S&P Global
Market Intelligence

Swiss Re Ltd SWX:SREN

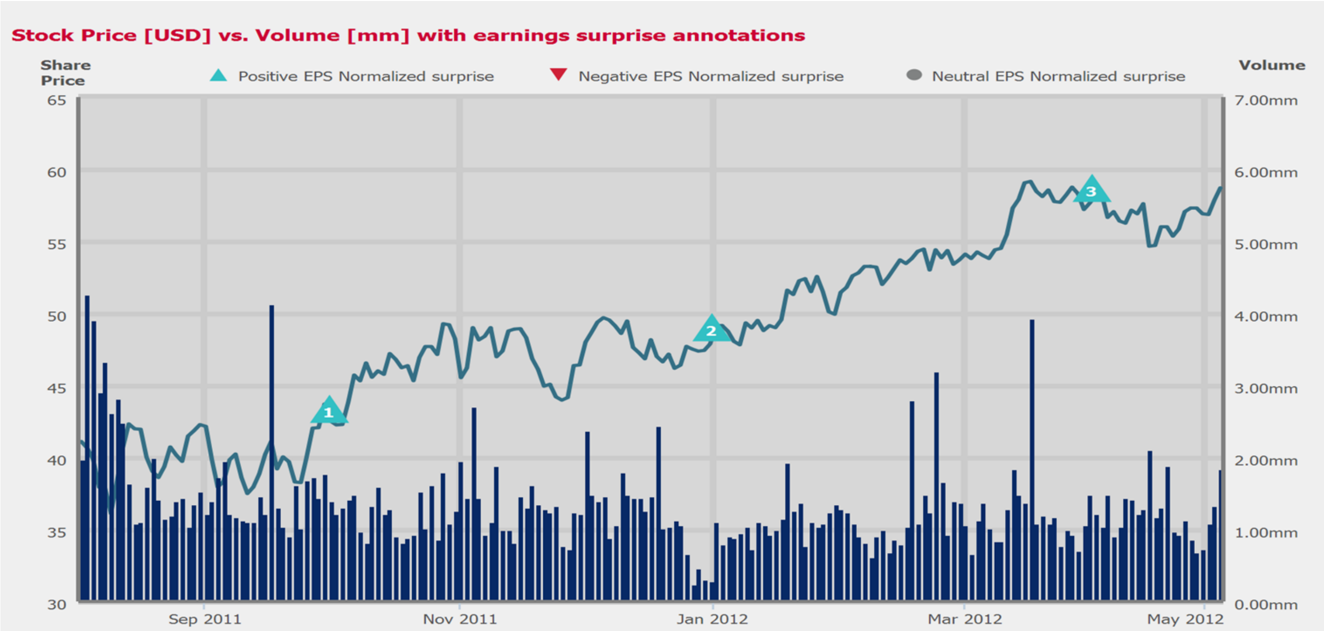
FQ3 2012 Earnings Call Transcripts

Thursday, November 08, 2012 9:30 AM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2012-	-FQ3 2012-		-FY 2012-	-FY 2013-
	CONSENSUS	CONSENSUS	SURPRISE	CONSENSUS	CONSENSUS
EPS Normalized	0.02	3.23	▲95.05	8.22	7.66
Revenue (mm)	6164.61	6734.24	-	30656.29	32582.15

Currency: USD
Consensus as of Nov-08-2012 9:01 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ2 2011	1.50	-	-
FQ3 2011	2.27	3.93	▲73.13 %
FQ4 2011	1.64	2.76	▲68.29 %
FQ1 2012	1.94	3.33	▲71.65 %

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Call Participants

EXECUTIVES

George Quinn
Group Chief Financial Officer

Rolf Tanner

ATTENDEES

Chris Cundy

Karina Whalley

Unknown Attendee

Presentation

Operator

Ladies and gentlemen, good morning or good afternoon. Welcome to the Swiss Re's third quarter 2012 results media conference call. [Operator Instructions] The conference is being recorded. [Operator Instructions]. At this time, it's my pleasure to hand over to Mr. Rolf Tanner. Please go ahead sir.

