S&P Global
Market Intelligence

Zurich Insurance Group AG SWX:ZURN

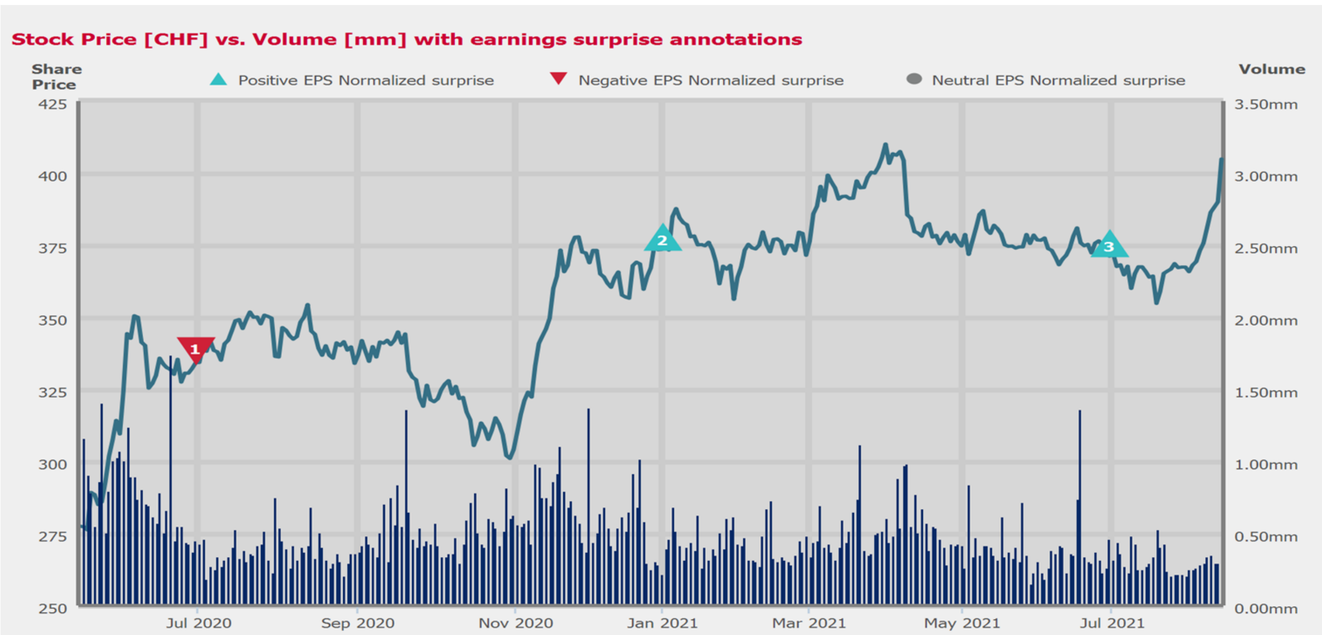
FH1 2021 Earnings Call Transcripts

Thursday, August 12, 2021 11:00 AM GMT

S&P Global Market Intelligence Estimates

	-FH1 2021-			-FY 2021-	-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS
EPS Normalized	11.91	NA	NA	27.64	NA
Revenue (mm)	NA	NA	NA	49641.63	NA

Currency: CHF
Consensus as of Aug-13-2021 9:11 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FH2 2019	NA	NA	NA
FH1 2020	9.07	7.63	(15.88 %)
FH2 2020	11.31	16.35	44.56 %
FH1 2021	11.91	13.28	11.50 %

Table of Contents

Call Participants

EXECUTIVES

George Quinn
Group CFO & Member of the Executive Committee

Mario Greco
Group CEO & Member of the Executive Committee

Richard Burden
Head Investor Relations & Rating Agency Management

ANALYSTS

Andrew James Ritchie
Autonomous Research LLP

Ashik Musaddi
JPMorgan Chase & Co, Research Division

Louise S. Miles
Morgan Stanley, Research Division

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

Peter Eliot
Kepler Cheuvreux, Research Division

Thomas Fossard
HSBC, Research Division

Unknown Analyst

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

William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

William Fraser Hardcastle
UBS Investment Bank, Research Division

Presentation

Operator

Ladies and gentlemen, welcome to the Zurich Insurance Group Half Year Results 2021 Conference Call. I am 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

Thank you. Good morning, good afternoon. Welcome to Zurich Insurance Group's first half 2021 results Q&A Call. On the call today is our group CEO, Mario Greco; and our Group CFO, George Quinn. Before I hand over to Mario and George for some introductory remarks, just a reminder for the Q&A, we kindly ask you to keep to a maximum of 2 questions in the first time around. And if we've got spare time at the end, we will come back to you.

So with that, Mario, over to you.

Mario Greco
Group CEO & Member of the Executive Committee

Thank you, Richard, and good morning, good afternoon from myself. And let me just have some few remarks as an introduction, and then we pass to Q&A. This morning, we published 1 of the strongest ever first half results for Zurich. Our earnings are back to pre-pandemic levels despite the continuing impact of the public health crisis and a very high level of natural catastrophes. This performance reflects the improvements made to the business since 2016 in terms of underwriting, simplifying our business and delivery for our customers. Our focus on customers is leading to higher levels of customer satisfaction, and this drove the growth in customer numbers by approximately 600,000 in the first half and supported growth in revenue across all of our businesses.

