S&P Capital IQ

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Zurich Insurance Group AG SWX:ZURN

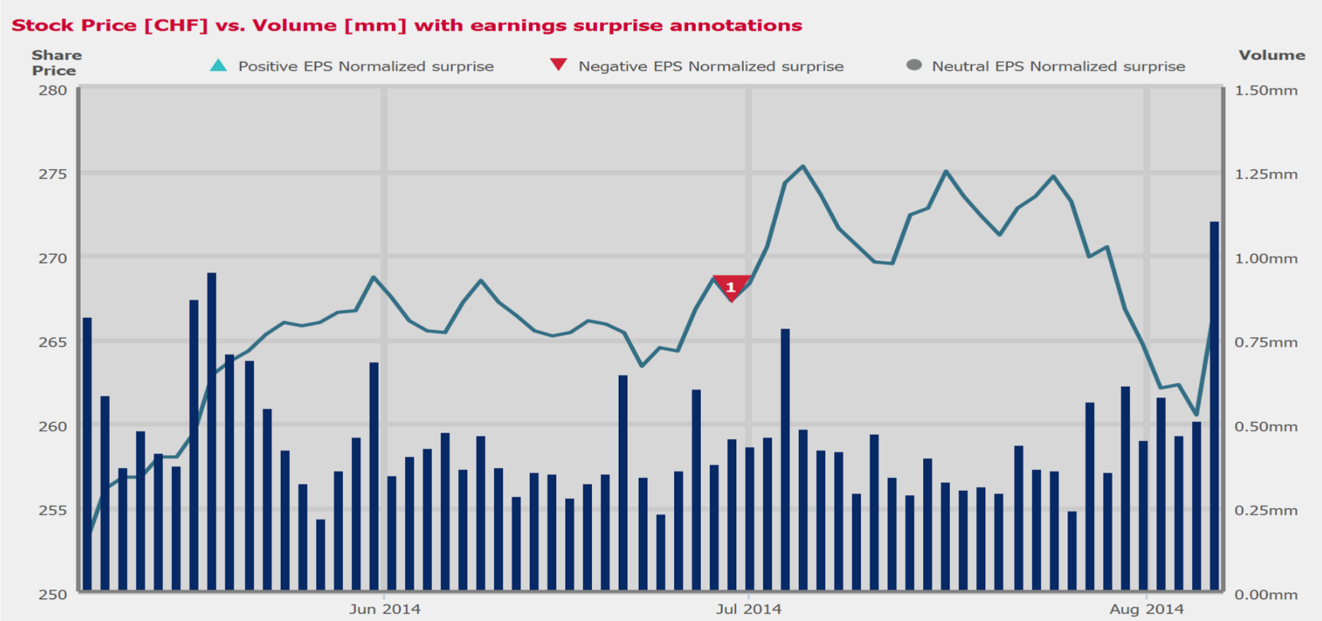
FH1 2016 Earnings Call Transcripts

Thursday, August 11, 2016 11:00 AM GMT

S&P Capital IQ Estimates

	-FH1 2016-	-FY 2016-	-FY 2017-
	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	10.81	21.27	23.37
Revenue (mm)	25146.67	47385.57	48559.31

Currency: CHF
Consensus as of Aug-11-2016 10:40 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FH1 2014	13.55	12.92	1 (4.65 %)

Call Participants

EXECUTIVES

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

Mario Greco
Chief Executive Officer

Richard Burden

ANALYSTS

Andrew Hughes
Macquarie Research

Andrew James Ritchie
Autonomous Research LLP

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HSBC, Research Division

James Austin Shuck
UBS Investment Bank, Research Division

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Nadine Adrienne Marion van der Meulen
Morgan Stanley, Research Division

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Exane BNP Paribas, Research Division

Nick Holmes
Societe Generale Cross Asset Research

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

Peter Eliot
Kepler Cheuvreux, Research Division

Sami Taipalus
Berenberg, Research Division

Stefan Schürmann
Bank Vontobel AG, Research Division

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

Vinit Malhotra

Presentation

Operator

Ladies and gentlemen, good morning or good afternoon. Welcome to the Zurich Insurance Group Half Year Results 2016 Analyst Conference Call. I'm Sarah, the Chorus Call operator. [Operator Instructions] The conference is being recorded. [Operator Instructions] The conference must not be recorded for publication or broadcast.

At this time, it's my pleasure to hand over to Mr. Richard Burden, Head of Investor Relations & Rating Agency Management. Please go ahead, sir.

Richard Burden

Thank you. Good morning and good afternoon, everybody, and welcome to Zurich Insurance Group's second quarter results call. On the call are our CEO, Mario Greco; and Group CFO, George Quinn.

Before we move to questions, we just wanted to highlight the supplemental disclosure that we provided this morning on our reserves. We kindly ask you to keep questions relating to this disclosure for tomorrow's additional call, which is dedicated to the topic. Mario will now make a few comments, and then we will take your questions. [Operator Instructions]

And I'll now hand over to Mario.

Mario Greco
Chief Executive Officer

Thank you, Richard, and hello to everybody from myself, and thank you for joining us. Allow me to make a few comments on the results and on the state of the company today before I open up to questions that George and I will address.

First of all, I'm very pleased to report these results. I think they're good results. They show that there is traction. They show that we're walking the talk, and we are delivering on the -- what was announced that we will do.

In GI, the underlying accident year loss ratio and the expense ratio have both improved, and we stay committed to the 2 to 3 point -- percentage point improvement in the underlying combined ratio for the year. And Global Life and Farmers Management Services continued to demonstrate solid growth and very stable earnings.