Rolf Tanner

Good morning ladies and gentlemen. Welcome to Swiss Re's Media Conference on the third quarter 2012 results. My name is Rolf Tanner; Head of Media Relations. With me I have George Quinn, Swiss Re's Chief Financial Officer. He will present Swiss Re's business performance for the third quarter. You will be able to ask questions during the Q&A part that will follow the CFO's presentation.

With that, I would like to handover to you George.

George Quinn
Group Chief Financial Officer

Thanks, Rolf. Good morning, everyone. I'll refer to the media presentation which is on our website this morning, so if you have it, you might find the comments a little easier to follow. I'll start Slide 3 in the presentation.

So as you've seen already today we have results of the third quarter $2.2 billion, a very strong result; translates into earnings per share of $6.33, or annualized return on equity of 28%. There are 3 factors that drive the performance in the third quarter: First the results from both of the property and casualty businesses. As you can see in the group's combined ratio of 72%. It's driven by a combination of good underlying performance, strong underwriting. Benign nat cat experience in the quarter as well as very substantial reserve releases from prior periods, it was over $400 million in quarter.

Second driver, with very strong group result was the completion of the sale of our Admin Re U.S. business, where we got some formerly unrealized gains that are realized as part of the transaction. We got a one-off gain of $626 million in the quarter that partially offset the loss that we reported in the second quarter.

And finally, on these drivers, the group investment job was very strong again. Return on investments is 4.5% partly from realized gains amounted to about $571 million in the quarter. That excludes the gain from the sale of Admin Re.

Our P&C Reinsurance business achieved net income of more than $1 billion in the quarter and again, the key factors driving the results for the group also lie here.

Life & Health reported headline net income of $187 million. This had the benefit of significant realized gains and investments, $288 million in the quarter.

Corporate Solutions is firmly on track to achieve its growth plans and it delivered net income of $110 million in the quarter which translates into return on equity of 16.6%. Admin Re delivered a quarter with particularly strong gross cash generation, $1.1 billion mainly driven by the closing of the Admin Re U.S. sale but also by management action to improve the cash position in the U.K.

Net earnings were also stronger even if we exclude the effects of the sale of the Admin Re U.S. business. And probably one of the highlights in the quarter, the group received the cash dividend of nearly $900 million from Admin Re towards the end of Q3.

You would expect a result like this to have a significant positive impact on the group's shareholder's equity and, in fact, book value per share have increased strongly from last quarter, it's risen to $94.50 or CHF 88.80.

SST capital ratios, our Swiss Solvency Test ratio remains very strong, 207% which is based on the most recent submission to FEMA in [ph] October. You should note that this does not include the fill effects of the sale of the Admin Re U.S. business which was positive, nor the issuance of a EUR 500 million hybrid that we issued in July.

All things being equal, this should improve the results that you'll see in the next submission which happens in the first quarter of 2013.

Also when we come to the full year results in the 21st of February, I'll provide you with an update of our excess capital levels, with S&Ps AA requirements. Overall though, the group continues to be very strongly capitalized.

On Slide 4 we have an overview of some of the key figures down from the group. I want to highlight 1 or 2 of these. Firstly you'll notice the shareholders equity of the group item which is $3.65 billion has increased significantly in this quarter.

Again, that's mainly a function of the incurred dividends that are being received primarily from the Admin Re dividends and you can assume that these funds are a significant part of the excess capital that the group holds, not all of it but significant part. And you can also see that the excess capital that is at that level can be redistributed with relative ease.

Last thing I want to highlight here is that overall after tax unrealized gains have again increased this quarter by about $300 million which is a function of falling interest rates but also tightening credit spreads. This also arrives in equity markets, but unrealized gains grew by more than enough to offset the reduction of the $600 million gains as a result of the Admin Re U.S. sales.