Since 2016, we have reshaped and improved our Property & Casualty portfolio. This is allowing us to take full advantage of growth opportunities within our commercial insurance business as price increases and terms and conditions further improve.

Property & Casualty gross written premiums grew an excellent 16% in the first half, while combined ratio fell to its lowest level in over 20 years, despite more than 6 points of natural catastrophe losses.

We expect pricing to remain strong through the remainder of 2021 and into 2022, and we're well placed to achieve further strong growth and margin expansion. Our consistent focus on protection and unit-linked Life business continues to pays off, and we have improved margins within the businesses through continued product development and selective repricing.

These actions led to a 44% increase in Life business' operating profit to an all-time high level. Farmers Management Services has saw a return to growth in the first half, driven by the improved growth at the Farmers Exchanges, where expansion in the agency force and improved productivity supported growth. With a further strengthening of the exchange's distribution through the completion of the acquisition of the MetLife Property & Casualty business, I'm confident of the growth outlook for the Farmers business.

This year's extreme weather events, which have touched most parts of the world, underscore the risk of climate change and the need for businesses to take immediate actions. Over the first half, we have continued to strengthen our own commitments to reduce CO_2 emissions through new intermediate targets for both our own operations and investments.

As part of these commitments, we're planning further actions to reduce emissions related to travel, vehicle fleets, foods -- food and real estate over the second half of this year, and we will publish news in the next 3 weeks about that.

The Group's simplification and strengthening of the business over recent years, together with our very strong balance sheet, positions us well to continue to take advantage of opportunities to grow all of our businesses and earnings as economies emerge from the COVID-19 pandemic.

I have great confidence in the strength of our business and the skills of our employees to maintain this momentum and to deliver on our goals.
Thank you for listening, and we are now ready to take your Q&A.

Question and Answer

Operator

[Operator Instructions] The first question comes from Louise Miles from Morgan Stanley.

Louise S. Miles
Morgan Stanley, Research Division

I'll stick to 2. So my first question is on the P&C business and on the PYD. So for the Group, it was 2.5% in the first half, it's a bit higher than previous years, and it's 4.8% in North America. I mean can you give us a bit of commentary on the outlook for the second half? I mean, should this trend be expected to continue? And just the rationale for a slightly -- well, certainly can see it at higher level in the first half of 2021.

And then looking at the SST, you just published 206%. Just thinking about the SST ratio towards the second half of this year, I mean, presumably it's going to hit somewhere close to 210% given that net capital generation or net dividend payment is probably going to be positive, so getting very close to that 210% kind of upper end of your range. I know you don't have a range, but that probably broadly equivalent to 120% on your Z-ECM.

And I also note that your debt leverage has spiked up a bit this year. I mean, if you have excess of capital, are you going to kind of prioritize delevering? Or there are other things that you'd like to do with that?

George Quinn
Group CFO & Member of the Executive Committee

Thanks, Louise. So on the PYD first, so you're right, we are above the normal range that you'd expect to see from us in the first half of the year. It's driven by the U.S. I mean if you look across the business, I'd say that the pressure in the first half of the year was certainly upwards. I think given the strength of PYD in the first half, I'd be surprised if we were fully within the range for the full year. But I expect at this point, at least, for the second half, we'll be back in the 1% to 2% range. We do have a regular workers' comp review coming up in the third quarter. So I don't yet know what that's going to show us. But certainly at this stage, I'm thinking that 1% to 2% in the second half with potentially PYD for the full year, slightly above the normal guided range.

On SST, I'm going to resist the temptation to create an upper bound around it because we found it really hard to get rid of that last year. I think from a capital perspective, we're obviously in a good place. We've had a significant move up through a combination of the market changes and the impact of operating capital generation in the first half.

I think you're right, you would expect to see that rise in the second half of the year. So I mean what would be the priorities? I mean I think at this stage, I mean, the past is a pretty good guide to the future. I think if you look at the various leverage metrics, I mean we're pretty green on almost all of them apart from the tangible debt leverage metric. I mean we're not going to lose sight of that, but it's not the -- I mean it's not something that's causing us any significant concern.

So I mean, I think from our perspective, I mean, we remain able to take a look at things that are out there, if we think they're advantageous for strategy that would help in financial performance. But as always, the targets and the plans don't depend on this, but it's nice to have the flexibility to explore them if they do come up.

Operator

The next question comes from Peter Eliot from Kepler Cheuvreux.

Peter Eliot
Kepler Cheuvreux, Research Division

The first one, I mean, after the great results today, on an underlying basis you've basically already reached your 15% BOPAT ROE, that you were hoping for or sort of thinking indicatively you might be achieved by next year. So I was just wondering if you could tell us what you think, if anything, is still to come from that ROE walk that you showed us. I mean, I guess I'd be especially interested in where we are in the buckets of portfolio quality and capital allocation, which you'd hope would add 2.5 points combined. So that's the first question.