Capital is resilient. The Zurich economic capital ratio is well within our target range at an estimated 107% at the end of June. Cash remittances, they are still coming above the targets, and we still target it to be over $10 billion at the end of '16.

So this looks like as a good start of the year. We acknowledge that there is more work to be done, and we're ready to do this work in the remaining part of the year and then in the next years. However, this start gives us a lot of confidence that the actions taken are the right one and that we can really fix the business and restore the profitability back as we thought we would.

We expect, of course, a further improvement in the second half of year, and then we will continue over the next years improving the business. Also, let me reconfirm to you that at the end of this semester, I still see the group as fundamentally sound. I still see our reserves position as a strong one. I still see the capital as strong and the brand as a very strong and effective one. These are all very important characteristics that we need to build upon.

And again, I'm not forgetting all the things that we need to fix. The loss ratio has to improve. The costs have to further come down. But this is very solid organization with lots of skills, a lot of professionalism, and these results show that, I think, in a tangible way.

Also, let me quickly spend a word on transparency and communication. I think the transparency -- the data that we provided for tomorrow on reserves give a lot of transparency also on this issue. And you can count on us continuing to build a very open dialogue and deliver all the necessary information in a very transparent way.

We're also working very hard to position Zurich for the future and to shape a very clear and simple strategy for the next years. However, the organization is already changing and is already getting simplified. We're progressing with the head office restructuring, and we are extending that same stream of actions to the countries, where we're piloting the impact of the simplified current [ph] organization into 3 European countries to draw then conclusions worth considering for all others.

We're looking forward to meeting all of you on 17th of November for the Investor's Day, where we will update you on the financial targets and on our strategy. But in the meantime, we remain committed to continue improving the business into have a strong second half of the year and showing you that the improvements will continue.
Thank you very much for listening, and now George and I will be happy to take your questions.

Question and Answer

Operator

[Operator Instructions] The first question is from Peter Eliot, Kepler Cheuvreux.

Peter Eliot
Kepler Cheuvreux, Research Division

I guess the first question was there's a lot of references to the impact of large losses both in your presentation and commentary. You've given us some numbers and comparatives there. But I guess you used to give us an aggregate figure. And I'm just wondering if you could quantify the overall impact that large losses had in the quarter and how that compares to historic averages. And then secondly, I'm just wondering if you can help me understand at a very high level the -- sort of the interaction, the timing of the actions you're implementing. I guess you attribute quite a lot of the improvement to actions you've taken, but I guess rate increases take time to earn their way through. And although you said you varied the rate increases overall 2%, I guess it's not a huge amount. And then with expense savings, restructuring charges are very much weighted towards the second half of the year. So I was just wondering if you could say at a high level, help sort of guide through the timing of the improvements and say perhaps that's why we're seeing quite a lot of this early.

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

Let me start. So on the last topic, I'm not going to get back into isolating large losses from the overall because the goal for the firm is to focus on the entire loss ratio, not to bring the entire thing down, whether it's attritional or large losses. But to try and help around what we have in the quarter versus what we expect, which may answer a question that a number of you may have. I mean, if you look at the result we have for the quarter, we have a combined ratio of 99. We are, I think, about 98.3 for the half year. I think the half year is a pretty good indication to where we think we are today on an underlying basis. So somewhere in that mid-98 range, and that compares to the ambition that we had to bring ourselves down by 2 to 3 points, as Mario mentioned, from a level that was around 100 points underlying for last year. If you look at the quarter, I mean, the main deviations would be that on the large loss side, I think if you take the number at face value, we've made more progress at this point than we expected. I think in reality when we dig into it, there's almost certainly some randomness in the large loss performance. And we would assume that that's resulted in a end result that's in our favor in Q2. So I would assume a slightly higher level than we've seen. Maybe about a point higher in the combined ratio than we've reported today. On the expense side, we also have a number of one-offs. I mean, you've seen we have a very strong figure, 30.3 on the expense ratio. If you allow for the impact of some of the one-offs and the impact of RCIS, which causes a bit of a flip between loss ratio and expense ratio, I mean, we would see the expense ratio for the year, I mean, being somewhere, I mean, close to a point higher. So if you allow for all of that and you allow for some continued earning through the attritions, coming on to your second question, timing, I mean, you've seen us report positive rate in Q1. It's slightly less in Q2. I mean, in general, what we see at the beginning of the year will earn in, I mean, roughly 1/2. But it's probably more than 1/2 this year, remainder next year and that pattern will continue. So there'll be a bit of a lag. But I mean, we would certainly expect to see that come through as around 0.5 point on the attritional as we get through the remainder of the year. I mean, overall, we think we're well on track, large losses, notwithstanding cats, notwithstanding to achieve that targeted combined ratio. On the broader topic of timing of the actions around restructuring, so you've seen that I mean, so far in the year, we've incurred about $227 million of restructuring cost. Mario announced several weeks ago a restructuring to improve and simplify the organization, increase the focus that we have on the customer. We're running through that process now. That will generate some more costs and likely -- mainly in Q3. I expect the total cost for this year to come within the overall guidance that we've given on restructuring, so within that $500 million guidance that I gave earlier in the year. As far as the benefits are concerned, I mean, there's no update I'll give you today on the benefits other than we still expect and anticipate it will deliver that $300 million improvement this year with an overall goal to deliver $1 billion by '18. That will be a topic that we'll update you on more when we get to the Investor Day.

Operator

The next question is from Dhruv Gahlaut, HSBC.

