S&P Capital IQ

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Swiss Re Ltd SWX:SREN

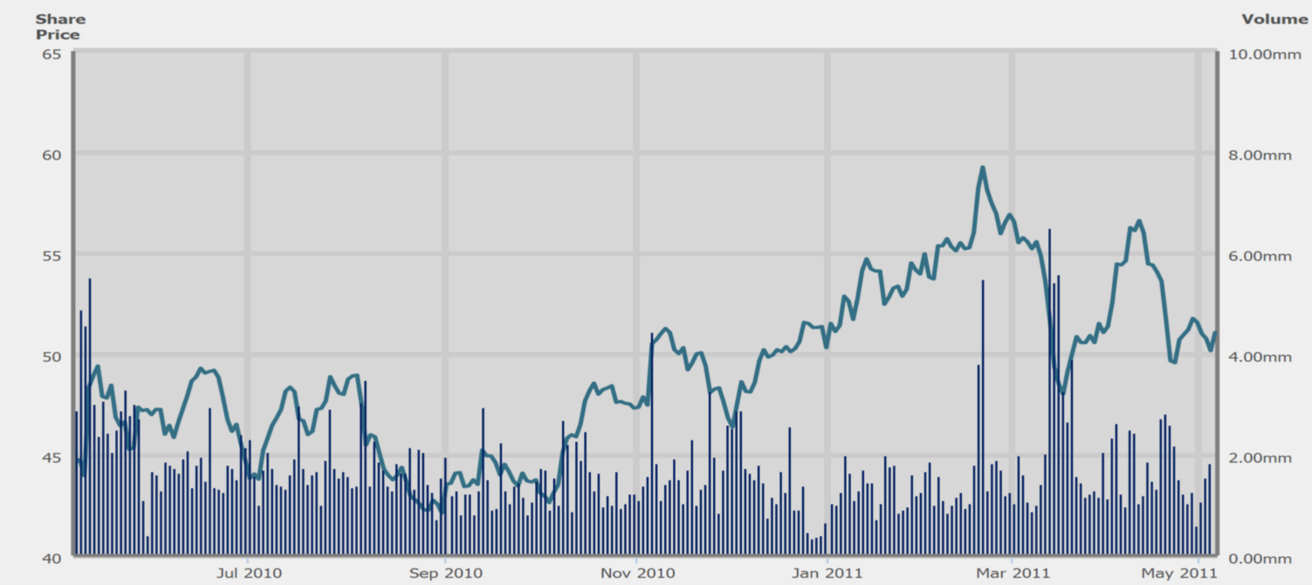
FQ3 2011 Earnings Call Transcripts

Thursday, November 03, 2011 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2011-	-FQ3 2011-		-FY 2011-	-FY 2012-
	CONSENSUS	CONSENSUS	SURPRISE	CONSENSUS	CONSENSUS
EPS Normalized	1.50	2.27	▲73.13	3.44	6.89
Revenue (mm)	5201.57	5627.42	-	23661.93	24592.68

Currency: USD
Consensus as of Nov-03-2011 9:00 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2010	-	-	-
FQ3 2010	-	-	-
FQ4 2010	-	-	-
FQ1 2011	-	-	-

Call Participants

EXECUTIVES

Eric Schuh
Former Head of Investor Relations

George Quinn
Former Chief Financial Officer

ANALYSTS

Andrew Broadfield
Barclays PLC, Research Division

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Autonomous Research LLP

Benjamin Cohen
Collins Stewart plc, Research Division

Brian Shea
BofA Merrill Lynch, Research Division

Fabrizio Croce
Kepler Capital Markets, Research Division

James Austin Shuck
Jefferies LLC, Research Division

Jean-Francois Tremblay
RBC Capital Markets, LLC, Research Division

Maciej Wasilewicz
Morgan Stanley, Research Division

Michael Klien
Nomura Securities Co. Ltd., Research Division

Paul F. Goodhind
Redburn (Europe) Limited, Research Division

Spencer Horgan
Deutsche Bank AG, Research Division

Thomas Fossard
HSBC, Research Division

Thomas Seidl

Vinit Malhotra
Goldman Sachs Group Inc., Research Division

Presentation

Eric Schuh
Former Head of Investor Relations

Good afternoon and good morning, everybody. And also from Swiss Re side, welcome to our third quarter 2011 results conference call. As already announced, we have changed the format of this call, and we will, today, solely focus on your questions. I'm here with our CFO, George Quinn, who will give you a one-minute opening remarks before we turn to the Q&A, with the usual restriction of 2 questions each, please.

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

George Quinn
Former Chief Financial Officer

Thanks, Eric. And I'm pretty sure this doesn't last for one minute, actually. Good morning and good afternoon to everyone.

As you've seen, and if you'll forgive me for mentioning the -- following the rating upgrade last week, we, today, reported an excellent overall result for the group. Net income for the quarter of $1.3 billion. Although it's one quarter, that translates into an ROE of over 20%. Well, the numbers have definitely been flattered by a number of one-offs, and we're very pleased with the underlying result for the quarter. And we believe that we're well on track towards the 2011-2015 financial targets that we established earlier this year.

Eric?

Eric Schuh
Former Head of Investor Relations
Thank you, George. And with that operator, could we please take the first question?

Question and Answer

Operator

The first question is from Mr. Spencer Horgan from Deutsche Bank.