Second one, the P&C investment income, you were saying $50 million to $100 million per annum decline. Now you're saying $100 million for '21. Just wondering what's happened to make this sort of fall faster than expected and whether we should expect it to continue falling at that rate? Any clarity there would be great.

George Quinn
Group CFO & Member of the Executive Committee

Peter, thanks. So on the first one, I mean to say there was 1 of the media asked me about that topic this morning. And they gave me flash back to November 2019, but I don't think anyone in the room was concluding that the targets were easy to achieve. I think you need to look at them all together.

So I mean, the delivery of the ROE target is something that's extremely important. I think we've made great progress on that. As you point out, and I'll come back to this in a second, there are some things we want to do around capital allocation that continues to be important to us.

But we also need to take care of the cash target. We need to take care of the earnings target. So I mean, all of these things are priorities for us. When it comes to management of the capital, obviously, the back book topic is high on the list of priorities. I mean, I'm probably not going to say too much about it today because I think it's better to wait until we've actually done something and then we can talk about, I think, what that means and the benefits that, that brings us.

But I think in the same way that you've seen us be disciplined around capital allocation in the past, we will do that in the future, and we have particular interest on the bank book side of things.

On the investment income guidance, I think in the past we've certainly indicated a range. I think I've also talked about the fact that when you need to take the duration of the book into account. If you look at the gap that we have between book yields and reinvestment yield, it would imply something. I mean, maybe not quite a 100%, but certainly something pretty close to it based on what we see currently. And I guess, I mean, what changes what -- I mean, that gap between the book and the reimbursement yield changes in both directions, I mean fairly frequently, and we update to give you a sense of what it currently looks like.

So I can't tell you that it's fixed because, of course, it's partly dependent on the future track of interest rates. But seen from today with today's gap, the upper end of that range is the more likely outcome.

Operator

The next question comes from William Hawkins from KBW.

William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

George, on Slide 20, the Asia Pacific Life BOP is still bouncing around quite a lot. I'm trying to figure out kind of what you consider normal. And then when we're thinking about the future, what any incremental impact of 1 path may or may not still be taking into account, presumably we're through integration costs but still have more to go on the synergies. So if you could just help me understand a bit about what's kind of normal in the outlook for the Asia Pacific Life BOP.

And then secondly, please, when you're talking about the north of $4 billion cash remittance hoped for, on Slide 9. If we're thinking about the incremental increase in that relative to what you achieved last year, the $3.4 billion. Should we be assuming all -- pretty much all of the incremental increase is coming from non-Life? Or are there material moving parts in Life, Farmers or the group center?

George Quinn
Group CFO & Member of the Executive Committee

Yes. Thanks, Will. So on the first one, on APAC Life BOP, I mean I think what you've seen this year is a big rebound in Australia. So that's obviously driven by the acquisition. I wish I could tell you the integration was over, it's not quite over yet. It should be over by the end of this year. In terms of incremental expectation, I mean, given what the team are telling us, I mean, we're not quite at the business case that we presented back at the end of 2017, when we announced the transaction.

So I think -- I mean, I'm still optimistic that we can see a bit more from where we are today. So I think there is room for Australia to improve further, obviously, a big driver of the benefit has been the recent repricing. We think there's also some product redesign to come in the market in Australia, which will actually dampen some of that volatility that's been a challenge in the market in the past. And the end of this year, you should see more or less the end of the integration cost side of it and the full benefit of the synergies that we had planned for the transaction.

On the cash remittance topic, so is it all P&C, so short answer is definitely no. Because I think if you think of what drives this, I mean, obviously a big chunk of its earnings for this year. But some of it is going to be catch-up for what's happened in the prior year because, off course, what we've had at the very start of this year is really still impacted by the -- impact of COVID on earnings and in some cases, on balance sheets.

And if you look at what we did last year, I mean, even though we had a very significant cash generation, I mean, there were 1 or 2 regulators who were still encouraging businesses to wait. And while it wasn't that material for us overall, those tended to be more Life-oriented than P&C. So I think you'll see we've bring us back from Life as well, but obviously, the strength of P&C earnings is going to be a significant driver.

Operator

The next question comes from Michael Huttner from Berenberg.

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

It sounds like [indiscernible] results are good. So the -- 2 questions. One is, is there more? And here, it sounds mysterious; it's not mysterious. When you sell insurance policies, the premiums booked over a year. And so the -- effectively, there's a lag benefit to price increases. So I just wondered if you could give us a figure of how much we could add for the lag to the figures you've published today?

And then the other figures, which would be interesting, you -- I think it's on Slide 6. You show it's -- you showed some mysterious bars. And I was just wondering whether you could give us the numbers, the -- effectively the inflation costs which you're seeing.

George Quinn
Group CFO & Member of the Executive Committee

Yes. Thanks, Michael. So on the first one, I try to avoid to give forecasts because Mario will remember them and hold me to them.

Mario Greco
Group CEO & Member of the Executive Committee

I can send you.

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

Results, he's not listening.

Mario Greco
Group CEO & Member of the Executive Committee

I am. I am.

