S&P Global
Market Intelligence

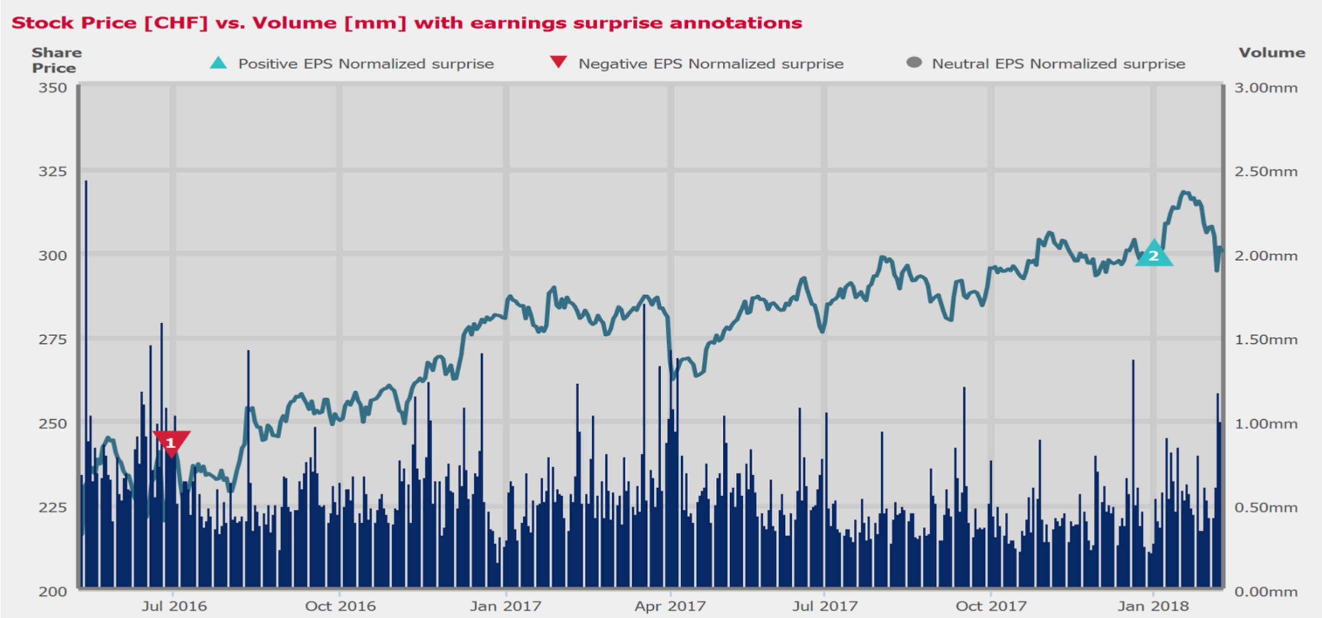
Zurich Insurance Group AG SWX:ZURN
FH1 2018 Earnings Call Transcripts

Thursday, August 09, 2018 11:00 AM GMT

S&P Global Market Intelligence Estimates

	-FH1 2018-	-FH2 2018-	-FY 2018-	-FY 2019-
	CONSENSUS	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	11.50	11.26	24.54	28.31
Revenue (mm)	26557.55	-	49889.51	50546.60

Currency: CHF
Consensus as of Aug-09-2018 9:14 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FH1 2016	10.81	10.55	(2.41 %)
FH2 2017	7.02	9.67	37.75 %

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EXECUTIVES

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Group CFO & Member of the Executive Committee

Mario Greco
Group CEO & Member of the Executive Committee

Richard Burden
Head Investor Relations & Rating Agency Management

ANALYSTS

Andrew James Ritchie
Autonomous Research LLP

Farooq Hanif
Crédit Suisse AG, Research Division

James Austin Shuck
Citigroup Inc, Research Division

Jonathan Peter Phillip Urwin
UBS Investment Bank, Research Division

Michael Igor Huttner
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Niccolo Cornelis Modesto Dalla-Palma
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Nick Holmes
Societe Generale Cross Asset Research

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

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

Presentation

Operator

Ladies and gentlemen, good afternoon. Welcome to the Zurich Insurance Group Half Year Results 2018 Conference Call. I'm Irina, the Chorus Call operator. [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 First Half 2018 Q&A Call. On the call today is our group CEO, Mario Greco; and our Group CFO, George Quinn.

Before we start, I'd just like to take the time to remind you that -- could you keep your questions to a maximum of 2 on the first go-round. And if we have time, we'll open it up to further questions afterwards. But before we start the Q&A, I would just like to hand it over to Mario to make a few introductory remarks with the results.

Mario Greco
Group CEO & Member of the Executive Committee

Thank you, Richard, and good day, ladies and gentlemen. Thank you for joining us today. I'm very pleased with our first half results. They demonstrate further progress against the targets and the priorities that we outlined in November 2016. Particularly pleasing is the continued strength of the results in our life business. Even adjusting for positive foreign exchange movements, they increased by 12% year-on-year. The results also show the high quality of our life business; 87% of revenues are coming from either technical margins or fees and loadings, and there is very little reliance then on investment results. This underlines the success of our consistent strategy of focusing on protection, unit-linked and corporate products. We have continued to execute on this strategy over the first half of this year, with 84% of APE from these products and 78% of new business value coming from protection business.

The first half has also seen the OnePath Life business in Australia begin to contribute to our results through the planned reinsurance of a portion of their portfolio.

