits, so to speak, actually comes in Europe. I won't get into what we'll do at Investor Day in November. We need to look again, how we performed in the first half of the year. We're in that process currently of preparing the plans and the targets for the next 3 years. And we'll come forward with another set of ambitious goals for the group when we get to November.

On the life side, so you're right, I think the -- it is really important to appreciate -- I mean we're happy with what we see in life. We think the constant FX performance is pretty much where we fixated it to be. So the headline guidance topic is entirely driven by foreign exchange. There's also a tough comparison to the prior year. And almost half of the one-off that we saw last year occurred in the first half of the year. If you remember, the FX topic around Argentina. There are always positives and moving parts -- positive and negative moving parts of the business. Overall, we're happy with what we're seeing in life. There are always opportunities to improve, and the team are focused on those, but the overall outcome is pretty much in line with plan.

Operator

The next question comes from Johnny Vo, Goldman Sachs.

Johnny Vo
Goldman Sachs Group Inc., Research Division

I guess it's good that the shape of the business has changed and it's been typified by the fact that 50% of your net earned premiums are now in specialty and property. I guess does this trend continue to happen? Or do you see other opportunities in potentially [merchant] and casualty in shifting the business back potentially?

The second question just relates to your sensitivity to rates. I've noticed that the sensitivity to a drop in 100 bps interest rate is very sensitive now as it was, as it was compared to the end of last year, where I think end of last year was about 3 percentage points, and now it's about 14 percentage points. Is it because you're opening up the duration? Or what's going on with the sensitivity there?

George Quinn
Group CFO & Member of the Executive Committee

So on the first one, the -- I think it was in response to the question earlier around rates. Apologies, I forget who asked it. I made the comment that the -- some of the things we're doing are really about strategic view of the portfolio. I think portfolio mix is one of those things, so that's something a bit like almost at the asset allocation, you should expect to see that change relatively slowly in any given direction over time. I mean we have priorities that we haven't yet achieved around some of the specialty lines, but our view is that the current market conditions are really quite difficult to support those. So if we see further price move, maybe you'll see a bit more specialty move into the portfolio. I mean specialty for us also includes credit. And this doesn't feel at the right point in the cycle to really push credit. So I mean think of this more of as a strategic view. There'll be some tactical movements but the overall goals for the portfolio remain the ones that we laid out, I think at least a couple of years ago.

Now on the sensitivities. I mean I need to go back and look because I don't recall a change of that magnitude. I mean there's a lack of linearity for obvious reasons. So as interest rates get compressed, you have a risk of developing higher sensitivities, but that scale of change, which surprised me, so we need to have a look and come back to you. Sorry, Johnny.

Operator

The next question comes from Farooq Hanif, Crédit Suisse.

Farooq Hanif
Crédit Suisse AG, Research Division

Just want just to ask one of Vinit's question in a slightly different way. So going back to the Investor Day, you talked about a potential convergence of your commercial combined ratio. I think you commented on 99.5% commercial combined ratio in the U.S. with big peers. Can you talk about the relative -- how you see your relative positioning in profitability in the U.S. versus those peers and whether that closed gap is now sustainable and where it needs to be?

And then secondly, just a very quick question on CoverWallet. I see that you're very happy with it. And you're going -- you're expanding into Switzerland. Can you just briefly tell us what the learning has been? I mean has it given you access to new premium growth? Or has it been an expense ratio reduction in SME? What is the learning? And how far could this go throughout your business?

George Quinn
Group CFO & Member of the Executive Committee

Thanks, Farooq. So on the convergence with peers in the UA, I think you need to give it a bit more time to absorb what we've seen of the peer groups. Of course, one of them already reported last night. I mean we did a lot of work ahead of Investor Day. So we want to repeat that exercise to get a sense of where we see ourselves relative to others. I mean for obvious reasons, we're really happy with the progress, which driven by commercial driven by the U.S., is a great combination. But I think we need a bit more time with the peer information before I can really draw any conclusion or depth from it.

Farooq Hanif
Crédit Suisse AG, Research Division

Sorry, could you have a combined ratio for the commercial as opposed to alternative markets for 1H '19?

George Quinn
Group CFO & Member of the Executive Committee

For the U.S.?

Farooq Hanif
Crédit Suisse AG, Research Division

Yes.

George Quinn
Group CFO & Member of the Executive Committee

We'll get one for you. We have it. It's not a state secret. I just don't have it.

Mario Greco
Group CEO & Member of the Executive Committee

We definitely have it.

Farooq Hanif
Crédit Suisse AG, Research Division

Of course.

George Quinn
Group CFO & Member of the Executive Committee

We'll come back to you. On CoverWallet. CoverWallet is pretty new in Switzerland. I can't say much there. It has been running in Spain for a bit longer. There's still a level where it's not so material to the group. I think most of us have seen what CoverWallet does -- works. I mean for me, I mean, having looked at it I mean, what's impressive is the ability to package something for a buyer in a way that helps them make sure they protect themselves across all the different risks that they may have without then having to stitch that coverage together for themselves or to find an agent to do it for them. It's a fairly inexpensive system. As you can imagine, ease-of-use is really very high. And we have high hopes for it in Switzerland, where we are a bit underpenetrated on the SME side, and we think we have a very significant opportunity here, but too early really to draw too many conclusions.

Mario Greco
Group CEO & Member of the Executive Committee

Look, in general, the SME opportunities are big that you can pursue it only with the one solution. So CoverWallet is very interesting because it allows us to contact the customers among the SMEs, who are already connected online, and they can be reached out of the web, but that's a portion of the huge, huge ocean of SME customers in Europe or in other continents. And so we're also using every other possible distribution mean to reach out to the SMEs. Switzerland has an SME program, which has been developing very nicely in H1. And CoverWallet is part of it, but it's not a big program altogether.