Dhruv Gahlaut
HSBC, Research Division

First question is in regard to the cash remittance target of more than $10 billion. Could you give us an indication in terms of where you are with the remittance since the start of the year? Secondly, also on an underlying basis on the GI book, could you say how price versus claim inflation is running at this point? And what are you expecting for the next -- in the second half basically?

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

So on the cash remittance, so just to reiterate, we've -- there's no change in our view of what will happen this year. We still expect that we'll deliver more than $10 billion compared to that target of $9 billion. That would imply a minimum of $2.4 billion. But we've also said that, I mean, assuming an unchanged dividend, we expect the dividend to be cash covered this year. I mean, the way the pattern works is that excellently the flows are split, I mean, roughly evenly, believe it or not. The summer is quite a quiet period. Towards the end of Q1, beginning of Q2 is the first major flow, and then in Q4 is the second one. So currently, we're exactly on track with where we expected to be. We don't see anything that would cause us to change our view. So we're confident that we'll achieve the cash remittance guidance that we've given you, right. On rate versus loss cost, I'd -- we haven't seen anything that signals a change in the loss cost pattern from what you -- what we talked about on the call here back in Q1. So we're still seeing positive margin growth with the rates that we're achieving but it is relatively modest. So I mean, given the 1.5% headline rate increase we talked about, we're talking about 50 bps of margin expansion or thereabouts.

Operator

The next question is from Andrew Ritchie, Autonomous.

Andrew James Ritchie
Autonomous Research LLP

First question is for Mario. Mario, you quoted on the papers saying you feel more confident about the second half. I mean, the -- nonlife is improving, albeit more or less in line with the run rate you've targeted. What really is it that's making you more confident about the second half and relative to what point? Is this because you now feel you understand more about the root cause of what the problems were? Or you've done a bit more work on understanding where the cost opportunities are? I'm just trying to understand exactly what it is that's giving you so much more confidence about the second half. And the second question for George. You talked about further attritional improvement coming through in the second half. What the impact of RCIS on that? Because obviously, most of the premium earned in crop is in the second half, quite late in the second half. What was sort of combined ratio RCIS is running at? And when you talk about further attritional loss improvement, are you talking excluding that? I appreciate it's a high -- I mean, obviously you had high losses, low expenses, but maybe just clarify what the impact of RCIS will be in the second half.

Mario Greco
Chief Executive Officer

Andrew, I'll start and then I'll pass it to George. I think I was saying that we're all more confident, not just me. When I joined the company at the end of February, beginning of March, I found everybody's hesitant, scared because '15 has been truly very bad year and very disappointing, and the disappointment and the sadness for the result were still there. I think these results give a great boost of confidence to the underwriters, to the sales people, to the claims people, to everybody that they have been doing the right things, that they put the situation under control, they took the right measures. And so it will give them much more confidence in continuing this, trusting that this is working and this is going to work also in the future, but this was needed. And so it's not just me, I mean, it is the morale of the organization. It is the confidence of the underwriters who will be now negotiating with people, and they know that they have been calling the right shots over the last months. It is rebuilding a little bit the pride and the conviction of the organization, which is very important. And still I see Zurich as a super competent organization, but morale and conviction are very important to make every day a success.

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

Andrew, on the second point, on RCIS, I don't expect that to have a major impact on the overall combined ratio to run through the full year. I mean, the components will have some impact on loss versus cost. But given some of the cost that we expect to incur in integration in the second half and the fact that -- I mean, I think you're right, the premium is back-end weighted, so I mean we have about $127 million in this quarter. We'll be a bit above $400 million by the last quarter. But overall, I'm expecting a result from RCIS that's not that far away from where I'm guiding for the group.

Andrew James Ritchie
Autonomous Research LLP

So it would be more impactful next year, I guess, then?

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

Right. We certainly expect more from it next year, yes.

Operator

The next question is from Sami Taipalus, Berenberg Bank.

Sami Taipalus
Berenberg, Research Division

Just 2 things. First of all, on the global commercial premiums, I think you put through 1%, the rate, and you saw about 13% drop in volume. It's a bit difficult to gauge from where I'm sitting how much of that -- exactly how that came through. So I'm wondering if you have a feel of how much rate decline you'd have to take to keep the volume flat. So that's the first question. Second question is, you gave us a bit of an update at Q1 about the positive impact that your increase in reinsurance buying had had. And I was wondering if you could give us a further update on that and whether that's changed your mind at all about buying reinsurance more broadly. I think in the past you said that you bought reinsurance to protect capital rather than earnings, but what -- whether you've changed that more towards buying reinsurance to help earnings rather than just to protect capital.

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

So maybe on the first question, I think that's probably the opposite way from the way that we normally think about it because I mean we're looking to solve for a return outcome rather than think of what kind of return do we have to give up to maintain the volume. I mean, I think you're right to point out earlier that -- I mean, we continue to do what we said we were going to do at start of the year and that's to focus on the underperforming parts of the portfolio and essentially do what you'd expect us to do, and that's either push for the required rate increase or give up that business. And that's something that in particular global corporate has been completely focused on through Q1 and Q2, and you see the largest impact there. I mean, in return for that, we do have a significant impact on rate. You see we've updated the tiering charts today. We continue to push very hard on the underperforming parts of the portfolio. That has impacts both on overall rate versus market. I mean, the market overall is clearly slightly negative, but we're still achieving positive margin improvement, but we are giving up business in the process. That's something that I expect will continue throughout the remainder of this year as we cycle through the entire portfolio.