Our Property & Casualty business also performed well. We saw an improvement in the accident year combined ratio. This was driven by improvements in the accident year loss ratio and lower administration expenses. And our commercial business has also seen improvements. The strength of our reserves further improved. While prior year development was at a good level, positive developments in claims related to the 3 hurricanes, Harvey, Irma and Maria, contributed to this development, further underlining the effectiveness of our underwriting.

Investment income in Property & Casualty has also stabilized over the first half of the year as reinvestment is improved. Looking forward, we remain focused on further improving our underwriting performance through a continued emphasis on profitability over volume, particularly in commercial insurance.

And the positive movement in pricing in the North American market that we began to see after the third quarter has continued to accelerate over the 4 quarters.

The Farmers Exchanges have continued to demonstrate solid growth in their chosen areas and in their ability to innovate with new business offerings like the commercial ride share business with Uber. Their customer-focused strategy has also continued to drive improved customer metrics. This has been achieved with an improved underwriting performance with the combined ratio reducing 6.6 percentage points compared to the first half of 2017. These trends should continue to support growth in Farmers Management Services.

Our balance sheet is very strong. Z-ECM ratio has increased further to 134%. This reflects the strong operating capital generation within our businesses.

The first half of the year has also seen us continue to deliver for customers and shareholders against our strategic priorities, with further strength in our leadership position in Latin America and in the travel and assistance business through targeted acquisitions in the first half. And we continue to extract capital from noncore activities. We also continued to invest in innovative customer solutions, including the launch of the first business of our European partnership with CoverWallet, a leading provider of direct insurance solutions for SMEs.

Our journey to become a more customer-focused organization also shows progress, with improvements in the retail Net Promoter Scores in our largest retail businesses. These developments will play an increasing role as we look increasingly beyond the delivery of our 2017-2019 targets.

Overall, these results give us confidence that we can maintain the positive momentum into the second half of the year.
Thank you for listening, and now George and I are ready to take your Q&A.

Question and Answer

Operator

[Operator Instructions] The first question from the phone comes from the line of Mr. Farooq Hanif from Crédit Suisse.

Farooq Hanif
Crédit Suisse AG, Research Division

The first question is on business mix in North America. Given that the sort of top line has dropped 4%, but pricing is accelerating, it seems to me that there's been quite a significant shift in lines. And I was wondering if you could you give us a guide, roughly, to workers' comp versus specialty versus other lines? If you could just give us a guide to the mix now and your intention for taking that forward? And then secondly, the second question is to address seasonality in combined ratios. So, I think there's kind of a 1 percentage point gap -- there was a 1 percentage point gap last year between 1H and 2H, an improvement. But in the second half, it seems to me that you've got pricing coming through, also you've got the effect of cost cutting. Just wondering if you think that could be repeated? Or whether you're looking to be a bit more positive?

George Quinn
Group CFO & Member of the Executive Committee

I'll start, Farooq, on the second piece, and then between us, I think Mario and I will answer the first one. I mean, we have some mathematical things, which I guess pretty much everyone's aware of. So we have a crop business that has a quite different structure in terms of loss ratio versus expense. There's close to $1 billion of premium yet to come in the year, and that business comes in with an expense ratio that's more in the high single, maybe just double-digit rate. So I think that, technically, will drive a different answer for the expense ratio in the second half. I think as regards optimism or what our expectations are, I mean, we do plan for further expense reduction in the second half. We have an expectation of about $200 million to come. I mean, as per -- in prior discussions, most of that's going to align with P&C. I mean, typically, you'd expect to see about 3 quarters of it. Those are the 2 obvious things that will drive expense ratio in the second half. As far as mix goes, I guess we'll be covering this on other questions, this issue of trading, commission versus loss ratio and the impact that can have on the expense ratio. We are looking to shift mix as -- I mean, as far as makes sense for us. But if I look at what we expect to see in the second half, certainly, in the things that will drive commission, I think most of them are there already. I'm not necessarily convinced we're going to see another significant step-up. And I think some of the trade-off that we have for loss ratio versus commission you've seen already in the first half. So I wouldn't expect to see that change significantly again in the second half. But overall business mix -- if you look at the numbers for us, within the U.S. portfolio, I mean, not surprising, we'd prefer actually to sell the retail and other business market despite the fact that you see more rates on the commercial side. Within the commercial lines, workers' comp is down a bit, not by a huge amount, down by a bit, around 1%. Commercial auto is still the strongest line in terms of rate. Inflation is running somewhere a bit south of rate. So there is still margin expansion taking place. But we did look at the overall numbers, and when you take the overall portfolio, it's a bit better of a proxy. I mean, we're still seeing 101% for commercial overall and 94% for retail. So even with the rates that we're seeing on the commercial side, we'd still have a preference to move the mix towards retail to the extent that we can. Workers' comp is strong, a little over the course of the last few years and, in fact, you'll see even more of that because of the reinsurance that we put in place at the beginning of this year. That will have a bigger impact in the second half, and a much bigger impact next year. But from a mix perspective, we're pursuing the priorities that we outlined at the Investor Day.

Operator

The next question comes from the line of Mr. Peter Eliot with Kepler Cheuvreux.

Peter Eliot

Kepler Cheuvreux, Research Division

Yes, the first one was maybe just to clarify your expectations for the expense ratio going forward, so not just the seasonality but more generally year-on-year. I mean, I think I understood from your answer just then that you don't expect commission ratio to go up any further from here, but perhaps you could just confirm that? And maybe give a little bit more color on where you see the expense ratio in general insurance going in future years? And then the second question was, I guess, are you thinking of starting to move that into the closed book space, especially in Germany? I'm just wondering your take on whether there's any sort of scope -- any more scope to do anything there? Or yes, your take on that environment.