George Quinn
Group CFO & Member of the Executive Committee

I mean the point that you make, though, Michael, is absolutely valid. So that clearly is a lot. I mean I think there's 2 things to bear in mind. So I mean, there is I think we all have an expectation that pricing will continue to benefit earnings from where we are now. There's not only a lag benefit from the price increases that we've seen. If you look at price strengths in the market, I mean, it looks as though this trajectory in the commercial market is going to be pretty gentle. I mean I think in the second half of the year, I'd be surprised if it was as strong as it was in the first half. I'm already surprised it was as strong in the first half as it was in the second half of last year. And I think you will see further benefits from P&C. So all things being equal, which is the claims experience, I would expect to see further improvements in the underwriting margin for P&C.

On Slide 6, so there are 2 ways you can do this because the IR team actually use a spreadsheet. So the -- I think the thing is the scale, but that's a bit unhelpful. If you look -- we are seeing loss cost inflation around the same level as the end of last year, so it's somewhere around the 5% mark, maybe just slightly above. Similar drivers to what we've seen before, so no real change. And I mean, there's not a lot of new information in the market. I mean we've seen some of these larger settlements that have been announced around opioids and the Boy Scout's topic. But on the broader social inflation topic, the courts are just starting to reopen.

So it's still too early to get a read on trajectory. But I mean, given what we've seen in the past, I mean, we feel pretty comfortable with our overall inflation assumption, but somewhere in that 5%, 5.5% type range.

Operator

The next question comes from Ritchie Andrew from Autonomous.

Andrew James Ritchie
Autonomous Research LLP

Two questions, please. First of all, George, are you encouraging us on the Life business to basically take the BOP reported adjusted for the $50 million positive one-off, but add back the COVID losses, and that's the new run rate for Life? I mean the problem is the Life business, there's a lot of variables in recent years -- acquisitions, a lot of FX noise and COVID. And I just wonder if maybe there's noise as well because the underlying is overstated slightly because of the COVID overstated because there's allocation issues there.

So what -- I guess, can you give us any guidance as to what you think the kind of right run rate is for Life now? And has there been a step up? And is that just sort of more normal markets that's driving that?

Second question, Farmers. What are the tools, what are the protections in place for the surplus ratio in the second half of the year? Because the service ratio has ticked down more than I expected. I thought you -- thought Farmers had bought MetLife at below book, so I thought there'd be a gain there. So are there any remaining tools to use for that surplus ratio? And what are the CAT protections? Remind us about those, should there be active, an active season in the second half?

George Quinn
Group CFO & Member of the Executive Committee

Right. So on the first one. So I think the -- if you look at what's changed over the prior year, and the -- I think the most obvious stand-out feature is the topic I covered earlier with Will. So I mean, we've managed to get the Australian business. I must say we, I'm talking about our CEO and the team in Australia because it's not as if I've had much to do with it. I mean they've matched to get this thing back more or less on track. So I think in terms of -- I mean, what's sustainable and durable that change is not something I expect to see reverse anytime soon.

Now the issue around COVID mortality versus excess mortality generally. I mean we've certainly seen that in the Farmers book, which I guess is not really relevant to the Life guidance, but the point is. So for example, if you look at the performance from a mortality perspective, Q1 is really heavy for excess debt claims driven by COVID. They still have excess debt claims in Q2, but they actually have superior mortality overall. So I think there is some of this that need to be a little bit careful of in terms of the temporary impacts.

But having said that, I mean, if I was looking at how I would do this. So I would certainly adjust for the topic that we discussed on the call this morning in Europe. I think if I chat to the Australians, they don't add back everything that we've seen from the Australia improvements in the first half, so they're assuming that some of the claim experience is temporary. But as I mentioned also to Will, I think we'll also see further improvement from them through the second half of this year into next.

I mean, overall, from a run rate perspective, I think we're probably slightly better than the 10% above guidance that we gave compared to the numbers for last year. I mean, I agree that I might be a wee bit careful around some of the mortality benefit we see in some of the markets more recently.

On the Exchanges, so I'm going to make a caveat to begin with. I'm not the CFO of the Farmers Exchanges. So I mean, obviously, I have a very keen interest in these topics in the same way that you do. But I'm going to be careful about how much information I get into because that's really a topic for them rather than for us, given they're an independent organization.

And on the surplus, so why might the surplus be a bit lower than perhaps an external observer would have expected? They've ended up expecting to place less reinsurance. So if you think of -- I mean, how that transaction work for them, I mean I think what you described in terms of the acquisition of something at a discount is true, but they certainly had intended earlier to increase the quota share by more than they have in the end. And I think that's driven by a feeling that maybe they have more reinsurance protection that they feel they need. And I guess part of that will be driven, if you look at historical reference points for the surplus ratio for Farmers, it's not quite as high as it's been in the last 18 months. But it's been a lot lower than the figure we've ended up with.

From a reinsurance structural protection perspective, they still have in place the structure that has protected them very effectively over the course -- over the last couple of years, in particular dealing with wildfires, and there's no significant change to how that operates compared to the past.

So I know talking to the team at Farmers on the Exchange side, I mean, they feel comfortable with their capital levels and don't feel that it's a topic of particular constraint for them.

Operator

The next question comes from Will Hardcastle from UBS.