Spencer Horgan
Deutsche Bank AG, Research Division

Two questions, please. First one is, well, I guess it's my usual one, actually, which is about the combined ratio, because it's obviously very good on an underlying basis, again, this quarter, that 90%. And I think at the start of the year, you said you had priced the business at 94%. And then I think last quarter, when I asked the same question, you're sort of implying maybe the underlying combined ratio been 93%, but you got a bit lucky in the second quarter. I'm just kind of wondering, I mean, is this business actually, in reality, priced to produce 90%? Because it sort of seems to be the case on a quarter-to-quarter basis? And then the second one was on the investment side. Obviously, the realized gains on the government bond side is a function of you shifting the portfolio around. I was just kind of wondering, what are the purpose of shifting around? Is that duration management exercise? And to the extent that it has been shifted around, presumably that might accelerate the reduction in running yield you might otherwise have expected to see. I mean, is that the case? And maybe you could give us some guidance on where we should see the running yield going from here.

George Quinn
Former Chief Financial Officer

Spencer, so on the first one, the -- I'd like to be cautious on the combined ratio. We -- obviously, we tracked very carefully the expected and actual nat cat losses, but we haven't got into the habit of trying to track in public the underlying man-made impact on the property side or even the liability loss cost. I think it's pretty clear that we've almost certainly overachieved this year versus where we thought we would be at the beginning. But of course, we have had better renewals than we would've anticipated when we announced the expectation of the combined ratio earlier in the year. So I think we're almost selling somewhere between 90% and 94%. Even though we have a large man-made loss from that explosion in Cyprus in the quarter, it still feels to me that we're -- we probably got good luck in places other than properties. So I wouldn't necessarily assume that the figure that you've seen today is the underlying normalized and predictive combined ratio for the following quarter, but it's clearly better than the 94%. On the asset side of things that you rate, there's been some pretty substantial moves, especially in our rates book in the quarter. I think that when you look at the rates portfolio, you need to look at the -- I think not just the realized gains on the cash side, but taking into account the movements on the derivatives. We use derivatives for portfolio efficiency to get duration or to -- and shift the shape of the key rate durations without necessarily turning the whole thing over. But we do and have made significant shifts, either because of duration updates across the portfolio or because of views on particular sovereign credits. It doesn't, going forward -- again, you're right that, that type of activity tends to accelerate the convergence between the current running yield and the yield that you would achieve if you invested into the same portfolio, on average, today. But again, given the duration of the overall portfolio, which is still between 5 and 6 years, it takes a reasonably long time even with accelerated sales to do that. And I think we still feel it's more important to try and manage the portfolio, manage the risk, try and keep the thing, either duration matched or be deliberately unmatched if that's the decision that we take. And we do more of that than trying to target a particular income number for rates for the quarter. In terms of future movements, we've seen a drop in the fixed income running yield this quarter. The 2 main drivers of that were the reinvestment rates. So we were reinvesting about -- a bit more than 2.5% in the quarter. Assets were rolling off about 2.9%. So that difference explains about 10 bps of the reduction in running yield. The remainder is due to the change in value of the portfolio because of the fallen interest rates. I think that the 2.5%, that doesn't really represent, I guess, the average yield that we would achieve if we were investing in the same portfolio mix. It's more an accident of which parts we were investing. And as you've seen, because of the fairly substantial rates activity, there's more invested on the government side, which is -- even today is still closer to risk free than any other parts of the portfolio. But the yield is clearly coming down in the current environment.

Operator

The next question is from Mr. Vinit Malhotra of Goldman Sachs.

Vinit Malhotra
Goldman Sachs Group Inc., Research Division

If I -- just on that combined, and just to be very clear, again. The beat that you are seeing out away from that 94%, did I get it right that you said that it was somewhere outside the property line? That's the first question really. But I'm quite curious as to where -- at least, broadly, where this is coming in? Is it specialty, that casualty or property? And on this -- on the life and health morbidity. Since last 2 years now, there's always a pretty strong, better-than-expected morbidity. And is there something that -- is it something that was written very conservatively? Or if you could just spend a few minutes on that.

George Quinn
Former Chief Financial Officer

Yes. So on the first one -- so apologies if I left the impression, in response to Spencer's question, I was giving an authoritative answer that there were absolutely 0 performance in that particular line of business is -- I think that what I was trying to say is that I haven't tried to measure the good luck and anything other than that natural catastrophe business, nat cat property. So that's why I expect that there is probably some good luck in the lines of business outside. I don't know today if -- exactly where that would be at this stage. I'm trying to caution that we don't take 90% as the running rate.

Vinit Malhotra
Goldman Sachs Group Inc., Research Division

Sure, sure.

George Quinn
Former Chief Financial Officer

On the morbidity cost for health for the quarter, again, you're right that we've seen -- actually several quarters now, a pretty good performance from health. I think if you go back long enough I can remember a time that it was different. But of course -- I think the way that we do health business has changed substantially over the last few years. The -- but having said that, I wouldn't claim that I believe the morbidity variation that we're seeing in this quarter is any different from the mortality variation I'm seeing negatively on the traditional life business. I think both of these things tend to be volatile. Although I think -- I probably also recognize that health has had more positives recently while life has probably had slightly more negatives. But I wouldn't point, again, to a trend. I would tell you, you should expect to continue. Health is performing well.

Vinit Malhotra
Goldman Sachs Group Inc., Research Division

Sure. And can I ask one more about the tax rate, please? The very low tax rate in 3Q, and I've had a chat with [indiscernible]. But is there a -- is there whole year outlook for tax changing now? Or is it -- in other words, the fourth quarter also going to see some tax benefits in you view? Sorry.