George Quinn
Group CFO & Member of the Executive Committee

Thanks, Peter. So on the expense ratio going forwards. So again, for the OUE component, that's the one where you're seeing all the benefit of the expense reduction. Expect to see another $200 million reduction through the remainder of this year. That will bring the OUE ratio down, and that's on top of the mechanical impact of the crop business. On the commission ratio, I don't expect to see the type of change you've seen in the first half. I mean, there are 2 particular blocks of business that drive that. One is actually the acquisition -- well, not the acquisition, but us taking over the underwriting of some parts of the travel business, the Cover-More and services. That attracts a fairly high commission rate. We'll have that impact in the first half, but I don't expect the impact of that to change in the second half. Having said that, though, I mean, within the overall book, to the extent that in the future, we have opportunities to further improve what I would describe as the quality of the book, i.e., improve the volatility characteristics. I mean, that is something we would look to do. But I think at this stage of the year, for this year, I don't expect other significant shifts up in the commission ratio. But Germany, on the quality of the book topic, I mean, I think we've talked about it before. I mean, given the way that we've positioned that business, given the way it's managed by the team in Germany, we don't have quite the same pressure that maybe some of our peers have had. So there's not the same impetus but, of course, we do want to make sure that the capital is managed efficiently and as well as we possibly can. So I mean, it's something we're certainly interested in and we'll look at in more detail. But I think in the near-term, the priorities for the group, but also for Germany, are more about operation on operational performance. And that's certainly where the CEO and CFO and the rest of the guys in Germany are currently focused.

Operator

The next question comes from Andrew Ritchie with Autonomous.

Andrew James Ritchie
Autonomous Research LLP

When we look at the commercial versus retail nonlife performance, it's very clear in retail the trade-off between the expense ratio and loss ratio, which I'm guessing reflects the business mix. But in commercial, I can see an expense ratio reduction, which is to be expected. But the implication is that the underlying loss ratio hasn't really improved in commercial, and that all of your underlying loss ratio improvement in the first half just reflects this trade-off issue on the retail business. Maybe just clarify, what is the underlying loss ratio doing in commercial lines? And what's happening with some of the problem books, particularly in the second half last year, which were, amongst others, financial lines pretty much everywhere and commercial auto? The second question, PYD, I presume you still encourage us to normalize that down to 1.5. I mean, clearly, there was some lumpiness in the first half to do with hidden emergence, but maybe -- but you still seem to be suggesting you're very confident in the reserve position.

George Quinn
Group CFO & Member of the Executive Committee

Thanks, Andrew. So on the first one, I think it's too negative to view commercial underlying as not improving. I think the analysis you've done is not -- there's nothing wrong with it. I think the difference in the way that I would look at it is that, certainly, compared to a year ago, I think we would've worked harder to try to identify all of the one-offs and exclude them and come up with a very scientific view of where we think commercial stands. We've taken the view that the answer is simply the answer. So if there's volatility, there's volatility that has to be paid for. But if you look at the quality of the book, if you look at the work they've done, especially around things like commercial auto, which had been a perennial problem for several years now, I mean, you can see a substantial rate movement. At the same time, you can see a reduction in the volume. But I think the things that the commercial team are doing are improving the underlying -- they're certainly improving the quality of the book. And I think we will see the benefit of it. I mean, there's no doubt it's taken us a bit longer than we anticipated. But I mean, to be honest, we have plenty of company with that issue in the commercial market.

Andrew James Ritchie
Autonomous Research LLP

And do you think the reason maybe we're not seeing it more in the actual headlines -- is it sort of a large loss noise? Or is it purely a timing thing? I mean, you're looking at it on a sort of an account-by-account basis and underwriting year basis. We're looking at it on a calendar year? Is that what's happening?

Mario Greco
Group CEO & Member of the Executive Committee

Where are large losses?

George Quinn
Group CFO & Member of the Executive Committee

So Mario and I [indiscernible] on that. No, it's a serious topic. We've just been through the reviews with the business unit. And we told them, don't come and talk to us about large losses. You go fix it yourself. If you've got issues with large losses, go fix it. So I don't want to have a conversation about large losses on the call. I mean, the attritional outcome is just attritional outcome. I think the things we're doing will have an impact. There's no doubt it's taking longer to show up than we anticipated, but I think the things we're doing are the right things, and it will benefit commercial. In fact, I don't have the view that, I mean, commercial's just not moving. I think they're working really hard on this.

Mario Greco
Group CEO & Member of the Executive Committee

They're also working -- if I may add a point, Andrew, they're working in a soft market. I mean, property has remained quite soft even after the storms last year. So they're improving their books, and they're improving their profitability in a soft environment, at least for a big portion of the books, which is why it's taking what it's taking. But we do see the right movements and the right traction in what we're doing, and this is generating the desired results.

George Quinn
Group CFO & Member of the Executive Committee

On PYD, I mean, so I don't want to encourage you to normalize it. However, I think I'd love for you to do -- we'd more love to end up in the upper end of the target range than the middle of it. I think if you look at it over the course of the last couple of years, if there's been pressure on PYD, it's typically been in an upward direction, i.e., we've had more emerge from the reserving decisions that we've made than we normally would. I mean, obviously, today, the number's a bit higher than even I would guide to, and that's partly driven by the fact that when we set the hurricane reserves last year, with the benefit of hindsight, we've been a touch too prudent. So we've had a bit of a release. But I mean, overall, given what we've seen this year, given what we see for the remainder of the year and what we saw last year, I mean, we would see PYD at the upper end of our range.

Operator

The next question comes from the line of Mr. James Shuck with Citi.