I mean, it won't continue forever, but in this adjustment is absolutely needed so that we get to that level of profitability that's required. On the reinsurance topic, there's not much more to say on that today from what we said earlier in the year, other than to reiterate that you won't see us go back to where we were before and prioritize keeping the lot -- the gross and net [indiscernible] but to try and use the reinsurance and then as intelligently [ph] as we can, and especially around risk that can be volatile but which are well priced. I mean, that's really where it can play the most effective role for us. I mean, so far this year, we haven't had to rely on reinsurance. The improvements that you've seen in the results today have come from what was done on the underwriting side and it's not driven by reinsurance. But the direction we've set around our risk appetite continues and that'll be reflected in the reinsurance programs that we put in place for next years and the years to come.

Operator

The next question is from Nadine van der Meulen, Morgan Stanley.

Nadine Adrienne Marion van der Meulen
Morgan Stanley, Research Division

A question on the cost savings on the life side. The operational costs in the -- in Global Life were quite a bit better than I expected at least. And how do you think about your existing cost savings target there? And how should we look at your approach on the longer term there? And secondly, on the dividends, you've commented in the past that you felt that perhaps one sort of fixed number was better replaced by dividend policy. Can you elaborate on that, maybe give us an idea of what kind of policy you're thinking about? And then on the reinsurance that George just spoke about, I was wondering whether you could give the gross loss ratio just to gauge the impact of the reinsurance program.

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

So cost savings, particularly in life, so -- I mean, life is one of the trickier areas because life has some relatively rapidly growing businesses, which I mean need cost support to continue that growth. So I mean, on life, the overall aim is to have the same discipline there that we've had in the rest of the business or we need to have in the rest of the business, and I think we see it. The -- but the characteristic is different from GI. Life is still expanding. Life has attractive margins in most of its businesses, and we continue to invest there where we can. I mean, where we've really seen the cost benefit on the life side is partly through charges. And so the impact that some of the things that we've announced this year have had on the cost efficiency of the firm translate through to the segments in the form of lower charges from the group. And that's a trend that I expect to see continue through this year and, in fact, as we complete the cost saving process or program, continue into next year. I think the other thing that makes life slightly tricky to judge is the policyholder elements, of course, the -- I mean, cost savings are shared with the policyholder in many of the businesses that we have. But overall, life is subject to the same disciplines as the rest of us, but the benefits you're seeing are probably coming mainly from lower charges from the Corporate sector.

Nadine Adrienne Marion van der Meulen
Morgan Stanley, Research Division

But that's reflected in the acquisition cost as a percentage of GWP being lower, is that right? That fell from 10% to 8%, I believe.

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

I don't know, Nadine. I need to go back and look at the precise driver there. I haven't done that comparison. On the dividend, I've nothing new to say on dividend today. The -- it'll be a topic we come back to again as part of the Investor Day. I have nothing to add.

Mario Greco
Chief Executive Officer

But nice try anyway.

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

On the reinsurance, I'm sure we can get you the gross. I don't have it to my fingertips, but we'll get you the gross number on reinsurance.

Operator

The next question is from Thomas Seidl, Bernstein.

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

First question on the business mix in P&C between the 4 units, I guess. Global Corporate was expected. Then we observed continued loss in Europe, U.K., Germany, Switzerland, Italy, you mentioned. You started to divest international market and I see you mainly grow in captives. My first question is, is sort of this a trend we should expect continue in the -- in those 3 segments? And the second question, we have seen quite dramatic fall in interest rates globally, I'd say, yet you stand out as a company showing higher running yields on the fixed income portfolio when you look at Slide 22. So I wonder how that is possible.

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

So you're right, it's not possible. So that when you look at the slide there, you need to be careful that the number in the thing is not annualized, so you have to annualize one to the other. So I think if you're looking at the GI numbers, I think you see 1.33 versus about 2. But of course, the correct comparison would be to annualize the 1.33 and you get about 2.66 versus 2.

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

No the -- to the prior year, it's 1.22, right? So you improved running yield by some 20 basis points.

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

But the other thing to watch for is, I mean, as we bring cash back to the center, that can have temporary impacts on how you compare year-over-year. So when you look at this year in Q2, I mean we can see some distortions because of the cash flows. In fact, the running yield in GI has actually risen Q2 over Q1, and that's mainly because of some of the internal routing of cash in the company rather than something that's taking place in the markets that would be inexplicable. So it's really that, Thomas, that's doing it. On the P&C business, I mean I think what you're really seeing -- I mean, it's going to be the same answer to the -- that I gave to the earlier question. The -- I mean, across all the businesses, we're looking at profitability. We continue to prioritize that over volume. That process is going to continue through the remainder of the year. I think you can still expect to see a GWP decline ex the RCIS business that's in that mid-single-digit range. That's going to be the key driving force for business mix shift in P&C, nothing more than that.

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

And in Europe, in particular, I'm interested in like Switzerland. Is your ambition to regain some of the lost market share there over there or no?

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

So again, the ambition for all markets is profitability. I mean, we want to grow profitably over time, but we're not going to grow at the expense of the firm's required returns. I mean, there are markets that will offer us opportunities to expand, I mean, even this year. But in general, given the starting point and given the current prevailing market trends, we expect to shrink the overall volume in P&C.

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

In Europe?

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

So overall. I mean, again, in some markets, in some lines of business. So if you look at -- for example, go back to Switzerland, so you see an improved performance in Switzerland. We're giving a piece of volume on one particular line of business because we prioritize profitability in that line and that we think has had a positive outcome for us. I mean, market by market, we'll respond as market conditions change, but we will give our market share if that's what's required to deliver the right level of return.