George Quinn
Former Chief Financial Officer

So the -- on the tax side of things, I -- like you understand how the process works. So the tax in contrast to other elements of financial statements, you actually project into the year-end and trying to make a determination of what is contribution. You then separate out discrete items, and we had a number of positives discrete items in the quarter. Our underlying tax rate is actually in line with the guidance that we gave earlier in the year. So they kept at 27%, 28%, though we've actually had some reserve releases on the Fin 48 side, and that has substantially reduced the reported tax rate. I can't predict what the discrete items would be in Q4. But certainly for an underlying perspective, the guidance that we gave earlier this year is still valid. So at this stage, if I was projecting Q4, I would return to the normal tax rate of 27% and 28%.

Operator

Next question is from Mr. Michael Klien of Nomura.

Michael Klien
Nomura Securities Co. Ltd., Research Division

Yes. I had just one question. Firstly, on the reserve releases on the liability side in Europe. Can you maybe give a little bit more indication in terms of where exactly this came, and what's -- what prompted you to release those reserves? And the second question is in terms of regaining the AA rating. I guess it comes now in times to -- for the general renewals. Do you think this is going to have some positive impact? Or do you retain the comments you have made previously post Monte Carlo and so on?

George Quinn
Former Chief Financial Officer

So on the reserve releases, first, Michael, the pattern that we see in Q3 is a lot like Q2. I think that the one deficit highlight here is that there are probably -- we got some big positives and some larger negatives than we saw in Q2. On the -- again, just reminding you of what happened in Q2. It was mainly driven by liability, liability Europe and mainly accident years 2007 and prior, which means under 18 years, mainly 2006 and prior. The picture is almost identical for Q3. And what we're really seeing is, again, an absence of the claim that you would expect to see compared to what the like factor would protect. So we just got missing claims compared to expectations in IBNR at the moment. Kind of -- lines of business is pretty much everywhere. We got it in GL. We got it in motor. I wouldn't isolate a particular part, but it's still mainly Europe. Asia is a small contributor, and the U.S. doesn't really figure in this, at least, so far. So story similar to Q2. On the renewal side of things, it would really stretch credibility if I said that I now believe that the -- regaining the rating would have a huge impact on renewals given I spent 2 years telling you that I hope the downgrades didn't have a very significant impact on the company. I still believe that today. I think as -- I think I said to the media this morning that it's also psychologically beneficial for the sales teams to have this on the back of their mind as they're going through the renewal. But I don't really think it's going to change things substantially. I think most of our clients have been following us very closely for the last couple of years, and I think they had probably already reached a level of comfort with Swiss Re's balance sheet and risk position ahead of this announcement. But it's a very good confirmation that we've actually achieved this point. But I don't expect this is going to produce a big boost for us in renewal.

Michael Klien
Nomura Securities Co. Ltd., Research Division

But will you maybe adjust it considering that now you have regained it and you still have got a certain amount of excess capital? Will you be maybe somewhat more forceful, or will you be willing to use a little bit more capital on the renewal side?

George Quinn
Former Chief Financial Officer

Well, I think, on this, that the capital position that we'd held, to be honest, was never an attempt to try and encourage S&P to upgrade us faster because we had a very redundant capital position. I think we held that because of our own risk appetite during the period. So again, the -- I think the capital management philosophy of the firm won't be changed by the decision of S&P last week, although I'm aware that we need to come forward and explain maybe more thoroughly what we're doing on the capital management side. For that, we will do in February.

Operator

The next question is from Jean-Francois Tremblay of RBC.

Jean-Francois Tremblay
RBC Capital Markets, LLC, Research Division

Just wanted to reconfirm your views on the upcoming renewals here. What are you seeing around the effect of your ratings upgrade? But when you look at the landscape -- or to what extent has your -- of your expectations will drift to market trends considering the general renewals have changed since your -- wont you care to update? So that's my first question. And then the second question has to do with the outlook for the life business. It seems to me that, again, it's no easy quarter for life. Can you try to highlight some of the -- what you see as the key underlying trends? And to what extent you think we should be expecting, meaning for noise, still in the fourth quarter and 2012?

George Quinn
Former Chief Financial Officer

Okay. So on the first one, the -- I don't think our view has changed post Monte Carlo. The -- I think that the one thing I should say is that while I don't think the rating change really has any significant positive impact on our ability to generate substantially more business in January, I think the reasons for the rating change are indication that we're in a very strong competitive position. And we can use that to do well in the January renewal. But I think our view on the kind of the positive rate pressure that we perceive in the market hasn't changed since Monte Carlo. I think if anything, if we look at the way the market has developed since on the financial market side and, of course, we have this ongoing event in Thailand, I think there's more challenges to come on the capital side. And we certainly hope that there'll be more call for our services to help support our clients. On life and health, yes, it's a tough quarter for life and health. We end up with a headline number that's slightly better than last year, probably slightly lower than expectations, but it's full of very, very large one-offs. I think the good news is that most of them now out. If I look at morbidity and mortality, poor mortality but good morbidity. If I look at some of the financial market effects like the impact of the B36 derivative or the impact of our own credit spread on the VA, there's a small negative out of that, but it's not massive. And then again, more by luck than by design within Admin Re, we had a very substantial negative from the impact of financial markets, both on fee income and on PVFP amortization. But that was offset by a model change or reserve release on the Admin Re book. So for trends going forward, I think all that we guided to say at this stage is that we obviously -- we'd not expect that health is the only provider of profit in the quarter, and I wouldn't expect morbidity to normalize again, but that would be equally true for mortality and traditional health. I think the challenge on the noise that comes from the financial markets, that's very difficult to predict, and I wouldn't take the risk of trying to predict that here. I think all I could tell you is that, obviously, if the markets can't do it and the spread's tame, we'll get some or all of the B36 adjustment back. But at the same time, we'll have to return the benefits that we received from the VA book. Unfortunately, the financial market volatility we have to live with. But the underlying lost cost, whether it's morbidity or mortality, I would expect to normalize. I don't see a bias in one direction or another.