James Austin Shuck
Citigroup Inc, Research Division

Two questions for me. First one, just actually on the retail side of things, the accident year ex nat cats. Could you just talk a little bit about the future direction of travel there? And also sort of what the development of crop was? If you could actually tell me what the combined ratio was for -- was crop -- was for crop in the first half, that would be very helpful. Obviously, as we move through the rest of the year, we're seeing quite a lot of drought and wildfires. I think most of your mix is in the U.S. where they're having drought around the West Coast. But also just to know whether Europe has any impact on you in the second half of the year. That's the first question. The second question, on global life. So I think a strong set of numbers there. I think you've raised the guidance a little bit for 2018. I just struggle a little bit to kind of get to the actual kind of genuine growth outlook on the -- for the earnings, because the new business value is slowing down; we're at 2% or so. And you've obviously got the M&A that will impact about $200 million next year. But when you think about the drivers of earnings growth, what -- how is that being driven by the realizations of the past kind of new business value? To what extent will it continue to be driven by improvements in policyholder crediting rates and operational leverage and the like?

George Quinn
Group CFO & Member of the Executive Committee

Yes, thanks, James. So first of all, on the outlook for accident year, I think that ex cat and retail -- I want to be careful that I don't start to give very granular guidance for different parts of the portfolio. I mean, in general, retail is a pretty stable book overall. I mean, obviously, it does have some exposure to more significant events because, of course, especially retail and other for us, and as you pointed out, crop fits within it. I mean, the first half, we're at maybe what we thought. I mean, that's probably not far away from where we would expect to see that business, maybe slightly lower when you allow for crop to fully get in for the full year. I mean, but it will have some volatility in it, but nothing like the scale of what we see in commercial. On the crop side of things, I mean, essentially a normal practice in crop is to hold crop unless there are negative issues in the first half. So either an actual experience that would point to a negative income, we would hold to our own plans, which is what we've done. And so the plan, obviously, wouldn't be as positive as last year, but it would be an uplift on the group's overall target for the combined ratio. So risk factors in crop, I mean, it's a revenue protection insurance product in the end. So it's not simply things like drought. Can it be impacted by, obviously, the broader market for the product? I think at this stage, we don't see anything that's causing us any significant -- because at this stage, not the events that we see in the U.S. in terms of weather or fire, nor necessarily some of the more geopolitical issues that can impact crop. But with that said, I mean, we're still a long way away -- not a long way away, but still several months away from discovering what the actual outcome for crop will be for this year. But at this stage, we don't have a major concern that crop's going to have a bad year for some reason. So I mean, we still -- I still expect to see a positive -- significant positive contribution from crop. On global life, you're absolutely right. I mean, we gave guidance at the beginning of the year. Given the very strong performance in the first half, we've raised that today. And just for everyone's benefit, we've indicated low double-digit growth rates, which essentially would annualize the relatively strong underlying performance that we're seeing from -- for life in the first half. I mean, the drivers of earnings growth, I mean, apart from the things that you referenced, varies quite a bit by the different businesses we have. So I mean, obviously, new business value in the more mature markets, particularly in Europe, I think will be very important to what the earnings outlook is going to be and very predictive of, I mean, a relatively long-term view of what you can expect from that business. Our faster-growing businesses, though, I mean, many of them are more -- they're more of a P&C than life in many ways. It's almost like it on a combined ratio basis. So if you looked at the business in LATAM, some of the business in Europe, not so much, I mean, they tend to have shorter-term drivers. If you look at what's driving the outcome in the first half of this year, obviously, a bit of FX. If you ignore that, you've still got significant growth. And some of the microeconomic environment is helping us, but we're seeing good growth in the business in Spain. Our businesses in Asia Pacific all contribute well. I see no reason why the current trend that we see currently would slow down significantly in the short term. I mean, we're looking for life to increase its contribution as a proportion of the group's overall earnings and improve the predictability.

Operator

The next question comes from Thomas Seidl with Bernstein.

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

First question is on commissions again. Sorry about this, but I just want to double-check here. I get, of course that the biggest step is done now, but with the high-commission businesses in Asia, like Cover-More, but also Latin America, growing faster than the average group, shouldn't we see further incremental increase of the commission rates? That's the first question. And this goes on for years, I guess, depending on how you see growth prospectively. Secondly, more from a top-down perspective, but related to that, you grow now much faster in APAC and Latin America in P&C, whereas, you're [indiscernible] in North America and stagnating in Europe in the higher-margin areas. So to what extent does this mean you are structurally moving into a weaker combined ratio mix, in a way, a headwind to your aim to get to the 95%, 96% combined ratio level?

George Quinn
Group CFO & Member of the Executive Committee

Thanks, Thomas. So on the first one, so I think you would be right. If we saw a continuation of what we've seen, I mean, absolutely. I mean, it's not a commission business. I think the reason why I gave the answer to Peter earlier -- Peter Eliot earlier -- there's 2 things. One on Cover-More. I mean, we didn't necessarily buy Cover-More for the underwriting side of what Cover-More does. I mean, we saw it much more as something that had, I mean, a real interesting proposition around assistance and some of the services around travel. We've given our businesses around the world where Cover-More is operating, I mean, the choice; they can make the decision if they want to compete and offer their underwriting capacity to Cover-More. But that wasn't the key driver. So far, for various reasons, Australia is the most significant place that we underwrite travel. I don't expect to see a major shift or a major -- I mean, a fairly significant growth rate that would distort the group's numbers in the second half. So for that component, I think what we've seen, it won't get better, it won't get worse. So this will be what it has been in the second half of the year. And in LATAM, it has had an impact. But I think if you look over the last, say, 2 or 3 years, you'll see most of the growth on the mass consumer side. It's a lot more gradual than we've seen either from the travel business this first half or even from the F&I business in North America, which actually is the other big driver of the commission shift. So from a presence perspective, we're happy to continue to see that shift, provided we see the overall profitability that we want. I think my comment to Peter was really as I look out towards the end of the year, I mean, do I expect another significant shift in this year? I don't. Is this in a trend that might continue over time? It may well do.

