S&P Global
Market Intelligence

Zurich Insurance Group AG SWX:ZURN

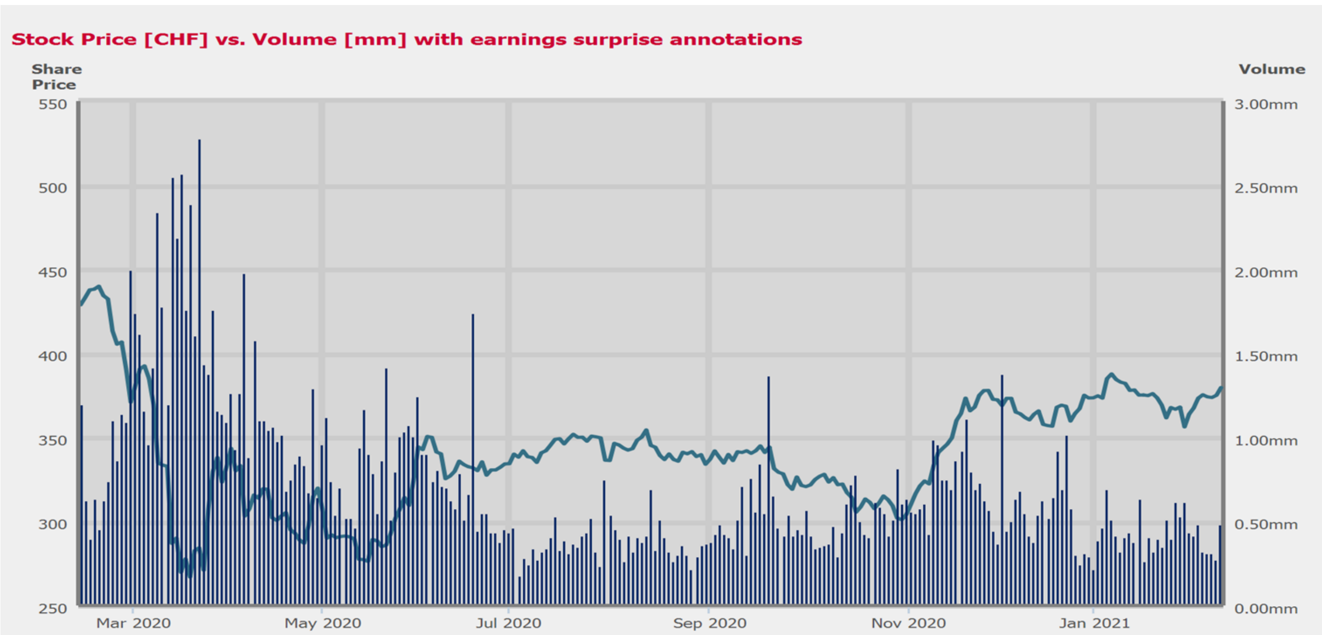
FY 2020 Earnings Call Transcripts

Thursday, February 11, 2021 12:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2020-			-FQ3 2020-	-FY 2020-	-FY 2021-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	4.93	NA	NA	4.48	17.89	NA
Revenue (mm)	NA	NA	NA	NA	44837.48	NA

Currency: CHF
Consensus as of Feb-11-2021 12:21 AM GMT



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William Hawkins
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Presentation

Operator

Ladies and gentlemen, welcome to the Zurich Insurance Group Annual Results 2020 Conference Call. I am Maria, the Chorus Call operator. [Operator Instructions] And 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 and Rating Agency Management. Please go ahead, sir.

Richard Burden
Head Investor Relations & Rating Agency Management

Good morning, good afternoon, everybody. Welcome to Zurich Insurance Group's Full Year 2020 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. And if we have time, we will circle back around again.

So with that, I'd like to pass it over to Mario.

Mario Greco
Group CEO & Member of the Executive Committee

Thank you, Richard, and good afternoon, ladies and gentlemen, and thank you very much for joining us today. I'd like to give a few remarks before handing over to George.

2020 has been an unprecedented year with unforeseeable events ranging from global pandemic and recession, to civil unrest in the United States and a high level of natural catastrophes. Throughout these challenges, we have supported our customers in local communities, while ensuring the safety and the well-being of our colleagues.

The performance over 2020 confirms the strength of the business. The agility of our people and the effectiveness of our digital strategy with our business remaining fully operational throughout. On the back of this, we have increased customer satisfaction and employee engagement. This is already leading to growth in our customer base and will be supportive of further growth in the next months and years.

Our results demonstrate a strong underlying performance with the decline in business operating profit for the full year, explained entirely by COVID-19 and by the above-normal levels of the natural catastrophes. Even with these effects, our combined ratio remain at the level that when we started this journey, would have been considered as a challenge to achieve.

The underlying performance of our Property & Casualty business was particularly pleasing. Not only did we experience a strong growth in gross written premiums, but we also saw a strong improvement in the underlying combined ratio of 2.6 points. Claims related to COVID-19, net of reinsurance and associated frequency benefits have remained in line with USD 450 million we reported at half year, a level which stands favorably against the peers of similar size in the industry.

This performance reflects the work done in recent years to improve the portfolio as well as the benefit of the recent price increases. Combined with the current price trends, which are expected to continue through this year, I'm really confident that our Property & Casualty business is well-positioned to deliver further strong profitable growth.

Our life business also showed a strong performance over the year, with growth of 7%, excluding the effect of COVID and despite falls in investment yields and in Latin American currencies. The group has focused on life protection business and capital-light savings products for over a decade, a decision that serves us well as global investment teams remain at historical lows.

Farmers Management Services saw an improved second half performance. And together with the acquisition of the MetLife Property & Casualty business, I'm confident in the future prospects for the Farmers business.

During the year, we paid our 2019 dividend on time and in full. Our confidence in our plans and continued strong balance sheet means that we are proposing a stable dividend in Swiss francs in regards to 2020. As I look at the business today, we have adapted our plans to the changed reality, and I'm confident that the strong delivery in 2020, the work done in recent years to improve the business position us well to deliver on the commitments we made in 2019 for the end of 2022.