William Fraser Hardcastle
UBS Investment Bank, Research Division

Just working back to Slide 6, if that's okay, and thinking about commercial and North America specific. If we were to carve out North America commercial stand-alone, is it possible to give us a broad idea of the extent of underlying improvement year-on-year on margin or half and half? And is this trend accelerating or slowing down given, I guess, what Michael would say about the not-immediate recognition of the price and the spreads have narrowed a few points, presumably we should be expecting a similar level of improvement over the next 12 months, given the pricing trajectory discussed.

And then the second 1 is on expense ratio. I guess can you give us an idea of how much of this improvement is sustainable, to what extent is their operational leverage at play, and how much is perhaps one-off-y if [traveling of] stock reverts back to some forward normality?

George Quinn
Group CFO & Member of the Executive Committee

Yes. Thanks, Will. So maybe if I reverse the order of not the question, but the point you made on ZNA. I think it would be -- I mean other than going back to Michael's point about the lag effect of the price rises that we've seen. I think to assume that pricing continues with the same spread over loss cost inflation that we see in the first half is, I mean I think it's touched too aggressive for me.

So I think as we go through planning this summer, I mean to -- I don't expect to see a significant drop in what we expect to see in the commercial pricing dynamic. But I don't expect it to be quite the same as we've seen in the past. So we wouldn't be planning for that. So you would anticipate seeing year-on-year improvement but not quite at the same pace as we've seen in the first half of this year.

In terms of quantum, I mean, if you look at the covered business that, that commercial rate indicator was talking about, it's about half of ZNA's book, maybe slightly less, but around that type of level. And I think you using that and assuming that it can earn in fully over about an 18-month period, that's a pretty good guide to how I would model the margin expansion that we see between price and loss cost trends.

On operational leverage, so I mean, again, it's a good point. So obviously, part of what we've benefited from, over the course of the last 12, 18 months is maybe a slightly lower expense base than you'd anticipate to be sustainable.

But Mario did make the point in his intro to the call, that I mean there are some aspects of what we do. I mean seen from the [den], especially from this week with the IPCC report earlier in the week, there are elements of the operating model change, and I mean forget expenses, I mean just from a sustainability perspective, we want to see change. And in fact, we were communicating that last night to a leadership team.

So I mean I do expect that some of this comes back, but I'm not convinced it's particularly material. And in fact, the concept that we typically discuss with the businesses and planning, we have an internal concept called growth credit. And basically, to the extent that businesses can present credible plans around growth, we will allow them to grow expenses not at the same rate as top line. But certainly, at the level required to make sure that clients looked after as we would expect them to be looked after.

So I think there is a bit of operational leverage. So you will see some bounce back, but I don't think it's that significant in the context of the overall group.

Operator

The next question comes from Anthony Young from RBC CM.

Unknown Analyst

Just 1 question actually on the Life book. So I see your plan is to focus more on capital-light and protection businesses. Could you give some color on what's your plan on corporate savings and savings annuity placed in the future? Because I think Slide 22 seems that the NBV for these 2 business lines are low.

George Quinn
Group CFO & Member of the Executive Committee

Yes. Thanks, Anthony. So I mean we prefer protection. That includes the corporate market. I mean, we are a significant player in corporate, and we try and leverage the relationship we have through the, I mean the large commercial P&C business that we have to get good access to organizations that are looking for corporate risk protection. It tends to be a more competitive market, though. I mean the distribution mechanism tends to mean that the pricing is quite keen. But seen from a Zurich perspective, I mean, these tend to come in large, I mean obviously large total amounts. We don't have quite the same overhead that you'd have, say, for example, in our retail business, which I guess is pretty obvious.

So for us, I mean the may be referred to as Corporate Life and Pensions. It's the protection and the savings component -- I'll point to the annuity component in a second. It's something that's an area of interest for us. So we are looking to grow that. But you are right that the margins are not as strong as we see in other parts of the book. But that's not a key concern for us.

On the annuity topic, annuity is not a preferred risk for us. So the asset risk that comes with annuities and annuitization options is not something that sits well within our capital model. I mean we tend to either avoid it or look for other ways to offer our clients the ability to seek annuities with third parties. So the annuity side of the risk profile is not an area of particular focus for us.

Operator

Next question comes from Ashik Musaddi from JPMorgan.

Ashik Musaddi
JPMorgan Chase & Co, Research Division

Just a couple of questions I have is, first of all, on CAT losses, I mean, we have been saying that CAT losses for most of the insurers and reinsurers have been pretty high for the last 3, 4 years, and we are seeing the same again for first half as well. Since you at 1 point did mention that companies need to be mindful of increasing CAT losses, and I don't know what it was intended for -- was it for primary, was it for themselves? Who knows? But clearly, there is some evidence of our climate change, et cetera.

So I mean, how do you think about your 3% budget for CAT losses? Do you think that needs to be higher and some of the prices increase could basically help support you move that number higher before impacting any profitability? So that's the first one.

And secondly, I mean, I'll just go back to the previous question around annuities. I mean, yes, you made it very clear, annuities is not really a preferred business. I mean -- but how would you think about your U.K. Life business overall? I mean is that something you would continue to maintain, which would include other parts as well, just not annuity? So how would you apply that?