I think your second question was about how we are structurally moving into a weaker combined ratio because of the higher growth rates in LATAM and Asia Pacific. So first off, let's take LATAM. I'm not sure I would call it weaker. I mean, obviously, interest rates are a bit higher in Latin America. So combined ratios tend to be a bit higher. I think the -- as we look at the pricing hurdles that we set in LATAM, and, again, go back to the Investor Day Presentation that was back last November, I mean, we do think about the trade-off of volatility and the duration of the impact on investment income and just outright returns on capital as we try and set the target portfolio mix. I think, provided we can achieve, I mean, what we want to achieve from a return on capital perspective, I mean, we're happy to see the growth rates that we see in LATAM. Again, I think given where we're coming from, I don't see that disturbing the group's overall expectations for combined ratio for next year. I mean, certainly, we think -- I think the -- the issue of the impacts are really quite different. We've had a challenge in the commercial market in Australia. But the underlying performance is better in the first half of this year, quite a bit less PYD, though, so the overall result was maybe not quite as strong. I mean, I would characterize that as a completely different issue from a growth preference for a business that is producing an attractive return on capital, albeit potentially a slightly higher combined ratio.

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

If I may, a follow-up on Cover-More. Given the high commission you're paying there overall, is the combined ratio running above the APAC level or below?

George Quinn

Group CFO & Member of the Executive Committee

So the first half is above. I mean, there's some initial, I'd call it, transition impacts that are special for the first half. We expect it to be at target levels for us in the second half of the year. And the target is based on return on capital.

Operator

The next question comes from the line of Mr. Michael Huttner with JPMorgan.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Two questions. The first one is on Farmers, and the second one is on the benefits of the M&A yet to come. On Farmers, you characterized the half year as solid growth. And I just wondered if you can explain that a bit more? Because as far as I can see, the fee contribution is growing at 2%, which is inflation. And that's fine, but I wouldn't exactly say that's -- it doesn't stand out. And it's quite different from the impression that I had gained from the Investor Day in November, when there was so much talk about the various initiatives and stuff. So I'm disappointed, and I can't quite reconcile it with your statements. So I must be wrong, but I just wondered if you could help out on this a little bit. Maybe you can share your view of where we are in the growth cycle of Farmers? And then on M&A. So, I think I remember, is there 2 deals which I'm not sure have closed or are closing. Can you just remind us, or remind me, of the benefits yet to come in addition to what we've seen in the first half from the ANZ deal and the QBE deal relative to the second half and also in 2019?

George Quinn
Group CFO & Member of the Executive Committee

Thank you, Michael. So sorry we disappointed you on Farmers. I think -- if we could split it into 2 parts. So I think a lot of the conversation we've had about Farmers, and I can remember, I think, you asking a question of Jeff or Mike at the event back in November, which I think you said was a question that perennially comes up around Farmers, which was about sustainability and whether the things that were happening and are happening around profitability would really have an impact on the business overall. So I think on the exchange side, I mean, what you see in particular in the overall result today is a technical performance that I think most people would recognize is, I mean, more consistent with a sustainable business model. So the benefits of the, I mean, really the market-driven changes around rate have helped Farmers achieve a combined ratio that's consistent with the targets that the exchanges have set. I think within that, there's still what to do around auto so that can improve further, but certainly the basic profitability of the business is good. Now on growth, on the fee growth which, of course, is the part that we're all interested in. We said already in Q1 that given the move into commercial ride share where the cost of acquisition of a very large book of business is clearly much less than the -- sourcing the individual policies, which has been the traditional business of Farmers, we'd agreed a lower fee level for that business. I think that's probably one of the reasons why there's a disconnect between the -- maybe the fee growth that you were hoping for versus the premium growth that we've seen in the past. I think the, for us, I mean, we focus on the overall fee growth for the organization. I mean, over time, we'd like to see that grow at around that same level as GWP. But the commercial ride share business, while that will introduce an element of -- I mean, I don't want to say unpredictability because it doesn't make Farmers unpredictable. But it will mean that the trend -- I mean, that very predictable trend between GWP and P&C that we've had in the past is a tiny bit broken. And from a group perspective, a Zurich Group perspective, I mean, we focus on the absolute fee growth more now than the margin and what things like the commercial ride share deal do for us. So you're absolutely right to be disappointed if you were hoping to see the same rate of fee growth. I'm not sure that you should assume that you will not see fee growth at similar levels to GWP growth in the future. But we have a special impact in this first half.

M&A. On the 2 deals, well, in fact, all of the benefits are yet to come. So QBE, we have closed Argentina and Brazil just after the quarter end. So we'll see the impact of that in the second half of this year. ANZ, given ANZ's commentary around the complexity of dealing with the restructure to affect the IOOF transfer, that looks like it'll slip until probably somewhere around the end of Q1, beginning of Q2 next year. So

Argentina and Brazil, from the very beginning of the first half, the remainder of QBE probably around the middle of the half, and ANZ somewhere around the middle of the first half of next year.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

And what's the -- can you just remind us of the numbers you'd cited before? The reason I ask in particular is I understood from the comment, the opening comments, that some of the ANZ benefit is already coming through. So I'm trying to reconcile bits which I've forgotten with bits which are in the numbers and I don't know about.