Operator

The next question is from Mr. Andrew Ritchie of Autonomous.

Andrew James Ritchie
Autonomous Research LLP

Just -- could I -- George, maybe just add a bit more colors to your comment on capital management. To remind us, you said that you would update the market on -- in February on that. But can you give us a bit more color? What was that did you mean? Were you always planning to update the market in February? Is this to maybe put in place a buyback facility, not necessarily execution? Maybe just give us a color as to why February is the date where you feel you could update capital management. Second question, more technical one, on premium growth. Obviously, in Q3, we have a lot of seasonality because of the booking of a higher force of your cat premiums in Q3. But there's also -- I guess the effect we're seeing this quarter are some of the earn-through of the business renewal earlier in the year. You have in the past given sort of guidance as to how think about momentum on earned premium growth. Can we assume --

can you just give us some clue as to the rest of the year, how much more of that renewed business there is to earn through in the Q4? Any sort of color there will be useful.

George Quinn
Former Chief Financial Officer

Right. So on the first one, I wasn't intending to announce something new today. The capital management comment was really me repeating, I think, what I said on earlier quarters. So it's just that the year-end is a natural time to update this given that's when most of the detail work has done around, for example, the statutory positions, and we get a very solid foundation. So I think if I answer the rest of your question, I'd start to anticipate some of the things I'm thinking about seeing in February, and I'd want to avoid that today. But in February, we'll come forward with a more comprehensive approach to capital management and what you can expect from us beyond the dividend policy that we announced earlier this year. On the premium, you're right, I gave guidance, I think, back at the end of Q1 for the end-through of the renewal impacts that we've seen so far this year. I think if you look at this quarter, we're not far off where I thought we would be, and I think we're very close even though we've had a pretty significant negative impact in the quarter from a client-notified reductions to prior year premium estimates. I -- now what I would expect from here on end, I think I'd expect the premium volumes to continue to rise. So there should be, on a like-for-like basis and more in Q4, the -- depends what happens in the January renewal, for how long that's going to continue. If you look at the pattern we've had this year on the renewals: January, slightly lower; April 1, substantially up; July 1, up. And in fact, we've written some substantial new business again in the third quarter after the renewal. So I think that you could still expect to see positive trends on the earned premium. I haven't tried to calculate a figure ahead of time today, so I don't have a good number in my head. But the thing I used the last time I did it was the written premium disclosure, which is in the footnotes, and that's -- that would give you a good sense of how the renewal is translating into what's been written. And given that on the P&C side, most things are pretty short tail. You'll see that written pattern be replicated in earns fairly rapidly. I'll look at that again for the year-end. But I think other than the fact I expect it to grow through Q4, I can't give you a precise indication of the number.

Operator

The next question is from Mr. Andy Broadfield of Barclays Capital.

Andrew Broadfield
Barclays PLC, Research Division

George, 2 questions, please. One is a quick technical one on the PVFP amortization, and I've racked my brain for some time trying to make sense of this. But the -- am I right in saying that the -- this is likely to -- if I look at the chart then, it has been quarter after quarter of accelerated amortization. Am I right in saying that, that is a consequence of the variable [ph], or AV42 [ph] to call it, being calculated on normalized twitter, and from -- therefore, as long as we remain in a low-interest rate environment, that unwind is going to always be accelerated a bit faster than the expected level? And that's the first question. Second question is a little bit broader actually about the business you're seeing. We've had a -- frankly, a couple years, we've had non-peak risks becoming pretty dominant factors in the catastrophe claims. And I was just wondering whether -- 2 things, whether you're changing that way that you're thinking about your own management. I know you've got good results. But nevertheless, are you thinking about how are you managing those non-peak risks? And also I think clients are asking for sort of more aggregate covers or all those sort of things. Does that, in any way, help you in terms of your -- of what you have to offer versus some of your competitors?

George Quinn
Former Chief Financial Officer

Okay. So on the first one, the very short answer to the question is, yes. So PVFP is amortized in that proportion to expected gross profits. And because we have an assumption of lower fee income, that's what's driving the speed up in the quarter. And of course, if that would -- that was continue, you see a continued accelerated amortization of PVFP. On the second one, just starting first with this broader point the non-peak cat risks. Our philosophy on cat risk is a combination of a -- we have volatility, limits or targets, so we set a volatility limit for peak risks and non-peak risks in relation to capital, we then set target in relation to the earnings volatility that we're prepared to accept, and that's reflected in the Q2 disclosures that we make. But then we also set targets to make sure that we don't inadvertently end up being overlain on particular risk. I think when we look at the experience -- and I think you also mentioned, it's not only of this year but over the last couple of years, we're -- in particular Australia, has been a source of number of significant losses. I think our view is that we're quite comfortable with the market in Australia. Even with the loss in New Zealand, we think that given the source of the loss for us, there's only the potential for payback. And we expect to get paid back for that loss. I think there are other non-peak risks where, with the benefit of hindsight, we're going to get a bit smarter. But it's much harder to see that the local market can pay you back. And the event of those sizeable is not sufficient enough to drive an overall global move. So I think that, for example, in Chile, will make things more difficult in the future. The change in the way that clients buy -- well, I think the anecdotal things I have heard, so far, from Brian, Brian Gray and the underwriting team, more of our clients trying to protect themselves around frequency. So people buying backup cover. Capacity is a big issue in all the loss affected -- the substantially loss-affected markets. So I think we feel quite comfortable where the market's [indiscernible]. We like the fact that rates have obviously risen very substantially, and we have more capacity that we can deploy. And we've done a bit of that this year, not a lot so far. We could deploy more capacity on January 1 if prices move. But I think that the -- we're not at very strong position, I think, to help clients. Then on the non-peak risks, we're also focusing on whether we can expect to recover over time some of the losses we may suffer, and that may impact our appetite for particular risks in the future.