I will now hand over to George to make some additional remarks. Thank you.

George Quinn
Group CFO & Member of the Executive Committee

Thanks, Mario, and good afternoon, good morning to everyone. I'd like to add some additional points on capital and the switch to Swiss Solvency Test, Z-ECM. Today, we've reported an SST capital level. That's obviously not the one you're expecting. The principal drivers are an update of the Q3 estimate that we reported back in November. Increased capital consumption related to additional growth that we expect to see in 2021 and some operating variances.

It's obviously not good when the most significant item and the analysis of change has nothing to do with the business. I'm sorry for this, and we've made changes to our processes, so that this can't happen again. Although we might not be happy with where we go to this point, we are very comfortable with where we are.

The updates of the Q3 SST number doesn't impact the other measures of capital on the old Z-ECM basis, we're in the upper half of the target range, and we have a very significant excess from a rating agency perspective.

In the past, we've also indicated that for -- if you compare our European Union business, a Solvency II ratio would be around 90 points higher than the SST ratio, and this remains the case today. Although we don't have a Solvency II ratio for the group, we remain comfortable that our SST capitalization would translate into Solvency II ratio at the upper end of those published by a period.

As mentioned at the time of the third quarter, we've also provided a new capital target based on the Swiss Solvency Test, with a target for the future of being to maintain an SST ratio at or in excess of 160%, which is equivalent to the previous 100% level under Z-ECM. This underlines our commitment to a strong balance sheet and the maintenance of at least AA standards across all capital measurings.

And perhaps just away from the capital topic for a second, I just want to reiterate Mario's earlier comments regarding the strength of the performance of the business over 2020 and the confidence that, that gives us in the outlook for 2021 across all of our businesses.
With that, I think we're now ready for Q&A.

Question and Answer

Operator

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

Jonathan Michael Hocking
Morgan Stanley, Research Division

I've got 2 questions, please. The first one on sort of where you are in terms of rate increases versus claims inflation. One of your U.S. peers that reported very similar rate increases yourselves in the fourth quarter was talking about 4% claims inflation. I wonder whether you could comment on that and also a comment on EMEA would also be helpful, please?

And then the second question, on Slide 41, where you've got the SST bridge for 2020, in the market retail space, there is 16 points for market volatilities, is that main interest rate volatility? And I wonder whether you could comment with any of that reverse already in 2021?

George Quinn
Group CFO & Member of the Executive Committee

So Jon, it's George. So maybe on the pricing point, first, let's check, can you hear me okay?

Jonathan Michael Hocking
Morgan Stanley, Research Division

Yes, loud and clear, George.

George Quinn
Group CFO & Member of the Executive Committee

Yes, excellent, good. So on pricing. So you've seen what we've reported today in terms of price trend in the business continues to be very strong through the fourth quarter. If you look at the various geographies, U.S. still stands out. So we are -- I mean, we're just at about the same level that we saw Q2, Q3, we're about 17% for the year. And we're above that in Q4. So there's no obvious sign at this point though. The things are slowing down in any significant way.

Distribution across the lines of business. It's been similar to what you've heard from me before in the Q3 call. So in the 20s across the 2 main classes of property and liability and lower on the others with motor just in double digits. Workers' comp has actually come up quite a bit in Q4. So maybe responding a bit to the yield pressure, but specialty, including credit, is still pretty low. I mean, it's close to 1% currently.

From a loss cost inflation perspective, view is similar to what we saw earlier in the year. So we've held a view. So if you look at -- I mean, all in, we're seeing a bit more than 5%. If you adjust for exposure, it would be closer to 4%. I think the challenge we've going to market is that the pandemic has slowed things down in the system during 2020. And I guess at some point, that will start to unwind. I mean, we've taken a very cautious approach around liability.

And so for example, when you look at activity, activity is down, and there may be a tendency to perceive that is frequency, and we've ignored that in the reserving process. So we've assumed that even with the absence, there's no change in underlying trends for the time being.

And other markets. So if we look at Europe, I mean Europe from a headline perspective, I mean it's not as strong as the U.S. So the overall rate, we would see around 5%. It's actually -- it's been coming up through the year. It's stronger than that in the fourth quarter. And the market that stands out is the U.K. So U.K. is in double digits. That's obviously driven by commercial and again, stronger in the second half of the year. Again, Q4, well above the average for the year.

From a loss cost perspective, and the trends in Europe are a bit different to those we see in the U.S., you don't see quite the same issues that exist around social cost inflation. But if you look at pain points in Europe in the portfolio, they tend to be pretty similar to what you see elsewhere. So it tends to be casualty lines, it tends to be professional indemnity, some financial lines like D&O, for example, I guess, kind of some total of all of this is the significant margin expansion, both in the results in the second half of the year, and we expect that to continue into 2021. And in fact, given where we're starting in 2021, I mean, most likely that will now spill over into 2022 in terms of [indiscernible].

On the slides and on the volatilities, so I mean, there'll be volatility across a wide range of the asset classes. I mean you've seen quite a bit of move on interest rates, that will be part to drive that. I don't have the precise breakdown in my hands. So I can't give that to you immediately. The challenge with it a bit is that because of the look back period that we have in the volatility model, it will take quite a while for that to work its way out of the system. So I think the elevated volatility may assume some of the markets come down at well average down. But I mean, we'll have that type of impact on the reported number, I would expect for most of 2021, if not into early 2022.

Operator

The next question is from Peter Eliot from Kepler Cheuvreux.

Peter Eliot
Kepler Cheuvreux, Research Division

Sorry, the first one is on solvency, George. But I guess, you always said the quarterly Z-ECM ratio estimates were accurate within 5 percentage points. It sounds like this was more of a sort of one-off event. I mean, should we sort of think going forward as the sort of quarterly SST estimates as being sort of pretty accurate or should we expect them to move around? Yes. I guess that sort of goes for the full year number as well. So I guess you haven't sort of fully filed that yet. We are the first one.