Operator

The next question comes from William Hawkins, KBW.

William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

I'm back on those Z-ECM sensitivities please, George. Is there any way that you can give us a hint -- an idea of what the absolute interest rate is that you're plugging in around which the sensitivities are being shown? I appreciate that it's going to be fiendishly complicated and based on curves and that kind of thing. But in the back of my mind, there's going to come a point when showing a 100 basis point reduction is implying that you've got significantly negative inputs across the curve, which, at some point, is going to sort of mean that your calculation is technically correct, but possibly economically kind of meaningless. So I'm just trying to get a sense about what the absolute rate is, so what you would be at, if you took it down 100 basis points?

And then secondly, could you give us any kind of qualitative or quantitative update on where your Solvency II ratio equivalent could have moved? Because again, the difficulty with both the ECM and the SST is that potentially exaggerating an awful lot of these market movements, so the divergence with the hints you've given us in the past could have moved on.

George Quinn
Group CFO & Member of the Executive Committee

Thanks, Will. So on the first one, I think maybe a topic that the IR team could cover in more detail with you after the call. On the issue having significantly negative rates, we obviously have the asset side of things, we will have significantly negative inputs in some parts of the model already, especially if you look at Europe. But I appreciate there are other aspects of the model where you may well floor things because in the real world, you're not going to get within the same thing you see on the borrowing side on the asset side. I mean please speak to Rich and the team afterwards, and they can walk you through that in more depth.

I don't have an update at the half year around Solvency II or the potential difference between -- I mean where we are now from a Z-ECM or SST perspective and what you would have seen versus the peer group. If you look at us, I mean, I think I mentioned in the early part of the call, there's about 7 points of market movement. We see that mainly as the longer interest rate in Europe, and the impact that that has on some of the very long liabilities we have on the life side. Again, I don't know to what extent we've seen that quite so much in the peer group. There would be some impact from the ultimate forward rates in the Solvency II system that would certainly dampen that more than you would see for us. I think probably that delta and so on, maybe it's a few points, it's not so significant, I think, in the half year comparison. I think it's the starting point of the basic SST versus Solvency II framework. And I did talk about the delta, I think, back in the -- I think back in the February call, maybe the May call and in the past, we've highlighted, I mean, deficits up to 50 points or more between SST and Solvency II, and we think they're still valid. And in fact, one of the most recent day we've seen it would be higher today.

Operator

We have a follow-up question from Peter Eliot, Kepler Cheuvreux.

Peter Eliot
Kepler Cheuvreux, Research Division

Two more for me. First of all, maybe just to carry on the life topic. I mean if I just look at a big picture down, one thing I noticed was that the costs sort of seems to be increasing on a like-for-like basis. And that was despite new business being down, so it can't sort of really be attributed to the acquisition. So I was just wondering if you could sort of comment on that dynamic? And if we might see any improvement going forward. The second thing was, I was interested, you flagged IFRS 17 costs of $50 million to $100 million in H2. I'm just wondering if you could comment any further out or in terms of total costs? Or if you've done the sort of first analysis and anything you might expect in the future?

George Quinn
Group CFO & Member of the Executive Committee

Okay. So on the cost side of it, I mean, you've seen most of the benefit flow through the P&C side. I mean there is some benefit that's partly obscured because some of it gets shared with the policyholders and some of it falls to the shareholder. In the second half, I mean, I think if you look at it, certainly from a operating profit perspective, you will see the impact, for example, some of the integration what we're doing in Australia. We do have a synergy goal there, and that will show up on a like-for-like basis with the Australian business and the starting point. I mean, otherwise, the main focus for us it's really been on the P&C side and trying to drive most of the expense improvement through there. Although you have seen life improve, certainly earlier in the time [series].

IFRS 17. I'm glad we're only talking about costs and not the project itself. I think -- I mean having said that, this point works giving you a sense of where we are, so, in fact, today is the first delivery day for our Tier 1 entities and our first practice run of IFRS 17, so we are actually having the company's report up today as we speak. I don't know that the numbers will make too much sense in the first go around for -- we have plenty of time to perfect them over the course of the next year or 2. We haven't given a total cost number, but I mean we're running, I mean between $50 million to $100 million, I mean, pretty much every year, this project runs currently, which is one of the reasons why we're keen to see the whole conversation come to an end and for the thing to get adopted, so that we can start -- all start to understand it together and move on. It's extremely expensive and unfortunately, while it does have benefits, I am not sure they will outweigh the costs.

Operator

We have another follow-up question from Michael Huttner, JPMorgan.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

On the -- in Farmers, you have a surplus ratio, which I think is better than your target of 41%, an improvement of $200 million of the events of $5.7 billion. What can you do with that money? How does it benefit you given that the growth is still relatively modest?

George Quinn
Group CFO & Member of the Executive Committee

Unfortunately, Michael, that's not our money. That belongs to the exchange, so that's their surplus ratio. And that's the -- the one thing I would point out is the exchange has been a big buyer of reinsurance. I mean the capital strength means that they can retain more of it. But in essence, any benefits that flow from the management surplus really will accrue to the exchange and not really to [indiscernible].

Richard Burden
Head Investor Relations & Rating Agency Management

Okay. Thank you very much, everybody, for dialing in. If you do have any further questions, please don't hesitate to call the Investor Relations team. We'd be happy to take any other questions you might have. Thank you very much, and goodbye.

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