Operator

The next question is from Paul De'Ath, RBC.

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

Just a couple of, hopefully, quick questions for me, firstly, on the prior year developments. There's another kind of reserve increase going through there and offsetting some of the positive developments. And I think in Q1 that was effectively increasing the group reserve. Is that still the case? And what's the sort of plan going forward on that? And then the second point was just on, you've obviously changed your portfolio of businesses around a bit. You've announced a number of sales. Are those already included in the numbers as in you're stripping out the businesses that you've sold? Or is that still to come and therefore could provide a boost in the second half?

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

Thanks, Paul. So on the first point, the PYD -- the reserve increases in the group re component, so you're seeing exactly what you saw again at Q1. We've taken advantage of the fact that group re comes relatively late in the process, allows us to sit back and look at all the risks that the group faces and make an overall judgment of where we would like to land, and that's exactly what we did. I mean I think we all realize that's not a very elegant way to do it. We're not intended to continue that policy far into the future, and I think you'll see that change so that we'll avoid this gross large PYD with a net number that, offset after group re, equals something that's in line with the guidance. We'll try and make sure that's integrated in future, but the picture you see is identical to Q1. On the disposals, I mean, we've made some -- you're aware of what's happened, so Morocco, South Africa, Taiwan, Middle East. There's a very small negative impact from a goodwill charge we take in, but it's not material in the result. Most of the impact is not in yet and that will come as we close the transactions. I think at this stage, the ones that are meaningful from a reported result perspective will likely close in Q4. We've got one where we'll take a relatively substantial gain. One will have a -- well, we still got a tangible book, but we'll have a book value loss. I mean, overall, we expect to see a loss of around $60 million from the transactions so far, most likely Q4.

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

And just to follow-up on that, what impact will that have on the combined ratio? Is there any sort of benefit as in they have a higher combined ratio of the businesses that you've sold?

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

I mean, overall, nothing material. I mean, some of the -- I mean the business is up -- I mean, the decent businesses but they don't have a huge impact on the results of the group.

Operator

The next question is from Vinit Malhotra, Mediobanca.

Vinit Malhotra

Just on the Z-ECM estimate of 107%, there's a footnote that there is a plus/minus 5 points of margin of error in this quick calculation probably. Would you say that you're on the conservative side of that? Because I'm otherwise struggling a bit to see how come after adding say 1 point for earning and 2 points for some debt, you're actually below your 1Q level. So if you could just please comment on that, or maybe even help us more by commenting on the interest rates and credit spreads you have effectively you have assumed there. Second thing is just on this whole attritional thing. There seems to be an improvement also in Brazil, well it's not only Lat Am, but mostly Brazil, which is probably -- have some, speaking to IR, around 5 points of delta Y-o-Y. Now we have seen some other players also talk about an improvement in Brazil. Given where the economy is, et cetera, I mean, what do you think is driving this improvement? And are you more bullish about this turnaround story now than you were last quarter?

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

Thanks, Vinit. So on Z-ECM first, so the -- I mean given this is not a regular year-end, we gave a comment around some of the increased risk we have around the estimate, but we have given you a best view of what the number is. It wasn't intended to be conservative. It's not intended to be aggressive. It's intended to be what we expect it to be. On the moves themselves, I think the -- if you look at, I mean what took place in the quarter and you're right. We have some additional capital which is really the refinancing of something that matured already last year. I think the part that's -- it's obviously very difficult to judge for outsiders. I mean, it's actually very difficult to calculate it for insiders as well, and that's some of the market moves. Some of them are obvious around spreads and equity markets. Interest rates are tougher. I mean, the disclosure we give, we tried to improve it at this time to include some of the nonfinancial market elements on the interest rate piece, but it's a parallel shift. And of course, I mean, most often the curve tends to have a bit of a twist somewhere in it, and I guess that's what you've seen. I think we saw already at Q1. You see it again in Q2. And the very long end, I mean, things are pretty flat currently. I mean also -- I mean, the Brexit timing, I mean, it couldn't be worse from a financial reporting perspective coming at the very end of the quarter. And of course some of that will have bounced back already as we've entered Q3. But in essence, I mean, what you see in the Z-ECM move is the impact of financial markets, interest rates and the mark-to-market impact on equities and corporates, partly offset by the issuance of the hybrid. On Brazil, I think the -- I hope before we didn't leave you with the impression that we didn't actually expect to achieve the goals that we set out for Brazil. I think we had confidence. I mean, I think we talked before about the changes in the team that were taking place, the increased focus we have there. I think there's -- I mean, from a market perspective, it's quite tough given the economic conditions. But I think we have the benefit of -- I mean, we were tackling some particular problems to Zurich, which I think the team have focused on and addressed very well, so that certainly helped on the performance side. And they've also had the benefit of the -- I mean, now the impact of a transaction we did about 18 months ago on the mass consumer side. I mean, the volumes on that deal are impacted by the economic conditions, but the deal is actually performing pretty well for us. So I think that combination has helped Brazil produce the performance that you see now.

Vinit Malhotra

Is there large losses as well there because maybe that's something that could be influencing?

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

Typically, it's less of an issue in Brazil given the nature of the business. It's much more of a mass consumer-oriented business.

Operator

The next question is from James Shuck, UBS.