George Quinn
Group CFO & Member of the Executive Committee

Sorry, Michael. So on the ANZ topic, I think someone referenced it earlier. We talked about $200 million per annum. So you should expect that to come, but with a lag. The reinsurance is now in place for a piece of ANZ. The proportion of earnings, I think we've had about 2 months of it in the course of this year. So it's had a relatively immaterial impact this year so far. Maybe when we get to the end of the second half, I can update you more clearly on what we've had in the second half of this year and, therefore, what you should model for next year in terms of the delta.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

On QBE?

George Quinn
Group CFO & Member of the Executive Committee

I'm sorry. You need to forgive me, because I don't -- I won't break down the individual parts of QBE. But I think you've seen from our disclosure that, I mean, we've invested between $300 million and $400 million in that transaction, and we guided that the return on equity -- or the return on investment, rather, is significantly above the target that we would normally set, which is 10%. Argentina was the most important part of that transaction.

Operator

The next question from the phone comes from the line of Mr. Nick Holmes from Societe Generale.

Nick Holmes
Societe Generale Cross Asset Research

Two questions. With the $900 million of expense savings, can you explain why we can't see these more clearly in the results? I mean, we can see them to some extent clearly in the P&C admin or OUE ratio and also, to some extent, in the lines. But I would've expected them to have a much bigger impact. And second question is on life and the high level of realized gains. I wondered, can you tell us was that a bit of a one-off? I think you said most of it related to -- or a lot of it related to ZZR.

George Quinn
Group CFO & Member of the Executive Committee

So on the first question of -- so I apologize that you can't see it, so we need to try and change the disclosure so that we can help you find it. Because I can see it quite clearly. I mean, I think we've talked about -- and the fact that even if you look at the face of the income statement and you compare the '15 level, you can annualize this year to get a clean comparison. You need to adjust a bit for foreign exchange, which has been a bit volatile over the period; adjust a bit for M&A. But you do see a very substantial reduction in expenses. You might not get precisely $900 million, but I mean, I think even with a very simple calculation, you see a very substantial reduction. On the second question on realized gains in life, I mean, obviously, there's a practice in Germany of how ZZR impacts are managed and part of that is by realizing gains. I think from an economic perspective, it changes nothing I think from an overall viewpoint. Given the likelihood, I think, at this stage, that we'll see a change in the stance of Bafin in ZZR in the second half, I mean, that may impact whether you see as many realized gains or not. But from a shareholder perspective, it really has almost no impact.

Nick Holmes
Societe Generale Cross Asset Research

Oh, okay. But -- sorry, just to follow up very quickly. So the realized gains is more sustainable than it might appear for the second half at a high level, you mean to say?

George Quinn
Group CFO & Member of the Executive Committee

Sorry, so what I was trying to say, Nick, was that -- I mean, within the life portfolio, I mean, there can be realized gains from time to time. It certainly is one of the techniques that's used in Germany to manage the impact of ZZR on the statutory financials. But I mean, it can be a bit volatile. For example, ZZR requirements changed. That might change when we manage the issue. So I don't want to paint it as sustainable. But from an overall perspective, I think we've talked here before about what the overall ZZR impact would be for us. And I guess, if you're looking at it incrementally, I mean, the change that Bafin seems to be contemplating could be nothing other than good news for us. That might impact the realized gains position of life. But from a shareholder perspective, the more important driver would simply be a less onerous ZZR requirement. That would have an impact on the reported operating profit in life.

Nick Holmes
Societe Generale Cross Asset Research

Understood. And just a very quick follow-up on the P&C expenses. Would it be right to assume that the OUE ratio is going to fall down to 13%, something like that?

George Quinn
Group CFO & Member of the Executive Committee

So I think if you look at what where we are now, again, going back to -- I think, again, maybe the answer I gave Peter, we've got about $600 million to go, I'd expect, over the course of the next 18 months. About $400 million-ish of that fall into P&C. It's a bit more than a point, and all of that will be in OUE.

Operator

The next question comes from Vinit Malhotra from Mediobanca.

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

Just one follow-up, sorry, on the life side. So, if I'm on Slide 19 of the presentation today, I see that the investment margin is up 35% in life in local currency terms, and there's some FX and some one-off, but still a big jump up. Is that part of the reason for this change in more confident guidance? Remember, we were discussing this topic even in the full year call. And I'm just curious as to how to project life going forward. And second, again, just a clarification. The reinvestment yield being cited now is 2.6% at the end of 1H, whereas, in the call in the 1Q, you had said 2.9%. Was it a different metric of some sort? Because if anything, probably it went up for at least many of the peer group. So I'm just curious on these 2 topics.

George Quinn
Group CFO & Member of the Executive Committee

Yes, thanks, Vinit. Thank you for paying attention, in particular, to my comments about the running yield at Q1. So I guess on the running yield topic, I mentioned the fact that we had 2.9%. I think if I had given a fuller answer, which I should've done, and I would have recognized that there were FX impacts in there that may have made that less sustainable than maybe I had thought when I gave the answer. So I think that's why you see a slightly different picture today. I think -- I mean ultimately, though, I mean, this will be the transition year for investment income for P&C. It will be, at least based on what we expect today, at the same level as last year, and, of course, if interest rates stay where they are, we'll start to edge back up. But you're absolutely right. I did guide 2.9%. The 2.9% had a bit of foreign exchange impact in it that did not repeat in Q2.