Operator

The next question is from Mr. Brian Shea of Bank of America Lynch -- excuse me, Bank of America Merrill Lynch, excuse me, sir.

Brian Shea
BofA Merrill Lynch, Research Division

Okay. Two questions, please. First of all, George, in your taped or recorded presentation, you described the life and health result as solid, and I just wondered if you could elaborate on the use of that word. I thought that the life and health result, it kind of smells like it's earning a mid single-digit ROE. Am I wrong with that? Or what on -- just on what basis would -- did you -- are you satisfied with that result? And then secondly, going back to a comment that was made when you were talking to Spencer. The 2.5% new money yield, it sounds like -- could you -- you said that's probably not indicative of how you'd be investing going forward if rates stay where they are, because you're -- there's a particular skew to where the new money was going in the quarter. It's kind of tough one. But any sense you can give us of a more indicative figure for the new money yield if you're investing in a more of a neutral way going forward?

George Quinn
Former Chief Financial Officer

Yes. So the first one, life and health. Yes, a tricky one. The -- I think that the -- to be -- the life and health number was not bad enough for me to be deeply concerned about, but it wasn't high enough for me to be particularly happy about it. I think if I look into the various components, I think the underlying number is actually stronger than the headline suggests. So as I mentioned earlier, I think in the earlier comments, I think to Vinit when he asked the answer the question, I'd look at 2 particular pieces of it: one being the 2 market-driven features, which is the VA impact and the B36. That's a negative. And I think it's not unreasonable to expect to over time that, that should be a 0 unless someone very substantial fails to meet their obligations. So that would tend to suggest the underlying performance is maybe a bit stronger than the headline result today. On the business side of it, I put Admin Re to one side for a second and just look at traditional life and traditional health. Again, on these 2, we got one which is suffering in the quarter and one which is doing very well. And I think there, if I just offset those 2 impacts, I probably wouldn't have a definite expectation for the future. So the net for me there is probably okay. If I bring in Admin Re, Admin Re has got a very noisy quarter. We got one item which was driven by the market switch. Of course, Andy highlighted a second ago that we cannot really expect or count on reversing very, very rapidly. But at the same time, we had a positive impact from models that you certainly wouldn't anticipate either quarter, and you certainly wouldn't anticipate it would always be positive. So I think Admin Re has still got a challenge. I think traditional life and traditional health is okay. I think the underlying is probably stronger than the headline suggests, and at Admin Re, we got some work to do. And I think the team there -- that you know we have a new management team. We've been working on the restructuring, have been recapitalizing. We're spending some money to try and put themselves in a more independent footing. I think we'll get -- you'll get a much better view of that business when we change to the new view in April next year, with the asset returns in the segment. But that's probably what leaves me to the view. Overall, it's solid which is not bad, but it's not great. And you ask me a second question. You did. So the new money yields, it's kind of stupid to highlight something that you don't have the answer to. I don't actually know. I'd need to go and look. So Eric and I will have a look at it. And if anyone has an interest in it, you can get it from the IR team. But it would be higher, but I don't know how much higher, Brian.

Operator

The next question is from Mr. Fabrizio Croce from Kepler.

Fabrizio Croce
Kepler Capital Markets, Research Division

Two questions, actually. The first one is about the agency's exposure. I saw that within the structural product portfolio, you had an increase by 41% of the U.S. agency exposure. Now irrespective of -- you could think that -- so there are different opinion on those type of exposure in these days. But what stressed me a little bit is that the exposure is currently over your strategic asset allocation in this segment, which is between 5% and 10% And so if you are over the strategic allocation, the question is how strong do you respect actually that asset allocation, and how tight is the grip of the risk manager on these -- on those investments? And the second one is about the demand that you are facing with new product. As I heard for several other companies that they had particularly volatility reduction product demands, which means focused on frequencies and large excess of lost contract. And the question is if the demand in your case is the same.

George Quinn
Former Chief Financial Officer

Fabrizio, so on the first one, you're right that we have increased agency. I think our view of agency, and I think just to make clear, is that, I think, it's broader than, just for example, Fannie, Freddie, et cetera. It includes [indiscernible] and other government-backed securities. So in turning to your issue on the concern on the asset allocation, I think probably in due course, we need to separate agency out of the securitize and show it more as part of the kind of government and rates -- because the risk is really quite different. I think I agree with you that you shouldn't be blind to the additional risks that do exist in agency. But the -- I think the risk there are really quite different from those that exist in the other RMBS and CMBS areas, et cetera. On the volatility-reduction point, I can't give you chapter and verse. But certainly, from the limited interactions I've had with our clients and certainly from the feedback I've had from the people who we speak to them more frequently, clients are clearly more concerned about volatility. So the appetite to accept volatility seems to be much lower. I haven't yet seen that translate into a new or innovative product. Probably the most obvious example for us is what people are buying backup covers because maybe there's a risks that exist in coverage that's about to run out. But I haven't yet seen it translate into some innovative form of product design.

Fabrizio Croce
Kepler Capital Markets, Research Division

And just -- sorry for the follow-up. I know that I have only 2 questions. But in -- okay, out of the $7 billion, $7.2 billion that you have now in agencies, how much is U.S. and how much is rest of world?