James Austin Shuck
UBS Investment Bank, Research Division

Two questions from me, please. I just wanted to return to the combined ratio outlook for the full year. Mario mentioned that the 2 to 3 point improvement is still on track for this year. So I think that's implying that you'd kind of be around 97 for the full year 2016. You've already mentioned H1 is normalizing at about 98.5 or so. I wasn't really too clear what you meant around the degree of luck in large losses in the first half, maybe a point or so of good luck. I guess the implication is if you're going to get to 97 for full year 2016, then H2 is going to have to be much better than the 98.4 you published at H1. So could you just help me understand or have I done my math right on that, and what is it that's kind of driving close to 95, 96 in the second half of the year? And then secondly, around the -- just hoping for a little bit more insight into the Z-ECM normalized capital generation, what a kind of normalized run rate is for that. I think based on your current kind of growth requirements, which the portfolio is shrinking somewhat as you reunderwrite and also the level of earnings is probably not quite where you would like it. So if you hit your kind of required targets on the combined ratio and once you move to a kind of more normal level of growth for this company, which I'm sure you can elaborate on at the Investor Day, but what should I be thinking about as a normalized level of Z-ECM capital generation? And how do you see that in relation to the dividend, please?

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

Yes. So on the first one. So apologies, it was because I gave 2 answers to the first question. I've probably confused some people. So I talked about the fact that the half year is, I think, a good guide to what we believe the underlying to be. That would require us to do better than that in the second half. I think for us -- I mean, one point to bear in mind, we don't expect to offset any natural catastrophe scenario. I mean, so far in the year, we're quite close to expected so there's no significant negative impact, but we do expect to see improvement in the second half. I mean, going back to what I said, if you focus on Q2, the headline number is 99. We would knock off about 2.5 points for excess nat cat. We'd probably take about 0.5 point for attritional. It's quite hard to judge, but given the rate improvement we've seen, that's what we'd expect to see roughly end through. On the expenses, we'd expect to see the expense ratio for the year come back up to around somewhere slightly over 31. And for the large loss piece, I mean, clearly we believe we actually have a bit of asset randomness. I don't want to use the word luck, but obviously there's some volatility in large losses. I mean, I would add back a point for that. I think if you do all of that for the full year, we'd expect to see the combined ratio land in the 97, 98 range. On the second topic on capital generation in Z-ECM, in many ways -- I mean, I think if you look at it in a very detailed way, it becomes a phenomenally complex question to try and answer. I think if you step back from it and you say, "Well, let's ignore all the noise that can come from the mark-to-market element." If we focus a bit on the fact that interest rates are just very, very low, so the discounting elements are also quite small. Given our bias to C [ph] and GI business that also tends to reduce the discounting element to a relatively low level. I mean, you have some of the capital requirements can be driven by some growth, but I guess in the short term, we're not going to have significant growth rates. I don't mean just because of the portfolio actions underway, I mean just because of the general prevailing market trends. So I mean growth in our business will be quite modest. And if you look at the diversified capital requirement, it's going to be very, very low for us. So for me, I think the best indicator is actually to look at the expected cash generation. I mean, that's a good indication if you look through all of the capital requirements that exist in the group to give you a sense of what we expect the capital generation to be. I mean, the 2 in the longer term are going to be synonymous with each other, and we would see cash being back to the level that we've guided to before provided we achieve the turnaround that you can see the beginnings of within GI currently. And that would imply somewhere around that $3 billion mark.

Operator

The next question is from Nick Holmes, Societe Generale.

Nick Holmes
Societe Generale Cross Asset Research

Just a couple of questions. First one is looking at NAC and Global Corporate, you're still showing rate increases in a soft market, and I wanted to ask do you think this can be relatively easily maintained? And presumably, there are some pricing pressures you're up against, and can you tell us more about which of the lines -- which are the biggest challenge? And then secondly, turning to the life business, I wondered if you could talk us through concerns about the low interest rate environment. Your investment margin seems to be holding up very well. But I guess my question specifically would be, if interest rates don't rise, then when do you see this investment margin starting to erode?

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

So on the first one, I think the -- I mean, the only way that you can really achieve rate increase in the current market conditions is either being very, very focused in a very small number of businesses that are actually showing improving rate or by doing the types of things that we're doing on the portfolio currently. If you look at NAC, I mean, NAC has -- I mean, even ex the RCIS acquisition -- I mean, headline growth, but the reality as we back out the captive impact from that, NAC has a decrease as well. I mean, it's that risk selection that's driving rate? I mean, if you look across the businesses and if we focus on North America again and its NAC, I mean what we would see there is that the softer end of the market continues to be property and workers' comp has also come off of a, I mean, a position 18 months ago where we saw a relatively healthy rate increase. And over the course of the last 18 months that's decayed to a level that's pretty flat today, but it's really risk selection portfolio management is driving the rate improvement.

Nick Holmes
Societe Generale Cross Asset Research

Sorry, George, just as a very quick follow-up. I mean, are there areas of worry for you in maintaining this big improvement in risk management?