On the life topic, I think the confidence around guidance -- I mean, it's not driven by the investment margin topic. And in fact, I think as you know from our previous disclosures of source of earnings, I mean, while it's not unimportant, it's not typically the biggest driver of income for us. And in fact, it's probably one of the more volatile components. I mean, for us, I mean loadings and the technical margin are typically much more important. I think the confidence that you see today, I think simply comes from probably the same thing that you guys all react to, and that's that the life business has continually produced stronger performance than we'd planned for. That's probably there is some one-off that slashed the number. So we have some foreign exchange in LATAM today, which, again, is not -- I mean, it's not something that's not management driven. We've got an active policy of how we do ALM in Latin America to avoid some of the devaluation or inflation risks. And that's what drives the chunk of this one-off, in inverted commas, in the first half. But even when you peel that back, I mean, all of the businesses are performing strongly. Some of them need some work, for example, around Germany, but the contribution is strong across the entire book. I think we're happy with the way we have the capital allocated. We're not looking to make major shifts in the short term. We expect to see more of what we've seen. There's no reason to expect something else. I think that's what drives the confidence.

Operator

The next question comes from Jonny Urwin from UBS.

Jonathan Peter Phillip Urwin
UBS Investment Bank, Research Division

Just one question for me, please, on German insurance. How much of the book is still falling short of hurdle rates? So I appreciate you've still got some work to do in terms of repositioning the book by shortening the tail. But I wonder, just in rough percentage terms, how much of the book do you view as unsatisfactory? I'm just trying to gauge how much more re-underwriting you think needs to be done.

George Quinn
Group CFO & Member of the Executive Committee

Thanks, Jonny. As someone who typically sees the world through a half-empty perspective, even I'm challenged by that question a bit. I think for us, the -- I mean, I think to take a realistic view of it, I mean, we look at several dimensions as we are trying to say what the portfolio we're looking for from the businesses going forward would be. I think it's not only where we stand today, it's what we expect all through the cycle for the business, and it's also where the market is currently. And I think from a very high level, as Mario mentioned earlier, I think the commercial market is a bit challenged by the market conditions. I mean, that's clearly the area that needs the most attention from us. I mean, within that, there are businesses that do very well. There are other businesses that remain very challenged. But I mean, it's mainly a commercial theme. And again, I think as I also said, I think it's not just us. I'm not just wanting to point the finger at our commercial teams at the global level or even at the countries. While there's clearly work to do, we're working hard against a difficult market backdrop. On the flip side, I mean, you can also see that on the retail and other businesses where, I mean, we found some -- they're not all niches, but I mean, we found some very attractive pockets in the market where the businesses are doing exactly what the clients want them to do, and they benefit significantly from doing that. So I mean, overall, P&C can certainly do more. But I think we're happy with the changes that we see. We think we know what the issues are, and we see those issues being addressed. We hope to see further improvements in the coming halves.

Operator

Our next question is a follow-up question from Mr. Eliot from Kepler Cheuvreux.

Peter Eliot
Kepler Cheuvreux, Research Division

Yes, maybe just a couple of thoughts. On the PYDs, I was wondering if you could quantify how much of that came from Harvey, Irma and Maria? And then secondly, I mean we touched on forest fires, some sort of impact on the crop business. Is there likely to be any effect from sort of H2 balance to-date on your business at all?

George Quinn
Group CFO & Member of the Executive Committee

[indiscernible] I mean, I've resisted the temptation to quantify the disclosure. I mean, you can assume that if you adjust for it, it would put us in our target range. I mean, again, maybe just worth reiterating that when we think about PYD, we're guiding to the top end of our target range. And that's taking into account all of the factors that are impacting our reserving position currently. On the second question of the second half, there's probably not much I can add to the answer I gave to James earlier. We're not aware of anything at this stage that causes immediate challenges for crop. I don't have a negative outlook for crop for the year. But the year is, by far, not over yet.

Peter Eliot
Kepler Cheuvreux, Research Division

Yes. Sorry, it wasn't -- I mean, I was just looking to expand it beyond crop, actually whether the rest of your...

George Quinn
Group CFO & Member of the Executive Committee

So, again -- I mean, obviously, if I was aware of something that was particularly significant, I would disclose it either as part of the written material or on the call. I mean, I would characterize our view of the business through the first half as on track. And we have no reason to expect something different in the second half of the year.

Operator

The next question comes from the line of Mr. Niccolo Dalla-Palma from Exane BNP Paribas.

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

The first question is on the reinsurance structure you put in place to drive further shift on -- of mix on net premiums. You mentioned it earlier in the year and also today on the call. Just wondered if you could remind us is this quota shares that kick in over time? And that's the reason why we'll see a more important impact of this in H2 and a further impact next year? So just what are the mechanics why it's taking some time to show up? And the second question is on the other operating results. Could you tell us, first, what the FX gains were in H1 so we can clean up for that going forward even if you give a guidance? And secondly, under lower recharges to the business units, are you now, let's say, at the normal level? And is there further change to come in terms of recharges between units and central?

George Quinn
Group CFO & Member of the Executive Committee

Thanks, Niccolo. So on the first one, so the issue simply is that we entered into a reinsurance agreement on a liability book, which excludes workers' comp, in this case, as of January 1. We haven't disclosed externally, I mean, the percentage scale of it is a quarter share. It's a very large quarter share, that's probably, I mean, about the kind of level that the -- the maximum level the market would accept. The mechanics are that this is a risk-attaching contract. And so new business attaches to it rather than the earned premium coming in from prior years. And just given the nature of the business, that means it will take, probably, up to 2 years to see the full impact churn through on the policy, the portfolio mix measured by earned premium.