If I turn now to the P&C Reinsurance results on Slide 5, again another very strong results for the quarter, driven by excellent underwriting performance which is something that we've become accustomed to over the last several year. We've had relatively benign nat cats in the quarter. Q3 is normally the quarter. Q3 is normally the quarter in which we expect the highest loss burden from natural catastrophe.

Premiums then grew by 15% which you'd expect, given the strong renewals in the second half of 2011 and the early part of 2012 and the combined ratio of 69.3% is the lowest combined ration I can remember. I think it's the lowest combined ratio we've ever reported.

Obviously the combined ratio benefits from benign nat cat losses, there's a 10.3 percentage point benefit. And we also have substantial reserve releases from prior year business. Again, a benefit of 12.4 percentage points or more than $400 million.

Exposed nat cat times prior year reserve releases were at expected levels; the underlying combined ratio would have been about 92%. That's slightly higher than we expect to see in the fourth quarter, given the seasonality of events. But we have slightly higher than expected man made losses this quarter.

The increase of net investment income compared to the prior year quarter is mainly due to net asset value changes in our private equity investments. That's partly offset by lower realized gains compared to the same period 1 year ago.

We have an ROE return on equity for P&C, its 36.6%, combination of the exceptional underwriting results based on good investment performance.

There is more detail by line of business on the slide that follows. I'll just give a few figures here. You can see the better than expected Nat cat experience in the quarter in the property figures. We have made some adjustments to existing claim estimates. For the 2011 Japan earthquake we have reduced the loss estimate by nearly $120 million and at the same time we increased the New Zealand earthquake by almost $100 million following some updates from clients and the detailed review of the underlying Risk Factors.

The majority of the reserve releases that we're seeing from prior years are in liability and you see that very well in the combined ratio of the quarter. Mainly, the releases come from 2006 and prior although we have some small positive impacts from 2007 and 2008. Also in contrast of prior periods, it comes from almost all markets.

Although we have a substantial net reserve release, there are areas where we have increased reserves in the largest of those was for U.K. as best is where we've added slightly more than $120 million to reserves.

If you move to the next slide, Slide 7, you can see a longer term view of the results of P&C Reinsurance and this longer term view probably tends to eliminate some of the effects which are more of a one-off or exceptional nature. If you see that third quarter 2012 was certainly an exceptionally strong quarter but we have a track record of strength and the past combined ratios showed this over the long period. And that's reflected in the average over the last 3 years. It doesn't matter which way you analyze P&C Reinsurance, the overall picture is very favorable with relatively low volatility for a reinsurance business. We think this demonstrate the success of our underwriting approach to cycle management and risk selection.

I'll move now to Life & Health Re which is on Slide 8. I'll actually start with net income. And realized gains are a reasonably significant component of net income in this quarter. And in fact, they're also a significant driver of the difference between the earnings this quarter and the third quarter last year. And we've had $288 million of gain, which is more what you expect to see in a typical quarter, but less than the $451 million of gains that we had in the same quarter last year. If we look at other parts of the investment results, you'll see that net investment income is lower than the comprised [ph] pays more than $120 million lower, and I'll provide some color on this on the next slide.

Coming to the technical items, which drive the benefit ratio, last year we had a positive impact from changes in morals [ph] and assumptions, whereas in the quarter this year, the impact is negative.

Over time we expect the volatility to cancel out but it can lead to significant swings into the third [ph] quarter. Also the benefit ratio of mortality and morbidity is typically a positive for us, but we have a small negative $2 million impact this quarter.

While mortality and morbidity and model change is negative this quarter, we actually have an improvement from the impact from our U.S. business written before 2004. I've mentioned this business in prior quarters and due to the natural maturity of underlying policies and in particular the repricing that we undertook back in 2004, we expect the impact in 2013 to be less than 2012.