George Quinn
Group CFO & Member of the Executive Committee

Right. So on the CAT topic first, I think you're right. Just 1 point. So when we updated guidance at the beginning of this year, we raised the CAT loads to be 3.5% just for everyone's benefit. I mean I think it's a tricky topic because on 1 hand, I mean these are clearly annual contracts. So the -- we're not taking long-term bets on the risk that climate continues to drive significant increases in CAT claims and CAT losses. I think at the same time, though, I mean, obviously, natural catastrophe business is a very hard business to judge on any short-term period. So you need to be careful with the capacity that you deploy.

And I think for us, that's why it's important to try and just be relatively consistent around the proportion of risk that we carry that's related to the CAT that we don't try and expand into a market that we perceive as being particularly profitable because of the volatility that it brings us. So I think consistency is going to be the most important topic for us here.

We do look at it pretty carefully. [You might] have seen earlier this week, Kristof who runs the North American business, his team were talking to me and Sierra, who's the Head of Commercial, about stance around particularly CAT risks over the course of the next couple of years. So I mean, I think we have views on how we can optimize this into the future. But it's a hard business to take a significant directional bet on it because of the volatility. I think that's really something that's best left for the reinsurers.

On the annuities, so the -- actually, we like the U.K. Life market. The team there are very focused on protection products. We've had a new product in the market for about 24 months now, they've had quite a bit of success in selling it. And the annuitization of -- the annuity part of the business that we do in the U.K., I mean, we've been pretty successful at reinsuring that in blocks as we go.

So the U.K. team have managed over time to keep any exposure that the business brings from an annuity perspective actually quite low. So, annuity is not an issue in the U.K. U.K.'s Life market is 1 that we like, and I continue to look for further growth in.

Operator

The next question comes from Vinit Malhotra from Mediobanca.

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

Just the first topic is from my side on frequency benefits of COVID. So I can see from some of the notes that 1.2 points has benefit, has been the benefit in 1H, giving us to 58.3% attritional loss ratio. Would you be doing just adding it back in and then trying to work out the whole spread between pricing and claims inflation that you talked about? Or would you say that in the new COVID, post-COVID world, you're going to continue to have some benefits. Just curious to hear your thoughts on frequency trends and benefits.

Second topic is just a clarification. I've seen some media had -- I think for a media conference about your comment on German floods of $150 million to $200 million, maybe euros. But what I don't -- I'm trying to understand is that the 5% outlook today for the full year net CAT seems to imply that 2H is being perceived as a 3.5% kind of normal CAT 2H. Is that the correct reading? Or are you expecting significant reinsurance recovery from the German floods? So any clarification would be helpful.

George Quinn
Group CFO & Member of the Executive Committee

Yes. Thanks, Vinit. So on the frequency topic, honestly I don't have a really good answer for you immediately. I need to go and ask someone closer to the underwriting on that topic. So if you allow me, I'll get Richard and the team to come back to you on that. I mean it feels natural, it feels reasonable to me that there must be some impact on how we approach it. I just don't know off the top of my head on that one. So if you allow us, we'll come back.

On German floods, $150 million to $200 million is the number. And you're absolutely right that the guidance we've given around CAT for the second half is not that, we're incredibly optimistic that we're going to see a very benign second half of the year. But just given the way the reinsurance program is structured, I mean, that does provide us with some measure of protection. And therefore, that's what drives our outlook for the second half. I think if we'd had a quieter first half, we'd be giving you a slightly different perspective on the second half of the year.

Operator

The next question comes from Thomas Fossard from HSBC.

Thomas Fossard
HSBC, Research Division

Two questions on the P&C side. The first 1 will be related to -- maybe to complement the question from Michael and Will. Can you talk a bit of your economic combined ratio? I mean actually, you reported this morning quite nice improvement in the reported combined ratio. But what about the economic combined ratio? And also because you're pointing to -- in your comments to the higher reserving situation or better reserving situation at the end of H1. So looks like potentially you may have moved again the loss pick. So any information on this will be of interest.

Second element would be on the 8% P&C growth in retail. Looked like, I mean pricing is still around 0. So I mean, could you be a bit clearer on where the growth is coming from and what is driving this?

George Quinn
Group CFO & Member of the Executive Committee

Yes, thanks, Thomas. So on the first point on the economic combined ratio, I guess we all have to agree on what economic combined ratio meant. But I mean, I assume we're talking about time value of money, mainly, rather than the capital charges. And I guess the key issue being that -- I mean, given the comments earlier about the impact of interest rates, some of that movement in the combined ratio is actually required to maintain earnings. But I mean, I guess you can see that the impact of the improvement in technical underwriting profit completely overwhelms the impact of interest rates, even if you model it forward for the entire duration and the entire turnover of the portfolio.

So I mean, I don't have a number I can give you for the economic combined ratio. But I guess the good news is when interest rates are this low, there won't be that much difference between an economic combined ratio and the actual one that we're currently printing. You mentioned within that, I mean some -- you raised the issue of loss picks. So I mean I do think we've changed the philosophy in the first half of the year. So I mean, we've tried to be pretty consistent. So the loss cost trend that I mentioned earlier is pretty much in the same area that we had for last year. So that means we're carrying the same assumptions through into these loss picks for inflation as we start 2021.