George Quinn
Former Chief Financial Officer

So if you hang on, it appears -- actually, it's almost all U.S. It's almost all U.S.

Fabrizio Croce
Kepler Capital Markets, Research Division

Okay then. So -- and to the story with the bond-wise [ph], the strategic bond-wise [ph], which is broken through with 11%.

George Quinn
Former Chief Financial Officer

Yes. The -- I think one thing to be really careful, Fabrizio, is that within the company, we have, honestly, a risk limit framework that is applied religiously in terms of everything we do. The chart here is intend to relate an indication to invest as of -- where we intend to put the money. So where we wouldn't -- well, you wouldn't expect to see lots of volatility outside these levels. These are not the risk controls that we apply internally. This is obviously intended to be a bit more indicative given the weight of some of the ranges. And I think the issue on the agency again is more that it's a -- has more of a government bond-risk characteristic than necessarily a securitized product, and may be at some point, we have to look at reclassifying that.

Operator

The next question is from Mr. Mark (sic) [Maciej] Wasilewicz, excuse me, of Morgan Stanley.

Maciej Wasilewicz
Morgan Stanley, Research Division

Maciej from Morgan Stanley. So my questions are -- my 2 questions are. Number one, just on you your big one-off trading FX gain this quarter. I'm just wondering if you could point to one or multiple macro drivers that I should be watching to try to predict when and if that macro -- that FX trading gain could potentially unravel? That's the first question. Second question is, I know you said already in this call that you have more capital than you could deploy. Just very simplistically, looking at your capital disclosure. You had $6.4 billion backing your P&C business before diversification. Even if we assumed $1.5 billion to end the quarter share, even if we assumed 20% growth per annum of that business on top of that, we still -- given that you're generating on run rate $2 billion maybe and paying dividend of $1 billion, it seems that you have far, far more capital than you could possibly burn up in your business. And yet, every time we meet, you say, "Well, we first want to deploy capital for business, if possible, rather than paying it back. And if that's not possible, pay it back." I'm just wondering, am I missing something? Is there some constraint, fungibility constraint? Is there some business opportunity outside of P&C? And could you -- could Admin Re suck up that capital? Is there something that I'm missing? Or is it basically the capitalization indicating quite strongly that you could do a buyback or something next year?

George Quinn
Former Chief Financial Officer

So first of all, thank you very much for the first question, I was hoping that someone was going to ask me that one. The -- so with all the caveats that come with this, so -- obviously, the portfolio can change. We can choose to hedge in different ways. It's a pretty dynamic process. But to try and give you something that you can all look to perhaps, the 2 main trading portfolio blocks are euro block and the sterling block. We have about interest rate sensitivity of DVO1. And each of these, about $2.8 billion, $2.9 billion -- sorry, $2.8 million, $2.9 million. So for a one basis point move, $2.8 million on the euro, $2.9 million impact on sterling. If I look at the third quarter, the euro shift was pretty parallel. So of course, we don't actually have -- we got a number of key durations in the exposure spread right out to 30 years. The overall duration is, say, between 8 and 9 years. So if you look at probably the 10 year being the simplest point to pick up, that would give you some very rough sense of at least what the sensitivity was at the end of September. So that would mean, for example, that if we saw 100 basis point rise on the euro, that would translate into a $280 million pretax negative, and 100 basis point move on sterling would be a $290 million pretax negative. I think that's the best guidance I can give you today to try and allow you to look at what happens at the end of the quarter with the caveat that if things change, we adjust the portfolio. But that's probably the best I can do at this stage. On the capital point, the -- I think that -- obviously, I would characterize the way we would express that, at this point on the capital side, maybe a bit differently this year. So we said back in February that we saw a number of potential ways to deploy the capital and the kind of -- in the lines of business. Really, there are number of what these opportunities might be, some of them have emerged, some of them haven't and some new ones have come to the floor. We've also seen some pretty volatile capital markets, which, of course, has reduced our capital position and reduced that of the competitors and the clients. If I look at the fungibility, all of the constraints that limit Swiss Re's ability to either use our return capital are the ones that we see internally, whether that's post extreme loss, solvency requirement or a post extreme loss liquidity requirement. We have headroom on all of them. But just a reminder that we had said, that I have said probably a couple of years ago now, that we will maintain a substantial buffer. And if you measure that in S&P capital terms, the figure I gave was $3 billion to $5 billion, and that's a level that is consistent with the internal risk tolerance that's set by our board, at least, as of today. So there are constraints, but we don't constrain us at this point in time. We have freedom to deploy more capital. And the point that you made, kind of the new business side, that I think one of the other analyst actually made early in the year also, is that it's actually very efficient to deploy more capital in the renewal. You quoted a number P&C capital, which in an economic view. The $1.5 billion that we've talked about in an S&P context to end the quarter share would actually be substantially less when it comes to economic capital. And economic capital is probably the key constraint for us. But I don't want to start to discuss we may do this, we may do that. As I mentioned to Andrew Ritchie in his question earlier, we'll come back to this topic in February when we're through the year-end, we have some sight of a January 1 renewal and have a view on the opportunities that lie ahead. And we'll talk about the capital deployment, either in the business or elsewhere, if that's what's required.

Operator

The next question is from Mr. James Shuck of Jefferies.