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

So the -- I wouldn't describe it as a worry, but I think what it really means is, is there's a limit to how far you can push this in a relatively soft market condition. So I mean, if while we're working on the portfolio composition, you can expect to see it continue. But once we get to the end of that, we'll be subject to the same vagaries of the market as everyone else. So I mean, I think that means that the improvements that we are pushing through the portfolio is certainly on the loss cost side. I mean, they have natural limits given the market trends. I think on expenses we can definitely do more, but the loss cost side obviously has limits. On the life business topic, the -- we obviously, the interest rate moves are -- and it's not new. It's not helpful for the life business in general. It's particularly problematic for some markets in Europe. And I think you know already that, I mean, that's a -- the markets that are particularly impacted are markets that we deprioritized, I mean, quite some time ago. So they're relatively a smaller part of our portfolio. So we're less exposed to the downside of it, we're also less exposed to the upside. I mean, for us, concretely, it's -- I mean if investment rates really don't rise then, for example, in Germany, it means the initial pressure that we'll see from ZZR, we've talked before about the -- I mean, this impact between 17, 18, 20, 21 and the need to fund ZZR. I mean, just for Germany, that will impact will continue for much longer if interest rates don't eventually start to demonstrate some upwards momentum. I think though -- I mean, I think if interest rates do stay here, I think we all -- I was going to say assume. It can't be assumed. I mean, insurance companies are going to have to act. I mean, the model is that we pass this through as part of a business model. I mean, maybe given the current competitive market conditions it's difficult to do that. But I mean, at some point, we all have to do it. And if interest rates stay where they are, I don't think that day is particularly far ahead of us.

Nick Holmes
Societe Generale Cross Asset Research

Okay. Can I just quickly follow-up with a specific question on the speed of the impact from low interest rates? I mean, as you say, you've described in the past in Germany, pressure building sort of over 5 years. Can you be more specific as to the effect on the investment margin over the next 2 years if interest rates do not rise? I mean, would you actually expect much effect on your earnings or not really? Would it be longer down the road?

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

So the short answer is, if we assume that the interest rates stay where they are and we really did nothing in response, what it really means is that -- I mean, much further down the road, earnings don't recover as quickly as they would otherwise. I mean, I don't see that it accelerates things, but equally I don't really believe that's the outcome we're going to have. I mean, I would expect us to take action to start to pass through the impact of that in the products that we have. And certainly if we don't do that, I mean that issue is -- I mean because of the duration that we have in the portfolio, I mean, we have many years before you hit the problem. You don't have the recovery that you'd expect to see.

Nick Holmes
Societe Generale Cross Asset Research

So for the next couple of years, you wouldn't expect to see much negative impact from low rates?

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

Not beyond that we've discussed already around Germany.

Operator

[Operator Instructions] The next question is from Michael Huttner, JPMorgan.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

And again, these are great numbers. Well done. And so my question is really to find out or to try and see how much more there is in terms of improvement. On the combined ratio, if I look at it from 2 points of view, so the first question, you explained in great detail in answer to the last question to the one before where the combined ratio could be. But I'm still not clear whether that means a second half combined ratio, so it's somewhere between 97 and 98 or the full year combined ratio between 97, 98. And of course, I'd like to hear the answer of 97 to 98 for the full year because that implies that there's a big improvement to come in the second half. So if you did 98.5 in the first half and 97.5 for the full year, you'd need 96.5 in the second. And then kind of pretty much the same topic, you discussed a lot the impact of the pricing, but you didn't identify separately, and I just wondered if that could come on top the benefit of all those cancellations in your Tier 4, where you're canceling twice as many or twice as much as you would in the other portfolio. So you're retaining 62% overall or you're retaining 80, so you're cancelling huge amounts hopefully they are very bad or not very attractive business.

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

So the combined ratio guidance was for the full year. So we expect to produce a combined ratio that's in that 97, 98 range full year. On the cancellations, a couple of comments on that first. So the -- you've seen the tiering slides. We talked already I think on Q1 about the proportion of the business that was in Tier 4 in particular.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Could you remind us because I'd forgotten that?

George Quinn

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

I think the guidance I gave, I think, was something in the mid to high teens percentage-wise of the overall portfolio. Tier 4, just because of the portfolio mix and the renewals that we have in Q2 is actually quite a bit smaller. It's maybe slightly more than half of the size of Tier 4 in Q1. I mean, the cancellation is fully factored into the rate change component. So I think if you look at that and you're using the volumes to project forwards, the benefit of that rate feeding through, I think to then separate that part out of the portfolio and deduct it again, I think I'd probably be double counting, Michael, if I did that. So I'd look at the rate change as the best indicator to the improvement you should expect to see.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

The 14%?

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

Well, I wouldn't pick out only that one piece. I'd look at the overall portfolio. So 1.5% overall.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

1.5%. Okay. May I just add just then one tiny little bit? The -- on solvency, so I was a little bit disappointed by the 107. I didn't think that you had so much sensitivity to markets, particularly, because you're not so big in German life. Is there -- at what stage should we -- would you see a potential risk that you're nearly 100% low end of your target range?

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

So I guess the first thing -- maybe a couple of comments around in how we measure things. I think actually -- I regret the fact that we didn't double the index that we used because we could be kind of direct [ph] 214% solvency ratio against the target of 200% to 220%. I mean, those sensitivities are -- I mean, greater, not because of a risk driver, but because of the methodology that's applied. So we have no -- unlike Solvency II, we don't have the benefit of the ultimate forward rates. We don't have the benefit of matching adjustment. We don't have the benefit of volatility adjustment. So in our numbers, you get a complete mark-to-market movement. And that means that, as a company, we've tried to calibrate our range to allow for that. And we accept the fact you'll see more volatility in our figures. I mean, given what's happened in this quarter, I'd expect to see a bounce back from a combination of -- I mean, some of the retraces seen in the market since the end of the quarter. And of course, I mean, we have been doing -- I mean it wasn't driven by this, but we have a refinancing program underway. And one of the things we've done is refinance a piece of senior as hybrid and that of course will benefit the capital strength of the group in the second half. I think if you're prepared to step back and look at the sensitivity from a real-world perspective, I mean, we could not be more sensitive to this issue than most of our European peers given the mix. So it's purely a reported number issue. And of course, I mean we won't -- we're not going to panic. I think we see a capital number that's resilient, roughly in the middle of our range. The trend we expect for Q2 will be positive. But of course, we don't know what will happen in terms of markets through the remainder of this quarter or next. But overall, from a capitalization perspective, we feel quite comfortable.