Second one on P&C investment income. Looking at that I guess it fell by $155 million in H2 alone. Given that trend and given the big back -- big gap, sorry, to the reinvestment yield, I had to -- I was quite positively surprised that you were guiding to sort of only a drop of $50 million to $100 million for the whole year in 2021, so I'm just -- I wonder if you can be -- I mean, is that just explained by the maturity profile of the assets? Or is there sort of something else that I'm missing there?

George Quinn
Group CFO & Member of the Executive Committee

Yes. Thanks, Peter. No need to apologize for the first question. So I mean, I think all of you would expect the numbers to be pretty accurate. So that's what you can expect from us going forward. I mean we made changes in Q4, which was to automate quite a bit of the quarterly production. That's, of course, what's triggered the revision that we've reported today. And I expect to purchase the level of quality that you're familiar from us across the other capital metrics that we disclose on a regular basis. So you can expect it to be accurate.

On the P&C investment income, I think the reason why you see this, this impact is -- there's really 2 things taking place. So if you look at last year, as you point out, you see a fall that's larger than you'd expect. And that's because you have a combination of yield, but also what we think is probably -- well, not probably, we can see that dividend receipts are quite a bit lower than they've been in the prior year. And if you look at the numbers, it's about $50 million, in the P&C number for 2020.

So as we look at the yield change next year, I mean, we've got about 100 basis point gap booked to new business. So that still equates to about $100 million, but we're expecting to see some of the absence of dividends in 2020 start to recover in 2021. So I think it's those 2 things that offset, to some degree, which is why you're hearing that $50 million to $100 million [indiscernible].

Peter Eliot
Kepler Cheuvreux, Research Division

Yes. That's great. I guess I was thinking the dividend is more sort of H1 phenomenon, where I was sort of looking at the running yield on H2, but I appreciate there's lots of moving parts.

Operator

The next question is from Andrew Ritchie from Autonomous.

Andrew James Ritchie
Autonomous Research LLP

First question is on your outlook for NEP growth in P&C. I guess if I have been writing the press release, I would have been tempted to say mid- to high single digit. I'm just trying to unpack kind of your guidance of mid-single digit, which

I assume is 5 because the stock of unearned premium reserve is the highest it's been, I think, for 5 years. You, I think, imply you're not renewing some of your reinsurance?

And then on retail, I guess retail is COVID impacted. But again, retail and SME seem to bounce back in the second half. So could you just unpack, I guess, my angle is why only mid-single-digit NEP growth for 2021?

And the second question on reserves. I guess, just an update. I think the implication is that you added a little bit to U.S. liability ex work comp in the first half. Did you do that again in the second half? And on reserves, I noticed Australia or Asia Pacific is the gift that keeps giving. What -- was there another sort of round of looking at some of the long tail business there? There appears to be looking at the PYD by division.

George Quinn
Group CFO & Member of the Executive Committee

Thanks, Andrew. So on outlook, I think I first started by saying that we wouldn't necessarily conclude that mid-single digits could only encompass 5. So we might be slightly more generous than that. But I agree with you that certainly compared to -- I mean, there are different factors driving the results, and you've commented on some of them.

You would anticipate something a bit higher. And in fact, of course, if foreign exchange stays where it is, that alone will drive it quite a bit higher than the mid-single digits. I mean the -- I think we tried to be a bit cautious on the growth outlook. I mean, we want to leave room, if necessary, to make sure that we can continue to manage the portfolio. We did some of that last year.

So for example, med-mal and some of the credit lines, what targets for reduction, I mean, I don't know today that there are significant parts of the portfolio that we'd look to shrink. But we have tried to be a bit cautious, just to reflect the fact that, I mean, we do at times as we review the portfolio, identify parts where perhaps we're not quite enthusiastic about growth. But certainly, I mean if like-for-like, and you'd probably see something a bit higher than mid single-digit growth even allowing for something that's not 5, if everything continues as is.

On reserving, I mean, no great -- there aren't major changes in the second half of the year around U.S. liability. I think there's -- as I addressed, but it's quite small compared to what we see before, workers' comp. And workers' comp in the U.S. and European retail continue to be the biggest drivers of the positive outturn. And yes, you're correct. Australia continues to be the gift that keeps on giving. And in this particular case, it's PI and in particular, design and construct.

So it's a cladding topic in Australia that's driving that experience. But I mean, overall, as you can see from the outside, I mean, we can easily manage PYD targets. And in fact, looking at reserve strength into future, I mean, arguably, if you were to take a slightly more short-term view of workers, so we take a fairly long look back on the lag factors for workers' comp. If you were to move to a 5-year rather than a 10-year or longer perspective, there would be a very substantial surplus in the current reserve position.

Andrew James Ritchie
Autonomous Research LLP

So is it fair to say not all the -- I think you said this earlier on. I just want to clarify, not all of the frequency benefit was allowed to drop through. Is that -- some of it has been tracked and reserved. Is that fair?

George Quinn
Group CFO & Member of the Executive Committee

Yes. That's fair. So the -- so just given the uncertainties that are still out there, we've decided that it's appropriate to hold some of that back for that.

Operator

Next question is from Farooq Hanif from Crédit Suisse.

Farooq Hanif
Crédit Suisse AG, Research Division

First question on expense ratio. So you've very kindly shown what the ratio would have been without the premium refund effect. Can we just take that as a base for 2021? And can you talk a little bit about how -- given the commission ratio seems to be flattening out, how some of your expenses could actually work into that ratio over the next few years?

And then secondly, on cash remittances. So you've obviously had a higher payout ratio because of surplus capital, you say in the P&C business. Is your aim going forward to try and manage that number to be quite smooth and avoid this continuity? Or do you think we could see more kind of surplus capital upstream to support that number going forward?

George Quinn
Group CFO & Member of the Executive Committee

Thanks, Farooq. So on the first one, on the expense ratio, so I think we're a little bit careful what I say. I think -- I mean, as a CFO, I'd love to just tell you that, yes, absolutely, we're going to maintain expenses exactly where they are. And there's clearly an element of the expense change that's driven by the circumstances of last year, that's definitely going to continue into the early part of next year.