Slide 9 shows sourcing of earnings for Life & Health including the variations expected. I'll highlight 1 or 2 features here. You can see from the table at the bottom of the slide that almost all of the drivers of results of Life & Health have moved against this. The mortality and morbidity I mentioned is significantly below the average we've seen over the last 4 years and in fact it's the lowest we've seen over that period. Similarly the changes the models and assumptions was far worse than average and close to the bottom end of the range. But again, while I wouldn't want to try and predict any individual quarter, it is unusual for both of these to be at the low end of the range and therefore we'd attribute some of this to just natural volatility.

On the prior slide I mentioned the pre-2004 U.S. impact, I'll also cover the impact of $91 million of others which is mainly the difference driven by investment income. We estimate that about $27 million of this is due to actually lower yields, due to the remainder is due to a combination of either seeking updates on business that's withheld by clients or an internal business transfer that we affected to Admin Re which took place at the beginning of the third quarter.

Corporate Solutions is on the next slide. Again, very significant growth in premium take. Net earned premiums up by 12%, but probably more importantly, gross written premium, which is an indicator of future growth in premium, is up by 22%. This business has the stated goal of growing premium between $4 billion and $5 billion by 2015 while at the same time, achieving an ROE of between 10% and 15%. All the lines of business have contributed to achieving the target.

In terms of operating performance profit solutions has reported a combined ratio of 87.4% and the story is similar to the P&C's Reinsurance. The benign nat cats, favorable prior year reserve development, but also strong underlying performance. If we adjust the result for underlying, the combined ratio would be

99%, which is in line with the guidance that we gave earlier this year of about 101% of this business. Net income for the quarter was $110 million which translates to a return on equity of 16.6%.

Admin Re’s on the next slide. Again I'll start with net income and just to clarify some of the components of Admin Re’s net income for the quarter, as it was in Q2, Admin Re’s results are dominated by the impact of the sale of Admin Re U.S. operations. You remember that we entered into a sale, again; it was Jackson National in the second quarter and we booked a loss in the second quarter of just over $1 billion. The deal closed on the 4th September in the third quarter and when the assets and liabilities were tracked back [ph] to Jackson National, the unrealized gains on the investment portfolio were realized. This produced a gain in the quarter of $626 million.

Taken together, this means that the overall loss from the sale of Admin Re and the net income statements is a loss of $399 million. Even if we ignore the gain that we made in the third quarter, Admin Re’s net income for the quarter is almost $200 million. It’s not a run rate nor a prediction for what we expect to see next year. There are a number of one-offs that which include a number of reserve adjustments. But there is no doubt that Admin Re’s underlying earnings are improving.

Admin Re’s return on investments remains stable at 5% quarter-over-quarter. It’s a particularly [ph] high number, given today's interest rate environment, it is driven by a running yield of 4.1% on the fixed income portfolio as well as realized gains which amounted to $100 million in the quarter.

Gross cash generation as I highlight, is very strong in the quarter worth nearly $1.1 billion, more than $800 million coming from the sale of the Admin Re U.S. operations. The sale wasn’t the only source though and as we completed the merger of the ALICO transaction that we did last year into our existing U.S. business, we released the capital and we also release capital during the finalization of the U.K. statutory statement. This added about a further $200 million to cash generation in the quarter.

Admin Re remains focused on management of the portfolio and has paid a dividend of $881 million to the group in the third quarter.

On the next slide, on Slide 12 we have a summary of the performance of asset management overall of the group. Yet another installment of very strong investment performance despite the continued prudent stats on the asset portfolio. Looking at invested assets, the sale of the Admin Re U.S. business, at least a decrease in volumes, we saw more than $11 billion worth of fixed income securities, so you’ll see that the asset volumes are actually flat and the impact of the sale was offset by mark to market gains on assets as well as a positive impact of foreign exchange. You’ll see that we also have very benign impairments and a very low exposure to peripheral views on solvency. It’s only $37 million of Portuguese government bonds.