James Austin Shuck
Jefferies LLC, Research Division

Yes. Apologies if this is something that you need to return to in February as well, but I'm just thinking about your targeted return on equity. Because risk-free rates -- so U.S. risk free at sub-2% at the moment, and you're targeting 700 basis points on top of that. So that means you're kind of only aiming for a kind of 9% ROE currently, and what markets are telling at the moment is your cost of equity certainly isn't that low. So I'm just trying to -- like to get a view of your -- your kind of updated view of actually what you're prepared to commit incremental capital as. Because -- now if you think in a wider context, in the reinsurance industry as a whole, that's one of the lowest hurdle rates in the industry. And I'm thinking to myself, "Okay. Well, you're making positive news about the cycle turning, and yet, one of the players with the lowest hurdle has got the most excess capital." So I can't quite square how I see the cycle turning when you're prepared to commit capital at 9% ROE and others are targeting more than that?

George Quinn
Former Chief Financial Officer

Just one question, James?

James Austin Shuck
Jefferies LLC, Research Division

Well, it's one with multi-parts. And I think Fabrizio asked 2 so...

George Quinn
Former Chief Financial Officer

Yes, okay. All right. So the -- so first thing, to be completely clear, we don't -- we do not target a 9% ROE on new business. The challenge, of course, is we've got business that's currently generating slightly less than that, and we cannot flip the entire company every renewal. So it'll take time for us to add new transactions at higher rates and move the overall average. But you shouldn't assume that the target we set, which recognizes the enforced portfolio and it's expiry over the next 5 years, is the target or the hurdle rate that we set for current new business. You'd expect a lot more than the 9% ROE to deploy chunks of capital in the current environment. That's for sure. I think the other thing I would say on this is, of course, the target is -- it's a 5-year target. We do track it on a quarterly basis. We all show it to you on a quarterly basis. But interest rates, I guess, are going to be volatile over the period. And I expect at some time in the 5-year period, it's going to be demanding much more from us. But the real reason that we have a target at that level is simply because we need to bring new business on it far higher rates of return and bring up the overall level return from the entire portfolio.

James Austin Shuck
Jefferies LLC, Research Division

But I suppose if -- I mean, if they -- if it's an average over 5-year period, then in 5 years time, there won't really be -- or shouldn't be any kind of back book depression or sort of dilution from it. I mean, another way of asking it is this kind of - what is your hurdle rate ROE on new business?

George Quinn
Former Chief Financial Officer

So the way that we do is we have an economic framework that we apply. We allocate frictional capital cost or cost of capital and market-risk premiums, in the case of asset management, and we track that overall cost in comparison to the market-implied cost of capital. And that's the rate that we expect the business to generate overall. And if I look at the -- if I look back to what we had presented on the economics earlier this year, this EVM information that we gave, I think that implies something more like a between 11% and 12% cost of capital. That was for last year.

Operator

The next question is from Mr. Paul Goodhind of Redburn.

Paul F. Goodhind
Redburn (Europe) Limited, Research Division

George, so I -- just present to the capital position movement in the quarter. And can you just give a feeling for how it change on the S&P basis? And in particular, what impact the spread widening had on that position?

George Quinn
Former Chief Financial Officer

Yes. So the -- I'm going to avoid the temptation to give you a number. The spread white, now if I could say the word it'd be easier, spread widening and the mark-to-market impact from equities is a direct hit to S&P capital. We can -- we don't assume that it reverses. We don't reverse the unrealized losses on life bonds. We take it straight into the S&P available as a reduction. So the -- I think if you look at the figures that we gave for credit spread sensitivities and you look at the widening in the quarter of high-grade corporate bonds, you'd get a good indication of the pretax capital impact from spreads and the equity impact, as shown in the equity waterfall. So I think even though we have a - I think arguably, our less risky portfolio than probably many of the peer group, it's still had an impact on us this quarter. But we're still obviously very strongly capitalized even at the end of September.

Paul F. Goodhind
Redburn (Europe) Limited, Research Division

And just as a follow-up if I can. I mean, your 20% ROE in the quarter, obviously, there's lots of noise there. If you strip out reserve releases, cats, normalized realized gains and normalize the tax charge, it's not obvious that you're kind of really clearing that 9% hurdle rate in the quarter. Is that fair? And does it make sense to publish some sort of more normalized level of profitability that makes more sense than the headline that we jump all over the place from quarter-to-quarter?

George Quinn
Former Chief Financial Officer

Yes. This is a real challenge. The -- I made a list yesterday of the one-offs, and it's -- well, my view, the one-offs, anyway. And it's a page long, which, of course, is the kind of thing that I know irritates all of you guys, because it makes it so hard to estimate kind of what's coming. But I think when you boil it down and the way I said it -- I explained it to the media, and this wasn't to try and dumb it down to a level that was digestible by them, it was intended to be kind of a broad indication of where we see the underlying. And that's -- I focused on the prior year. The interest rate impact or the mark-to-market on this trading portfolio and then the tax, I taxed the 2 pretax items that the -- our underlying expected tax rate for the year. That's the 27%, 28%. And I end up with the result underlying that's in the 650-700 range. I think, you can get through the rest of the book and you could pick out all kinds of things. So I mentioned to Brian earlier on life and health, that was like a more bullish view because of the 2 market movements. On asset management, I almost certainly have a slightly more negative view. I think we've outperformed our own expectations for the quarter. Expenses are too high. The Group, for Admin Re and some one-offs, I think, reversed. There's a small negative from legacy and I -- you can go on and on and on. But the -- I think my view is kind of 650, maybe slightly higher, is a reasonably reliable indicator of what we think the underlying looked like in Q3 of 2011.

Operator

The next question is from Mr. Thomas Fossard of HSBC.

Thomas Fossard
HSBC, Research Division

Yes. I have just one question left on my side. CBI, obviously, we see then Asia [ph], a very quiet area following the Japanese quake. I just wanted to -- how your understanding of what the situation is? Is that already -- is that completely - is this risk completely gone? Or is it -- I would say, is the usual, long-emerging process for this losses to be reported?