And some of the structural changes that will happen in the way that we operate means that some of that -- most of that maybe never comes back into the organization. But I think to make the assumption that there's no prospect of any of its going back is too aggressive.

Having said that, I mean, you know that from the Investor Day that we had November of 2019, but it's an ambition to bring the expense ratio for the group down to around 12%. So there's a number of other initiatives that are currently ongoing. We're trying to push efficiency. We're looking to try and again reduce and adjust the resource allocation within the group. So we -- that were just some of the back end within the corporate center and allow the business to expand slightly while still achieving the overall goals for the group.

So I think it'd be in the very short term, assuming that we start to see, for example, travel come back to normal, you'd expect to see some of that come back into the picture, but not as much as we've had in the past.

On the commission ratio, so I mean, you've seen that flatten off, we've talked in the past a bit. I mean, we do have a level of appetite for that. And I think we're point not that far off of it. I mean, we do continue to evaluate transactions with distributors that we think would be a good use of our capital. I mean, they tend to be the -- look at the mass consumer-type things that do tend to still come with elevated commissions. I mean I don't know that we'll do that in 2021, but I want to leave open the possibility. But I mean, there is a limit to how far we're prepared to see the commission ratio rise.

On the cash remittance topic, so, I mean, in all honestly, I'm a bit greedy. And I think it just makes sense from a group perspective, if we can move capital into the center, you're just better off doing that because it gives us far more flexibility to deal with, I mean, any challenge that can occur in any particular part of the group. I think the reality of it is though that, I mean, as we approach regulators, particularly to deal with excess capital position as versus target. I mean regulators don't tend to react too well to a sudden shift in the capital base of a subsidiary.

So we'll normally try and agree a step-wise process, of say, 2 years, 3 years to bring us back down to target. And we've been doing that pretty consistently over the course of the last 4, 5 years. I mean the challenge of even maybe the good news behind it as we address existing excess capital acquisitions, what we tend to find is that by the time we finish that process, the business has now generated a new excess capital level. And we then go back and agree a plan to take that.

So I mean, the reason that you see this pretty strong number for last year, which, of course, is quite a bit ahead of what you'd expect given the performance of the business, just that we've done that with -- I mean, one of our largest businesses, so they've talked to their regulator about how they come back down to target. And the plan is that that's not just a single year topic, that will be, let's say, a 2-, 3-year exercise, and that's helped balance out some of the shortfalls that you'd otherwise had expected because of COVID in 2020.

Farooq Hanif
Crédit Suisse AG, Research Division

So just on that, it's possible, obviously not a guarantee that you could see the payout ratio being above 85% in some of the future years as you put this into place.

George Quinn
Group CFO & Member of the Executive Committee

It's possible.

Operator

The next question is from Michael Haid from Commerzbank.

Michael Hermann Haid
Commerzbank AG, Research Division

Two questions. First on the net realized capital gains you had in the fourth quarter, which were significantly above my expectations. Can you tell us what were the motivations of these high disposals of equities and real estate? I saw that you left the equity ratio within your portfolio unchanged.

And second question with respect to expectations for the top line growth in P&C in 2021, I saw you expect a mid-single digit, possibly above 5% growth in P&C on net earned premiums. Also the SST was burdened by some higher growth assumptions, presumably in P&C, I would have expected some pressure actually on commercial premiums, not coming from price, of course, but from volume as often premiums are tied to blind revenues. So can you tell us your view on how this affects the growth, and maybe you can provide a breakdown of how much of the premium growth is price-driven and how much is volume?

George Quinn
Group CFO & Member of the Executive Committee

Michael, thanks very much. So on the first topic of net realized capital gains, so you've got a variety of drivers. So property is probably the most straightforward. Within property, I think we've talked this in the past about the fact that we've got one of our largest business units that is probably slightly overexposed to property from a capital structure perspective. I mean, well, the overall allocation that we have to property in the SA, I think, is perfectly reasonable. The way that we've actually financed that from a capital perspective is inefficient. And we've been correcting that over the course of -- I mean, for the last 2 years now.

I think there's still a bit more to do, but I mean, urban and the team have made great strides in this topic. It can affect some of what you see at the end of last year. Again, as I was addressing that overweight position in one of our businesses.

On the equity sides, I mean, it just varies depending on what the managers are deciding to do. I'd say that probably also, the realized gains were a bit higher than I expected towards the end of last year. It obviously has a slightly negative impact, but it puts a bit of pressure on the ROE. But we tend to leave the team to decide what they think they need to do when they need to do it.

On the growth topic on P&C, I mean, I think the point is absolutely valid. So you've certainly got a bit of a competition between rates, also activity. And I think I'd add a third thing to the mix, and that's just the budgets that some of our clients set. So I mean I've talked to quite a few of my opposite numbers, some of our clients over the course of the last 6 or 7 months. I know that they're probably struggling to some degree, I mean what's happening in the market. I think we see 2 issues. I mean price is certainly one issue. But I mean, capacity is probably at least as big an issue for some companies. There's an absence in some lines of business. And of course, that's what's driving quite a bit of the rate picture.

So I think there is -- I mean whether it's activity driven, whether it's just the fact that maybe someone retains a bit more risk, either because they don't like the price or because they have to because of lack of capacity. I mean there is some offset effects in the top line growth. So having said that, when you look at the rate that we're seeing in commercial at the moment, I mean that's going to overwhelm any volume or other impact. And we've allowed for that in the estimates that we've given today.

So in the comments I made to Andrew earlier, as we think about 2021, we've said mid-single digits. Maybe that's a bit north of the midpoint of that range. And certainly, we're also allowing for the fact we may continue to manage the portfolio. So like-for-like, I think the opportunity in 2021 is probably a bit stronger than that. And again, foreign exchange, if we continue to be throughout the year where we are today, that will also [indiscernible] in the remainder of the year.