We have as we previously highlighted and continue to reinvest the portfolio in a very measured way; we shifted $1.4 billion in to corporate bonds as well as smaller amounts into equities and securitized products. This still leaves us with a very prudent portfolio and particular have seen relative to the segment.

In today's environment, a return on investment 4.5% is clearly an indicator of a strong asset management performance. The majority of this can be attributed to the running yield on fixed income, which is 3.1% but there were also substantial realized gains in third quarter; in total, $571 million.

Even though you have seen significant gains in prior quarters, there are some special effects I would like to highlight. The majority of gains were generated by a combination of asset liability management activity particularly around the Admin Re sale in the U.S. A decision to reduce our allocation to Eurozone Supernationals and agencies and the asset allocation shift out of government bonds partly to finance the increase in credit. One point I want to highlight, I would expect gains in the fourth quarter to be much, much lower.

If I turn now to shareholders equity which is on Slide 13, overall, you can see the developments in the third quarter. We've seen a further significant increase of the order of $2.5 billion which is high, given the quarter’s net income and this is possible because of a significant increase in unrealized gains. The last contributors to the higher level of unrealized gains were corporate bonds which benefited from slightly lower interest rates but mainly from the tightening of the credit spreads.

On the next slide, we have an update on our financial targets and you can see here that we are well on track with the ROE and EPS targets. We include all the one-off items where the loss is appropriate as they happen and at the targets out of 5 year target, we expect the operating performance over time to determine whether or not we achieve them.

We have one update on this slide which is an update on economic net worth per share. We provide that information twice per year and you can see that we still have some work to do here. Economic net worth per share excluding dividends paid to date is below the level that we set.

Before I move on to the outlook, let me just change topic for a second, I think you all know that sustainability and sustainable, responsible investments, or SRI, have become a much more important topic for investors over the last 10 years. It’s also very important to Swiss Re, given the business that we are in; we have a long standing commitment sustainability that goes back many years. For example, we are the signatory of the UN Global Compact and we have recently launched principals for sustainable insurance. And on top of all this, our enterprise risk management framework incorporates sustainability risk. And these topics do impact our business viewing decisions.

Having said this though, it’s important that we can convey intangible qualities like sustainability and innovation into business opportunities. And I think you’ve seen that regularly from us over the last several years. We are particularly proud that this quarter we've been recognized that the world’s most sustainable insurance company for the fifth year in a row by Sustainable Asset Management.

So finally, on the last slide, outlook, for P&C reinsurance business, we expect to see continued moderate price rise for the January 2013 renewal. No change in the message here from the view we gave at the Monte Carlo Rendezvous; this isn’t a function of Hurricane Sandy. In Life & Health Reinsurance, we expect to see some improvement as a negative impact of the pre-2004 U.S. business reduces, compared with the impact that we've seen this year and we continue to emphasize that capital management is an absolute core priority. In particular, maintaining and drawing the regular dividend in line with our [indiscernible] targets.

After that comes business growth, where the business growth meets profitability requirements and then we have the ability beyond that to consider capital repatriation to shareholders and the board has made it clear that its preference would be for a special dividend.

We’ll report any concrete plans we have here from the 21st of February next year together with the full year results. You know by now that achieving the 2011-2015 financial target was, is and continues to be the firm’s highest priority.

Thank you. I'll give it back to Rolf.

Rolf Tanner
Thanks George. We’ll start now with the Q&A session where George Quinn will answer your questions. I hand over to the operator who will give you instructions on how to proceed to ask a question. Operator, please.

Question and Answer

Operator

[Operator Instructions] The first question comes from Karina Whalley from The Insurance Insider.