George Quinn
Former Chief Financial Officer

So, Thomas, just to check, you're referring to CBI for Japan. Is that right?

Thomas Fossard
HSBC, Research Division

Exactly, yes.

George Quinn
Former Chief Financial Officer

So the -- I think on one hand, that they -- when, in fact, several of our team were in Japan last week. We have the impression that I think the more straight-forward part of the losses are actually pretty well advanced. The Japanese company seemed to have dealt with it very, very efficiently, locally. On the CBI side, I don't think -- we're not seeing a trend that's causing us a concern on CBI. The -- obviously, the loss estimate remains open, and I wouldn't make a commitment today. But we're not perceiving a problem around CBI on Japan, at least, today.

Thomas Fossard
HSBC, Research Division

On that turn, did you encourage any, I would say, what could be qualified as significant loss at Q3 -- for the Q3 -- for Q3 on the Japanese quake? Or I mean, up to now, you booked some IBNR, but you're still not receiving, I would say, for more claims yet?

George Quinn
Former Chief Financial Officer

The -- so I don't know for sure what the exact notified claim is for the CBI element of Japan. But I do know for sure that when we made the estimate, we made a -- there's a component that was in there for

CBI. And just by its very nature, it tends to be one of the pieces that comes through to you slightly later in the process. But I couldn't give you an update today, Thomas, for that, I mean, on how much of our original estimate we have used so far.

Operator

The next question is from Mr. Thomas Seidl of Sanford Bernstein.

Thomas Seidl

Yes. Basically, 2 questions, one on the reserve releases. I think we have seen now a string of reserve releases. And my question is on this date or back to 2006 and prior years, as you said, George, how should we think about this going forward? And could you give us some guidance there? And the other thing is given, let's say, the statement of profitability of the non-life book, how should we think about the quarter share reinsurance or retrocession going forward? Any ideas about how this evolves?

George Quinn
Former Chief Financial Officer

Yes. So the -- I guess on the first question you're asking me, I think there's a sustainable element of the reserve releases. I tried to be very cautious on the Q2 call. I've been no different today. I think it's fundamentally different for reinsurers than it is from primary companies. The portfolios that we have are just inherently more volatile. And the chief actually would shoot me if I made any forward-looking statement about reserve releases. The -- if you look at this quarter, I think there's enough evidence that you can have some very big movements in either direction. And we've seen that this quarter with the significant positive that we've seen across the liability book, but also a significant negative on the U.K. motor end of liability. So it's been good news this year. We don't plan for reserve releases and nor do we project them into the future. And to be honest, I can't give you guidance here. The only guidance I'd give you is that you should not assume that what we've seen in Q2 and Q3 is a pattern that will necessarily continue. On the -- on your second point, on the P&C book and the quarter share, I -- obviously, we're very happy with the performance with P&C and the team. Our client team and our underwriting team have done a fantastic job over several quarters, if not several years now. On the quarter share itself, the -- if you -- the quarter share expires end of next year, and neither we nor Berkshire Hathaway have any rights or options to renew. And I think that -- I might have said earlier this year that, in fact, we're planning for that contract to expire and for us to retain the risk. I think the quarter share has not been bad for us, but the book is clearly performing extremely strongly. We're in a strong capital position, and it's a risk that we can relatively, easily retain, I think, in future. And at least today, that's our plan for the future.

Thomas Seidl

And then probably that's eating up some of the capital we discussed earlier?

George Quinn
Former Chief Financial Officer

Yes. The -- so without want to kind of reopen the capital discussion again, the -- just to repeat that. I know we focused on the discussions that we've had in the past on the rating capital side of this. On the economic side, the capital requirements from the retention of that business are much, much smaller. The -- I think the challenge more is to try and make sure that when we retain the business, that we actually stay within some of the other limits that I mentioned earlier, so appetite for capital volatility or earnings volatility. So we'd have to do something, but the -- certainly from what we see today, there are some additional attractive economics that we would expect to retain either of the end of 2012 for our shareholders.

Operator

The next question is from Mr. Ben Cohen of Collins Stewart.

Benjamin Cohen
Collins Stewart plc, Research Division

Just one question. I was just interested in terms of where you are actually investing new money at the moment. I know you gave a comment earlier in terms of the sort of the yield and how you would shift. But just in terms of what you see as a reasonable risk in what are clearly difficult markets for investments just now?

George Quinn
Former Chief Financial Officer

Yes. It's a good question, Ben. The -- so we took a pretty risk-adverse approach in the third quarter. So I think -- and most of you know that we've had -- we've been in the process for most of this year of launching mandates either on the equity side. In fact, we've had actually some new ones on corporate credit and, in fact, on securitized earlier in the year. For the ones that weren't in ramp up, we stopped them in Q3. And while the current volatility continues, I think we're unlikely taking a dipper toward deeper into the water. So we would reinvest our new money at the lower return end of the spectrum. It wouldn't be our intention to maintain that position. I'm assuming that at some point, the market recovers its poise and some of the immediate threats start to decay. We then go back to complete the derisking, the derisking of the portfolio we'd identified earlier. But currently, new money has mainly gone into governments or similarly low-risk investments.

Operator

Gentlemen, there are no more questions registered at this time.

Eric Schuh
Former Head of Investor Relations

Okay. Thanks very much, everybody. And if you have further questions, please feel free to give the Investor Relations team a call. I think we had a very interactive session today. This is also the first time in a long time that we stayed within one hour. So it helps to leave out the presentation I guess. And with that, I'd like to thank everybody for listening, and we'd like to close the call.