Operator

The next question is from James Shuck from Citi.

James Austin Shuck
Citigroup Inc., Research Division

George, my first question was on the reinsurance recoverables. If I look at that number over the last 18 months or so, it's increased by close to $3 billion. I think the reserves have grown over that time. But even in relation to the reserves, that number has gone up. I'm just wondering how much of that actually relates to COVID-type issues? And if you could elaborate on any potential friction points with the reinsurers of that amount, please?

And then secondly, on the SST, I mean in calibration it is interesting, particularly when you compare it with the Z-ECM. So the market risk is 68% now. That was 52% under Z-ECM. The SST interest rate sensitivity doubled to about 19 points for minus 50 bps. The credit spread sensitivities have come down. Can you just elaborate a little bit on how you're seeing that market risk and how you're going to manage that SST volatility going forward, please?

George Quinn
Group CFO & Member of the Executive Committee

Yes. Thank you. So on the reinsurance recoverable topic, I mean it's tricky to look at the headline number because there's a bunch of stuff in there that's either captive relationships. So I mean things that simply flow straight through our balance sheets on the way back to our commercial clients in many cases. So it's -- it can be a bit misleading to look at the rise and attribute that solely to a rise in gross claims that translate into a higher expected recoverable.

Now having said that, I mean the point you make about COVID is clear. So if you compare I mean where we are today to where we were, say, at the half year. So since then, we've had the FCA decision in the U.K. and well, as you know, our wording was upheld, the industry has lost on the resilience wording. So that's triggered additional losses. The Quarantine Act topic in Australia has also triggered some additional losses. I mean, in general, both of those have been absorbed by reinsurance currently. So it has increased the recovery.

And in fact, I mean, through a combination of COVID and the other cat losses through the year like Laura, Sally, the civil and risk topics, we're relatively deep into the aggregate at this point. So there is a more substantial recovery to be expected there.

Now in terms of risk from that, I mean, obviously, we're in regular contacts with our reinsurance partners. We updated them prior to renewal of the cat aggregate. I mean, not just about the drivers, but our views of potential ranges, so the cover that they're backing. And then, of course, well no one has said, yes, absolutely, we'll just waive it all through.

I mean we're not anticipating significant issues here. I think the -- we've tried to structure what we expect in a relatively conservative manner. They're not trying to be aggressive about how we attach this to the reinsurance protection. And I think that puts us in a good place in terms of risk around the expected recovery. So I don't think there's an indicator in that higher number, that means there's a higher risk.

On the second point, on Z-ECM versus SST and volatility. I mean is it -- I mean, apart from the thing I talked about earlier in terms of it, it's a tricky year. I mean, we've seen market risk consumption passively increase by pretty huge amounts, mainly driven by the 2 things that came up at the top of the call. So obviously, interest rates, as you mentioned, but also market volatility.

I mean from a from a risk perspective and how we manage it going forward, I mean I think everyone is aware that -- I mean, SST is going to bring -- it will bring more stability than Z-ECM and, in fact, that's partly reflected in the -- what's happened in Q4 in terms of the difference in the movement of the 2 numbers.

I think in terms of risks and how we approach the management of it, I think the philosophy actually should be the same. I mean the -- if you look at it fundamentally, Z-ECM typically doesn't have any dampening measure. We do get some benefits under SST that we pick up some of the UFR from the Solvency II entities, although we get no benefit of that on the required capital side.

So I think the existing mechanisms that we have in place to manage that interest rate risk will certainly help us. But I think also as we think about capital allocation going forward and some of the things that we're going to do anyway to reduce some of that sensitivity even under the old model equally for now, is under this. So I think as we look at some of the portfolio action and some of the portfolio simplification that we intend to undertake over the next year or 2, you'll know it's a close correlation between those portfolios and the contribution to this particular risk.

Operator

The next question is from William Hawkins from KBW.

William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

George, I wondered if I could come back to the answer you gave Farooq about the cash remittance. Could you help me maybe by being a bit more explicit on what the excess capital was within the $3.4 billion? Again, you've guided qualitatively to neutralizing the impact of COVID, but obviously, it depends on how much of that growth figure as in America or anywhere else. So if you could be helpful on that, that would be kind.

And then again, just to be clear, in your final part of the answer, given that you've got more excess capital to come up this year and possibly the year after, and given at the moment, your budgets still look all right, rather than saying it's possible you're going to be higher than $3.4 billion or whatever in 2021, is it not almost inevitable? Or is there some other moving parts of the downside that I wouldn't have thought of?

And then secondly, please, could you maybe give a bit more color on your thought process behind some of the changing assumptions on the ROE waterfall on Slide 7? I mean for me, at least, I guess, the investment income and portfolio quality changes directionally seem quite obvious. But I'm a little bit surprised that you've reasonably visibly cut the business growth impact and also the productivity.

Again, I would have thought given the hard market and given the opportunities you're taking, I appreciate the growth is capital intensive, but I still would have thought that your growth should actually be accretive to ROE rather than incrementally dilutive. And again, the activity rate is lower. But post that everything we've heard from Zurich over the past 18 months, it is about better productivity rather than tighter. So why have those 2 numbers taken a bit of a hit?

George Quinn
Group CFO & Member of the Executive Committee

Yes. Okay. So on the first one, on cash remittance, so the U.S. special is [indiscernible] of what we reported today. Hopefully that helps answer that question.

William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

I'm sorry, say again, please, sorry?

George Quinn
Group CFO & Member of the Executive Committee

The special is [indiscernible], 20%. Can you hear me well?

William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

Yes, I can, George, sorry.

George Quinn
Group CFO & Member of the Executive Committee

Sorry, I thought I lost you for a second. So it's [indiscernible], just to be relatively precise.

So the second part of that question, is the fact that the -- it creates some expectation that some of that will continue. I mean, does that mean that we are anticipating something adverse? No. It just means we're a bit conservative. I mean that's all that means. I think if you look at the cash remittance numbers that we've generated through the last cycle, we were quite a bit ahead of where we expected to be. And of course, that was to a significant extent, not entirely, but to a significant extent, driven by us making sure that we were efficiently managing the placement of capital around the group. And there's no change in that process for us today.