On the foreign exchange gains, I mean, there's nothing unusual. I mean, the foreign exchange gains can be a bit volatile quarter-to-quarter. I think they're -- I think we have given guidance in the past around the nontechnical part of the performance. I don't think -- there's nothing that would cause me to change that plan currently. And then on recharges, I mean, the way we've worked over the course of the last 2 years is that all of the reductions in the corporate center are passed on to the businesses. We've had a further reduction in the corporate center in the first half of this year. I think our plan for next year, which hasn't actually yet been through Mario, so I should be careful what I say. It doesn't yet anticipate the same level of reduction as -- it hasn't been approved yet. But I guess the way to think of this is that we have an overall target of $600 million still to come. Some of that will definitely come from the corporate center. But all of it will flow to the businesses. So we will hold the net position in group functions and operations around this level you've seen for the last couple of years of somewhere in the $750 million, $800 million range. And all of the benefits of the reductions should show up mainly in P&C.

Operator

We have a follow-up question from Mr. Michael Huttner from JPMorgan.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Actually, I have 3, but -- the first one, do you remember, I think it was in the full year, we said, "Oh, you're going to achieve your targets easily. Why don't you raise the hurdle rates on what you get paid, et cetera?" This was, I think, on the ROE waterfall. I just wondered if the optimism which I sense on your P&C business would mean that if you were to look at that waterfall chart today, you'd nudge it up a little bit more even than we've had in the past. The second is on deals. So you very kindly explained the past deals. But I just wondered, what's left in the kitty for deals yet to come? And the third one -- and I'm really sorry, please don't cut me off. On the ZZR benefit, I wonder if you could give a figure -- I think you're one of the few groups where, in the past, you've said that it does affect operating profit. So if the Bafin does change the rules, what sort of -- what's the variance?

George Quinn
Group CFO & Member of the Executive Committee

Thank you, Michael. Thank you, in particular, for trying to tempt me into changing the target. I think it must've been the [indiscernible] that we showed people what the impact of the acquisitions and the impact of the tax reform in the U.S. would be. I mean, as you can see today, I think if you look at the results on the same basis, we've got an ROE somewhere in the mid-12s, about 12.6% or thereabouts. That would leave some room still to go to achieve the level that we set last year. But I think from a portfolio perspective, to maximize the economics, to draw the returns to shareholders, there's a point at which if you push that number too far, you end up going backwards. I think the targets, or rather the pension that we laid out last year I hoped would be an attractive one for shareholders. And that's what we're aiming to try and deliver. Deals, I think the question was what's left in the kitty? I mean, we're in the fortunate position that we are well capitalized. It's a feature of the way that the group operates that it prioritizes balance sheet strength. And we have fairly exceptional balance sheet strength currently. I mean, for us, in terms of how we use that balance sheet strength, I mean, I think actually, past behavior is a good gauge to what you will see in the future from us. I mean, our policies haven't changed. It's all about the operational topic. And if opportunities arise to invest that at attractive rates of return, we would certainly consider it. But it's not required to achieve the goals that we've laid out. And we are in the position that if we choose to, we could fund more growth. It just has to produce the right return.

On ZZR, we have given guidance around the negative impact of ZZR on the current basis. I mean, ahead of any potential formal change, I don't want to try and guess what the impact would be. I mean, my sense is that it cannot be negative, it can only be positive. But I mean, I don't really want to share information that could easily be misleading if outcomes are different from the ones that we anticipate. But I mean, it offers the potential of some upside, depending on exactly where the rules land.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

And what was the guidance in the past on the negative?

George Quinn
Group CFO & Member of the Executive Committee

So I think the guidance on the negative side was -- so this goes back already to 2016. We said we would be flat into 2017, and we weren't even flat, because we didn't have the full negative impact of ZZR. Can I leave it that we'll come back to you on that, Michael?

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Of course. And it was my third question, so I appreciate it.

Operator

The next question is another follow-up question, from Mr. Farooq Hanif from Crédit Suisse.

Farooq Hanif
Crédit Suisse AG, Research Division

On the capital position, you've been well above target for quite a long time. And that's in spite of having deployed quite a significant amount of capital. So I'm just kind of wondering about the time line on what -- on when you will address this? Or do you still believe that it's good to be -- to have an elevated position because of you have market risk, for example? If you could just comment on sort of time line. And then secondly, going back to your sort of guidance on life, double-digit growth. I mean, obviously, that will happen this year, hopefully, because of the first half trend. I mean, next year, you've got M&A. But just sort of thinking longer term, do you think high-single digit is doable given the growth that you're seeing in various areas in the business mix shift?

George Quinn
Group CFO & Member of the Executive Committee

So on the first one, yes, I think there's probably nothing I can say that would be any different from everything we've said before on the capital topic. I mean, there is no change in how we operate. There is no hidden set of rules that we operate to that we haven't disclosed. I think as you pointed out, Farooq, we have not only invested, we've returned capital already this year. I think the only thing I'd add to what we said before is I think we'll always try to be prudent and measured on anything that we do, whether it's an investment or whether it's a capital return. But what we've done before and the policies that we've had, they're unchanged. You'll see -- we'll approach it the same way in the future. On the guidance on life, I think, again, I'll resist the temptation to give the financial guidance ahead of the strategic direction of the firm. We have an Investor Day coming up in December. Maybe we can talk about it there in a slightly broader context.

Richard Burden
Head Investor Relations & Rating Agency Management

Thanks very much, everybody, for dialing in. We are aware that there's 1 or 2 more questions pending. Unfortunately, we don't have any more time to take them now. However, the Investor Relations team will get back to you later on this afternoon.

Thank you.

Mario Greco
Group CEO & Member of the Executive Committee

Thank you.

George Quinn
Group CFO & Member of the Executive Committee

Bye.

Operator

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