I think if anything, the -- I mean this very recent experience on the more recent years is probably slightly better as we ended 2021 than we would have assumed a year earlier. [indiscernible] liability from that, given that that takes some time to develop. But at least the early signs around the reserving at the end of 2020 would give me the impression that things are actually stronger than we would have assumed a year earlier.

On the retail side of things, so I mean, we do have pretty strong growth in retail. I think that's probably 1 of the more surprising things for me. I think we -- well, certainly I had anticipated that retail might be under more pressure than has transpired. I think because of the way the particular market positions that we have, that we're not so concentrated in some of the ultra competitive parts of the market where maybe some of the frequency change and the point that Vinit mentioned earlier has started to feed back into pricing. But if you look at our retail markets, I mean, we've seen pretty good growth everywhere perhaps with the exception of the Zurich business in Latin America where because of the -- I guess the later incidence of COVID, they've had more restrictions. So as for example, the mass consumer business in Brazil has had a pretty tough first half to 2021. But the retail business has gone well, and it's gone well very much across the board.

Operator

[Operator Instructions] The next question is a follow-up question from Mr. Andrew Ritchie from Autonomous.

Andrew James Ritchie
Autonomous Research LLP

Sorry to return to the topic of reserves. I can see there's been some holding back of the divisional PYD at Group Center, but I'm more interested in specifically North America. I remember George last year, you strengthened some of the casualty years, including recent years against sort of reinvesting some of the work comp releases. Has that continued in the first half?

I'm just trying to understand if you're still holding loss picks up in some of those casualty classes, given there's really a lack of data on claims for the last 12, 18 months. So that's the first question.

Second question, you acquired a financial adviser business in Italy recently. This is your first sort of forum -- that was a slightly surprising acquisition, maybe just outline what the rationale was behind that deal?

George Quinn
Group CFO & Member of the Executive Committee

Yes. Thanks, Andrew. And at least we have your name the right way, right? On the reserves, so what to say on this? So for the current year, particularly different from what you've seen in the prior year. We did go back and address some older year issues that you can associate with some of the public changes around some of the mass tort topics. So I think that's why you might see the picture that you see from North America. And it's pretty important to point out that that's ahead of the workers' comp review that will take place in Q3.

So I mean, I think from a reserving position, I mean I thought we were in a good place end of last year; seen from today, I'd say that we're in an even stronger position overall.

On the Financial Adviser business...

Mario Greco
Group CEO & Member of the Executive Committee

Can I had to point to this, Andrew? Also, remember that we are in the hardening market, and this is something that always happens in the hardening markets, where 1 of the benefits is that you negotiate better terms and conditions with the clients. But actuaries and claims people continue to reserve for the past conditions, right? I mean, because they don't base their assessments on future, they only base their assessment on what they have seen already. So the knowledge there is the past. And the past is different and worse than what we have today in the books. And that creates a typical situation in the hard markets that reserves are better, are better quality in a sense than ever before. That happens every time, and we're seeing this happening even this time.

George Quinn
Group CFO & Member of the Executive Committee

On the acquisition that we made very recently or we've announced recently, I mean this wasn't something where we sat down earlier in the year and said, you know what, we need to go out and acquire some financial advisers. I mean this is something that is -- it's clearly connected to the relationship we have with Deutsche. Already, this is a group who sells a Zurich product. And I mean, for us to take this step will benefit the business in Italy from a longer-term perspective. But it doesn't change the Group's stance on how we expect to run the business in the future.

Mario Greco
Group CEO & Member of the Executive Committee

And Andrew, remember that we have been working with this network for almost 15 years, successfully for us and successfully for them. So for us, it was a natural thought when we heard that Deutsche Bank was selling them to consider the acquisition, and now this gives us the opportunity to connect them to the insurance agents and use the customer bases of the insurance agents to foster the sales results on the Life side. This network is quite good at selling unit-linked products, which is also our priority in Italy. And so -- it was just grabbing a nice opportunity in the market.

Operator

The next question is a follow-up from Mr. Vinit Malhotra from Mediobanca.

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

Just trying to follow up again on the combined ratio element. The -- just on this pricing, out, I mean if I look at the Europe and North America commercial, the European commercial pricing 2Q is roughly 13% and almost very close to the 14% of North America. Could you just comment on where this is coming from? Because 1Q was 11%, so while everybody in the world talks about moderation, here, we have European commercial actually adding 2 points versus even 1Q. Any comment on that would be very interesting.

And second question is just on Slide 18, I think. The one where we show the retail SME, [AY CR ex-CAT and COVID]. And it's nice to see an 80 basis point improvement. I thought for a while, this segment was kind of flattish. Could you say where this could be coming from? Because I presume COVID frequencies and everything is cleaned out here. Any comments also interesting?

George Quinn
Group CFO & Member of the Executive Committee

Yes. Okay. So on the first one on U.K., it's the U.K. commercial market that's driving this. I think I talked already at the end of the year, but I mean the U.K. was catching up very rapidly on the U.S. I mean that's why you see the outcomes that you see here. I think if you look at the retail business generally and look at where the improvement is coming from, I mean, it's a wide range of markets. And in fact, it's easier for us to exclude some of them than to list all of them. I mean, I think -- I mean a market where traditionally, you don't see a lot of price movement and we tend to be a much bigger motor player, which is a market that has more challenges in Switzerland.