On the second topic, on the walk -- let me just turn to the page. The -- so I think on the concerns about productivity, it's not that we've lowered the target. It's simply a reflection of where we've now gotten to in the current number. So I mean the ambition is still the same, but we've actually delivered a part of it. And I think for the reasons that I gave an answer to the earlier question from Farooq around the expense ratio. I mean we've -- maybe we've accelerated. We -- maybe we've had some help in the course of 2020. He's given the change in activity. But the overall goal is certainly unchanged. It's just a reflection of a change in the starting point is the way that I think it.

In terms of growth, I think what's happened there is if you go back to the Investor Day conversation that we had back in 2019, there was certainly more of an expectation of retail growth and the modeling that we've done. And of course, some of what we had geared up to do was completely targeted to see that as a more significant driver of the plan over the course of the 3-year period. Seen rom today, we just don't have that perspective. So it's not a -- we don't like that, so we wouldn't take advantage of that, if that was to offer it, but we just think the market conditions around that topic are not as conducive. And we'll just say far more driven by rates on the commercial side. So I think that's really why you see some of the change.

William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

Yes. Got it. And at the risk of stating the obvious, the retail comment you just made is COVID related, right?

George Quinn
Group CFO & Member of the Executive Committee

Sorry, say that again?

William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

At the risk of stating the obvious, the cautionary comment you made about retail is all COVID related?

George Quinn
Group CFO & Member of the Executive Committee

Well, I mean, it depends, the So I think in my mind, the way I see it is, certainly, there's a COVID issue that's obviously knocked some parts of the business that will take longer to recover. And I guess the part of our portfolio that's always there is the travel topic, so you see it. Overall, we cover more number and in particular, in the APAC number. But there's a secondary issue, which is that the -- I think the frequency effects have driven a more competitive retail environment. I think that will persist for a while. And it just makes the, I think, the environment a bit trickier. So for us, it just makes a bit more sense to allocate a bit more of the capital towards commercial because that's where we see the stronger opportunity currently.

Operator

The next question is from Michael Huttner from Berenberg.

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

And you must be quite -- in your words, you'd be quite pleased, I expect for the numbers here, quite cautious. I had questions because my peers are so good on questions. I couldn't think of anything very clever. One is on farmers, and the other one is on businesses for sale.

So on farmers, I'd be a bit contentious here, and I say, well, can -- your business model is to lose market share, create capital and buy businesses. You bought, was it 2009 or something, 21st Century and now you're buying MetLife. And I just wondered how you would react to something which is a little bit aggressive. Apologies.

And linked to that, why isn't Farmers in that likely waterfall chart that through 2022? And then in the ROE.

And then the other broad question of fishing a little bit is when you talk about allocating capital, are any businesses for sale? Or can you say something about, yes, there's some businesses we know, like, you are kind of mentioning retail not so hard. That's it.

George Quinn
Group CFO & Member of the Executive Committee

Thanks, Michael. I think I'm pleased with almost everything apart from maybe one number. The -- I think on Farmers, I mean I remember the questions that you posed to Jeff at the Investor Day back in 2017 when we were all together in London. I understand why you put it that way, but that's definitely not the way we think of it. I mean, we don't -- that's I mean, from a longer-term perspective, I don't think you need to operate that Farmers -- you operate Farmers that way. I mean if you see the business and the business model today, we know that -- you guys are all very familiar with the -- I mean the very positive nature. There's obviously a fairly consistent concern. The growth is hard to come by because of the expense levels that you end up with within the structure. We've talked in the past that -- I mean, that's at least partly compensated by the way that people think about the return on capital within that structure. I think it's just -- it's too easy.

So one of the things we've been doing with Jeff and the team is -- I mean, working really hard to work. I mean, how can we support the business more? What does it have to do to make sure it's competitive and to try and get us away from that so that -- well, this thing is a highly priced premium product. And therefore, it plays in a completely different market.

And I think maybe the customer segmentation is a bit different. But I mean, Jeff and the team know, when you look at the pricing, I mean, they're competitive. We just need to try and make sure that we can support the exchange and trying to find ways to make the distribution system more effective. Because I mean, when Jeff talks to me and Mario about it, we can see that when we look at benchmarks against some of the obvious peers in the U.S.

We've got a gap that needs to be closed. And that's the thing that we want to focus on. And we think that would drive some growth, that will drive higher production, it would drive higher fee returns to us. And we're also hoping that the acquisition of the MetLife business and the addition of a new distribution channel will actually help accelerate some of those things. So I understand why you've made the point, but perspective on it would be completely different.

Farmers as is in the ROE walk, it's hidden in that business growth number. So apologies for not pulling out. Did you have a second part to your question?

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

Yes. The fishing question. Are you -- what businesses are you thinking to sell given that you sound a little bit less -- a bit more lukewarm on retail. Are there any like traditional agency businesses or my favorite, the German life, whatever?

George Quinn
Group CFO & Member of the Executive Committee

Actually, I think -- so you can appreciate there are lots of reasons why I'm not going to list a group of businesses that we may or may not sell in the future. I think just one thing to be careful of, so the comment that I made to well on retail, I mean, that's not -- it's not a long-term perspective, but all of a sudden, we don't like retail and only love commercial. It's simply a capital management topic. I mean, we're looking for the stronger returns and to the extent that we can move capital around in a way that finds that, we will always do what we can to maximize that.

So there's nothing wrong with retail. The challenges at the moment is just not offering quite the same return. Now if you look at the portfolio, and I won't get into precisely what and where, but I mean you guys can see how we allocate capital today. You can see the kind of risks that don't fit with the model or all, you're well aware of what solutions the outside world offers. And I mean, hopefully, we can use the market to help us, again, further improve the capital allocation over the course of the next couple of years. I can't say more than that.

Operator

The next question is from Nick Holmes from Societe Generale.