Operator

The next question is from Stefan Schürmann, Bank Vontobel.

Stefan Schürmann
Bank Vontobel AG, Research Division

Just 2 questions. The first one on update on the BT [ph] acquisitions. George, you mentioned that the impact will be mostly in Q4. I just wanted to make sure that the $60 million or so you guided was basically a NIAS sort of BOP related figure or both. The second one just generally update on duration gap. Can you give me an update is there anything changed from Q1, end of Q2 life and nonlife, please?

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

So on the first one, the figure I gave you is a NIAS impact. So consistent with our past practice, we'll keep that outside of BOP. But I mean, watch for it coming in NIAS. On the duration gap, I think we were very slightly long. We are currently very slightly short, but the change is completely immaterial.

Operator

The next question is from Andy Hughes, Macquarie.

Andrew Hughes
Macquarie Research

A couple of questions, both about costs, I'm afraid. So what you've done in the U.K. is kind of bring the life and GI businesses close together under common management. And I guess it's kind of mainly the life guys who are running that. And sort of -- this sort of press is sort of jumping on it as kind of a bit of a brain drain from the GI business. I'm just wondering, is that the kind of strategy you're going to roll out? Is it going to be bringing the kind of life and GI businesses closer together? And kind of how's that going to work in terms of a life guy managing a GI business and et cetera, et cetera? And I guess the question on cost savings was, I know you talked about the life cost savings you shared with the policyholders, but obviously if you achieve the life cost savings and you put through the renewal cost reduction in that year, you suddenly get a leverage benefit on your earnings and a leverage benefit also on capital, I guess. So I guess the question is, so can you break down the kind of $1 billion in '18 or the $300 million benefit between life and nonlife and give us an idea about how that impacts Z-ECM? Do we get kind of big benefit when you realize the cost savings through the life business?

Mario Greco
Chief Executive Officer

So Andy, this is Mario. I kindly ask George to take care of the last question because I wouldn't be able to address it. On the country organization, yes, we're putting together life and GI in the countries and we're testing now this simpler organization in 3 European countries, but not yet in U.K. U.K. is a different market. And there what we want to achieve is to have a unified strategical view on the U.K. market, avoiding having competing requests from a disjoint business unit. But I don't think that we will go into the direction in U.K. of merging GI and life. I don't think this makes sense given the market. Now this is mainly relevant to retail. In retail, I think it does make full sense to do this because when you confront an individual, the individual doesn't really distinguish between products. They have need and they don't like to have different answers to their needs depending on to which Zurich unit the people bring in the answers belong to. So there are lot of advantages in terms of customer management and customer facings in unifying the retail management skills and people. Now you said how can life people run GI. So first of all, we already have in Switzerland, Germany, in Italy country CEOs who are already in charge of both businesses. And I think they have proven competencies irrespective of where they're coming from before. What we're doing is not only working on a country CEO, but unifying the country structures, which we are, even under one CEO, often still disjoint from each other. And ultimately, your question is if we will choose a good or appropriate country CEOs given the skills we have available. I think so far, I'm pretty much relaxed that we have the competencies in place, and we will closely monitor also for the future. Did I answer you? Did I catch your questions?

Andrew Hughes
Macquarie Research

No, that's fine. And the other one?

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

On the other one, so on the life cost savings, you're absolutely right. So to the extent that the cost saving impacts life, there's a capitalization impact. And given the duration of the business, I mean that can have a positive impact. The short answer is, I don't know the answer to your question today. I mean, the main focus at the moment is actually on driving the cost out of the system and improving the operating performance. And if you allow me, I'll give it more thought for when we come back for the Investor Day and we touch on costs again there. But you're absolutely right.

Operator

Our next question is from Niccolo Dalla Palma, Exane BNP Paribas.

Niccolo Cornelis Modesto Dalla-Palma
Exane BNP Paribas, Research Division

Just a quick and boring one from my side on the tax rate. You have clearly guided for what we should be expecting in the second half of the year. Just wondering if the previous guidance of around 25% as a normalized tax rate is still valid for the years after that, and so what's driving the difference also for the second half of the year, and how we should think about that.

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

Thanks, Niccolo. So it's still valid. So the longer-term expectation is still around that 25% range. What's really driving what you see at the moment is -- I mean, the principal thing is restructuring. So we had restructuring last year. We have it again this year. It tends to fall disproportionately in the center, and we get very limited tax relief on that cost. And that's what tends to push the rate up. We have another factor in the first half, which is around the cat losses or cat protection. I mean, a center of excellence for that is in Bermuda and that also means we get, in a bad year, less tax relief than we would like. But the main driver is restructuring. But longer term, 25.

Richard Burden

Well, thanks very much, everybody, for dialing in today. We're conscious there are a few more questions out there, but unfortunately we don't have any time to take them right now. But obviously, the IR team remains at your disposal for any questions you have this afternoon. I'd just remind you tomorrow, obviously we have the supplementary call around the GI reserve disclosures. There's also a webcast with that, so please follow that for the slides. So with that, I would close the call, and we thank you and look forward to speaking to you in due course.

Operator
Ladies and gentlemen, this concludes today's Q&A session. Thank you for participating and wish you a pleasant rest of the day. Goodbye.