So I mean, here, it's not a big driver of what you've seen in terms of the improvement. But if you look at all the others, I mean, most of them tend to contribute in some way. I mean overall, the picture is still fairly flattish. So the business benefits from the fact that some of the things that -- in fact, I mean, the point that you made earlier about frequency, maybe some of the change in behavior, I mean we benefit more from that than we do from pure price down.

Operator

We have a follow-up question from Michael Huttner from Berenberg.

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

And you probably said this already, so apologies. But how much of the aggregate cover have you used up and how much is still left before you hit the -- not the cover but the retention before you benefit from the cover?

And then the second, and this is really cheeky. Is there anything you can say about dividends? So I was trying -- if I say a question politely, it would be to say, well, if I pretended to be a Board member, I'm not -- then I would look at the excellent solvency, the wonderful cash and the clear, strong trend in net profit and that would be ready to put a big increase number, but I'm not sure if the Board thinks like that or do they think more in terms of what's sustainable.

George Quinn
Group CFO & Member of the Executive Committee

I thought the first question was quite cheeky already. So I mean all I can say on the first topic is that we weren't in the aggregate at the end of the first half. So as I mentioned earlier, I mean, just given the CAT load assumption that we have, I mean, any reasonable modeling allowing for the franchise requirements on the CAT would suggest that we will attach it at some point in the second half of the year, but I can't give you a current update but can't is not the right one. I won't give you a current update is probably the more accurate statement. So sorry for that.

On the dividend topic, I mean, I think all the things that you listed as considerations are correct. The only thing that's a wee bit off is time. So typically, the Board does this starting in December. So I mean it wouldn't be until the end of the year, that this is a topic that we get in depth with the Board.

Operator

The last question for today's call is from Peter Eliot from Kepler Cheuvreux.

Peter Eliot
Kepler Cheuvreux, Research Division

First 1, I mean, I guess you've given us very clear guidance on what the pricing and loss cost inflation is doing, so we can model the outlook. I mean you've also mentioned the tighter terms and conditions. I'm just wondering if qualitatively, George, you could sort of give us a feel for how you'd be building that into your model as well and the sort of materiality of that on the margin outlook, that was the first one.

The second one, just returning to your guidance. I guess you've upped a little bit the outlook for the Group functions and operations in terms of drag there. Just wondering if there's anything in particular that surprised you in that segment that's -- yes, those bits, too.

George Quinn
Group CFO & Member of the Executive Committee

Yes. Thanks, Peter. So I'll do the GF&O change first. I mean not really. I think the -- I mean, there's a series of drivers of it. So we've got a bit of adverse FX in the first half. We got some financing costs related to the Met deal. We've given up some investment income. And I'm currently charging the businesses less for services than we were at this point last year. And I think probably the only change that I've decided to make is that I'm not planning to go back and charge them more and take it back to where it was, say, at the half point last year. That puts more pressure on the Corporate Center to adapt and adjust. And I think generally, that's a good pressure to have in the first place.

On the side of terms of conditions, it's a really tricky one. I think the -- I mean, I guess, if we go back to prior hard markets, you have to go back quite a long time to find the last one. I mean the way that I remember it and it's the way I remember it rather than I can prove it, that tends to be the aspect that has more longevity.

It tends to be the thing that eliminates some of the frequency that the deductible's gone up. Some of the soft markets options that you give to customers to put claims to you, they are removed. But in terms of quantum, I don't -- I honestly don't know today. And if -- I think if we could put a quantum to it, I think the Chief Actuary would have then the reserve strength addition to offset it for the time being until it was approved.

So I think it's something that will benefit us and not just this year but actually even more as we move into the future. But I can't give you any sense of size and not even a materiality, but I think it's extremely important for us. It's part of -- I mean, it's 1 of the things that Sierra and the entire commercial team actually focus on most because it's the thing that will still be here when the rate is not quite as high as it is today.

Richard Burden
Head Investor Relations & Rating Agency Management

Well, thank you, everybody, for dialing in today. If you do have any further questions, the IR team is ready to take them off-line. And with that, thank you and goodbye.

George Quinn
Group CFO & Member of the Executive Committee

Can I interrupt you just for a second? So I guess you guys are all aware. This is Richard's last outing as our Head of IR.

Richard Burden
Head Investor Relations & Rating Agency Management

Well, I guess you hope it's the last as Head of IR.

George Quinn
Group CFO & Member of the Executive Committee

On behalf of Mario and the entire team, I just want to say thanks for the fantastic job you've done, Richard. I'm sorry to see you leave this role, but I'm looking forward to seeing you in the Europe job.

Richard Burden
Head Investor Relations & Rating Agency Management

I'm looking forward to it, too.

Mario Greco
Group CEO & Member of the Executive Committee

Thank you, Richard.

Richard Burden
Head Investor Relations & Rating Agency Management

Thank you, everybody.

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. Good bye.