Nick Holmes
Societe Generale Cross Asset Research

Two questions, please. The first is, can you tell us more about what's causing the 90 percentage point difference between SST and Solvency II, sort of which parts of the business, which risk areas?

And then secondly, would it just make sense to publish a Solvency II estimate for the group? Or is that simply a waste of time do you think?

George Quinn

Group CFO & Member of the Executive Committee

Thanks, Nick. I just -- I'm reflecting on the second part of your question because I'm thinking that -- I probably have a few too many capital measures rather than a few too few. I mean I understand why in terms of the immediate comparability with others rather than this fairly soft summary that we give of how you end up with something that optically looks lower, but probably in the end -- ends up being substantially higher.

So I mean I can't -- I'm not going to commit to us doing a Solvency II number. I mean the course of doing that would be pretty substantial. I know that one of our friends did that a couple of years back and I understand why they did it, but it's tricky. And just given the complexity of our businesses -- and just given the other demands that are out there on them today like IFRS 17, for example, which is not a small undertaking, it'd just be -- it'd be hard to not only justify, be hard to find the people around to actually do it for us. So I mean -- so what we typically do is we point to -- I mean what we can see clearly in the EU businesses, it comes to lots of caveats because these are typically standard model EU businesses or standard model Solvency II outcomes. And you need to be cautious when you're comparing them to the internal model outcomes of some of our peers for their entire group.

I mean, when you look at -- I mean, what drives it I mean there's a variety of different topics, ranges from things like VA, the UFR structure, treatment of non Solvency II businesses. The way that capital requirement is set, the way that we shock for interest rates and the capital requirements, some of the runoff capital requirements or additional expense reserve that are required in the Solvency II model, there's a whole wide range of drivers. But the best guide is if we look at the EU businesses, we can see precisely what the differences are versus SST.

They are, on average, about 90% currently. And it wouldn't be that significant if you were to move the entire group and do a comparison to an internal model, but we're still talking about many tens of points. I understand the reason you ask but.

Nick Holmes
Societe Generale Cross Asset Research

Yes. I mean, that's very, very helpful. But just your point, it's tens of percentage points versus internal model. I mean, if one was, say, not standard model of the EU subsidiaries, but the -- if there was to be on an internal model and therefore, I mean, I think you've said in the past, haven't you that it's 40 percentage to 50 percentage points around about that versus peers? Is that -- I mean, I think you said that a few years ago. Is that still a valid comparison?

George Quinn
Group CFO & Member of the Executive Committee

I think it's a very substantial number. And the reason for any hesitation is just that the basis for that calculation is quite old at this point today. So I want to be cautious, but there's many tens. I mean the challenge is either if I calculate that number, other than to show you guys what it is, I can't do anything with it. It doesn't help me in managing the business. I need to manage to the things that are relevant to us today, and that's the Swiss Solvency Test, that's S&P's capital requirements, and these are the things that need to drive what we do.

Operator

The next question is from Paris Hadjiantonis from Exane BNP Paribas.

Paris Hadjiantonis
Exane BNP Paribas, Research Division

The first one on SST. You've given us a minimum level that you're targeting, but I was wondering if you can give us an idea of what you consider optimal? So should we be -- expect you to operate, let's say?

And the second one is on the catastrophe ratio, which is going up to 3.5% for 2021. I was just wondering what is driving that? Is it business and exchanges, higher frequency or something else?

George Quinn
Group CFO & Member of the Executive Committee

Great. So on the SST topic, so we've obviously indicated today that target is to be operating or above 160% historically. If you look at the numbers, we've been, I mean, closer to the 200s-percent mark. So I mean, I would expect that you'd probably normally see us and operate somewhere between where we are currently and probably somewhere a bit higher and maybe close to 200%. But of course, that will depend to quite a significant degree on the external environment, what's happening in the financial markets and also what's happening in terms of opportunity because if we can deploy more capital at attractive rates of return as we can today, I mean, we will use that capital strength to go do that.

On the cat topic, what's driving it? I mean if you look -- maybe a couple of things. So we've taken off some of the co-share that we had in the property book in the U.S. So that brings in a bit more cat exposure. I mean we're buying roughly the same protection and the deductible is slightly higher than it was last year, just given the growth in the portfolio overall. And it's really those 2 things in conjunction that's driving the slightly higher cat loss expectation.

Operator

Next question is from Vinit Malhotra from Mediobanca.

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

Just very quickly. First thing is the BI litigation risk, which George in the past and today as well, you've commented, you remain comfortable with what's more gratuity in nature regarding wordings. But we have seen a particular ruling in the U.S. earlier this -- early last month. And just if you still remain comfortable, that's just what I'm looking for. So if you could comment on that, please?

Second thing is just on the SST target, the 160%. I mean, the problem I face is that when I see 160% versus 182%, I get to an excess capital, if you like, of close to $5.5 billion, a bit more. When I see 110 % versus 100%, I get to $3.5 billion. So I'm just trying to figure out, I mean, you've implied today that 100% of Z-EMC equivalent to 160% of SST. But then this doesn't seem to be adding up on the excess capital calculations. And also, isn't 160% feeling a little lighter compared to the peer group? So just any comments, please.

George Quinn
Group CFO & Member of the Executive Committee

Yes. Thanks, Vinit. So I guess, short answer to the first question is I remain comfortable. I mean I think the -- I mean, it's to be expected that it will not be a completely straight-line to the outcome -- the overall outcome that we expect to the end, but I think if you look at what's happened in the U.S. and so far across the industry, I mean, the vast bulk has gone in favor of the insurance companies even at the dismissal stage, so before it reaches full trial.

I think though -- I mean, you're going to find that in most states, just given the numbers that at state -- you'll probably end up at State Supreme Court level for most jurisdictions. So even with all of this -- all these decisions at this stage, there's probably a [indiscernible] for everyone at the very end of this process, where the key courts in each of the states will weigh in on the topic.

So even if you get a variety of outcomes, and you've seen that already in Ohio where the case that we've had that attracted some attention a few weeks ago, was handed down. I think these things will get tied up at the end, and we remain confident in the position that we've adopted.

On SST and target ratios, so the -- I guess the -- you make an assumption in there that is not unreasonable, but I'm not sure I've actually said it. So I think -- so the inbuilt assumption there is that somehow the number that we've printed today is, say, precisely equal to the midpoint of what Z-ECM. Z-ECM today is actually a bit higher than midpoint as you've seen in the disclosure based on the estimates that we've got.

I mean, there will be some differences between them. But if you allow for the fact that Z-ECM may be a bit higher than midpoint, and if you want to correlate that to the 182% number that we've published today, then I think that maybe actually answers the question that you've asked about whether the excess is different.

I mean they won't be substantially different today. I can't guarantee that because the 2 models are not linear in relation that we'll maintain that relationship into the future. Does that help?

Operator

The next question is from Ashik Musaddi from JPMorgan.

Ashik Musaddi

JPMorgan Chase & Co, Research Division

Just a couple of questions I have is, first of all, going back to James' question earlier about on SST ratio and stress test, I mean if I look at your hurdle of about 160%, so first of all can you give us some clarity as to what this hurdle means? I mean, below this, do we think about dividend cut? Or how do we think about this hurdle, right?

And if we think about like a combined stress of, say, falling rates, rising spread and falling equities, which is not a unique stress, which is what typically happens these days. I mean you can easily breach 160% because that's just 20 percentage point offer you have at the moment. So how do you think about the combined stress scenario rather than on an individual basis? So that will be first question.

Secondly, you mentioned that you are trying to think a bit more about commercial lines at the moment versus retail lines. So how do you -- how are you thinking about the return differential between the 2? I mean, clearly, price increases are pretty punchy on the commercial lines. But is it really translating into a much higher combined -- much better combined ratio so as to make that shift from commercial to retail? Because if I remember correctly, I think a couple of years back, you were like pretty much focused on shifting away from commercial into retail. And now we are thinking about the worst. So how do you think about over the cycle?

George Quinn
Group CFO & Member of the Executive Committee

Yes. Great. So I think on the first one, so the -- what does 160% mean, and what about the risk of a combined stress in the number. I think you end up with an answer for the same, actually, for both questions. So we try and avoid bright line. So even under the old way that we approached it, where we had 100% to 120% Z-ECM, nothing remarkable happened at 99%. I mean the requirement was that there's a formal switch in how we operate internally.

So I am the capital manager. When we're within target, the leadership moves to the Chief Risk Officer. When we move outside of tolerance, in practice, nothing actually changes because the 2 of us, we work closely together on this, whether it's in target or otherwise, and we look at facts and circumstances about what has to be done.

And so are the changes temporary in nature? Is there something idiosyncratic? We would apply all the judgment that I think you would expect us to apply, so that we avoid that. We become a victim of the capital model and that should not be how this works. We are allowed to apply significant judgment. We're required to present a plan, but there's nothing that significant happens as you go from 160% to 159%. It really depends on where you think you're headed from there, that will determine what we think the best course of action will be even under that combined strength.

From a commercial lines versus retail perspective, I think if you look at the results, again, I think -- I don't want to give the impression that all of a sudden 1 day, we said that retail thing is not attractive anymore, and we suddenly pick up and try and move everything to commercial, given the scale of the organization and given the fact that we need to be a reliable partner. You can't do that. What we are looking trying to do is, where we have the ability to deploy more capital and potentially take it away in markets that are underperforming, we would look to do that.

The reason for that it's embedded in some of the results today. So for example, if you look at, let's do ex cat, just to keep it simple. So retail for us, last year, would have been slightly stronger than commercial. So maybe the retail combined is in the 94s-percent, the accident year combined ex cat for commercial will be in the 95%. You look at it again this year and just given the strength of rate already, that's somewhat flipped around. So if you're looking at retail, we do ex cat. We will also do ex COVID to keep it clean. Maybe it's improved slightly. So maybe you're in the 93s-percent. But if you're looking at commercial, commercial is around 91%. And rate trends versus loss cost in commercial is way stronger than you'll find in retail. Now there is a capital penalty that you have to have in mind. So the commercial business tends to be a bit more capital intensive. So it does need to produce a bit more. I mean that kind of differential is meaningful. And given that we would expect it to broaden rather than narrow the capital allocation choice that we're making makes complete sense to me.

Mario Greco
Group CEO & Member of the Executive Committee

Can I add to point because I don't think we ever say that we want to grow retail against commercial or vice versa. We want to grow both. But the cycle is not aligned, and there are times at which it's easier, more profitable to grow one with respect to the other. But in general, we don't have a preference and we try to develop both kind of customers, the commercial and the retail as well as we can. But again, we consider the market opportunity as we're supposed to do. And we push harder depending on what is the potential opportunity that we see in the market.

Ashik Musaddi
JPMorgan Chase & Co, Research Division

Yes. That's very clear. Just have one more question. Sorry?

George Quinn
Group CFO & Member of the Executive Committee

I'm going to say that's all as I might be conscious of the fact that there's a number of other conference calls that are about to start for other companies. Richard, are you happy to continue?

Richard Burden
Head Investor Relations & Rating Agency Management

I think we need to wrap up in fairness to some of our peers out there. So we should probably...

George Quinn
Group CFO & Member of the Executive Committee

So actually, if you don't mind, we are happy to catch up after the call.

Ashik Musaddi
JPMorgan Chase & Co, Research Division

Yes, yes, I'm fine. Not a problem at all.

George Quinn
Group CFO & Member of the Executive Committee

If you reach out to the team, we will address it there. But I just want to say that I want to be mindful we don't do an over too much. So Richard, can I hand it back to you?

Richard Burden
Head Investor Relations & Rating Agency Management

Yes, George. Thanks. So thank you very much to everybody for dialing in this afternoon. We are aware of the outstanding questions on the call. So we will come back to you from the IR team post the call. Have a good afternoon, and thank you for your interest.

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