Karina Whalley

I was just wondering we've just seen Lancashire release their Q3 results as well and the CEO, Richard Brindle was saying, he was quite surprised about how opportunistic the industry was on rate increases for 2013 and he says there is enough capacity to put pressure on the pricing hereof. I was just wondering why Swiss Re thinks otherwise?

George Quinn
Group Chief Financial Officer

I think if we look at the market conditions, I mean if we look at recent trends, we've seen the benefit of significant price rise in the early part of the year mainly in response to the nat cats of last year through continued price rise at the July 1 renewal date. And if you look at things like interest rates, the pressure it puts on insurance companies, you look at some of the challenges that come up from regulation. We think there is enough pricing power in the markets for the reinsurance for it to see moderate price rise. We're not forecasting very substantial movements and we think some of the moderate price change we've seen can still be achieved in January next year.

Operator

The next question comes from Thomas Gartner [ph] from [indiscernible].

Unknown Attendee

I wonder what you can tell us about the development of the economic solvency of the company as the increase in shareholders' equity is mainly driven by of course the profit and of course also of increase in the value of bonds. So the economic solvency is of interest, what can you tell us about that please?

George Quinn
Group Chief Financial Officer

I think you get some say about comments from the update we've given on SST, so the most recent filing to FEMA which is from October, the actual date of preparation of that would have been end of June, beginning of July. So it dates back to that stage and you see that the FEMA has an SST ratio of 207%. I think if you look at the GAAP equity changes in the quarter, I mean, typically, items such as interest rate movements have limited or no impact on economic solvency, but things like equity market movements, spread movements, they do have either positive or negative impacts on solvency. And so I think if you look at the GAAP changes, unlike last year where we saw very substantial rise in GAAP equity [ph] which was mainly interest rate driven. In this quarter we've seen one which is really around market improvement and that would typically have a positive impact on solvency. But we won't give a formal update on this until we come back with the full year results in February.

Unknown Attendee

Would you just remind us of the former figure of the SST?

George Quinn
Group Chief Financial Officer

So the former figure was 211, 212 as of SST one, so it's slightly down.

Operator

Your next question comes from Chris Cundy from InsuranceERM.

Chris Cundy

Just wanted to ask you a bit more on Hurricane Sandy. I noticed that the results said, too early to come out with a figure, but what's modeling saying? What kind of figures, what kind of impact are you expecting from the hurricane?

George Quinn
Group Chief Financial Officer

I think that will be a different way for me to give a number. I apologize; I can't give you a figure today. Obviously we're running model runs of scenarios; we'll get some indication of what the loss will be. In this stage, we have no information from clients. I mean the exact extent of the event is not entirely clear. So given the relatively small [indiscernible] lapse since the event has ended, we're going to take a bit more time to try to make sure that we have a reliable estimate before we prevalence. And I think all I can say at this stage, it seems very clear that Sandy is going to be bigger than Irene and so I'd expect the loss to be larger but the exact quantum of the loss and in fact I think you can see in some of the market estimates that are over there, I mean I've seen market estimates, loss estimate for the insured part loss that seem to range from about $8 billion up to $30 billion or more. If we were to base estimates on those type of views, we'd have a range that we render the estimate in a relatively meaningless for the time being. So we're working on it and the team's putting together the information and as soon as we believe we have a reasonable figure, we'll be out with an estimate for the claim.

Operator

[Operator Instructions] We have a follow up question from Karina Whalley from The Insurance Insider.

Karina Whalley

We saw that you said something about recognizing $45 million as a loss from the chemical plant explosion in April and I was just wondering if you could give a bit more detail on this? And also sorry, you said previously as well of underlying compound ratio was actually higher than expected in this quarter and you mentioned something about manmade losses being a bit higher and I was just wondering if that had anything to do with that?

George Quinn
Group Chief Financial Officer

I can't give you a lot of detail about the chemical plant; I don't like to breach client confidentiality. We're doing a business that we routinely have, large losses from time to time and this is one of the reasons why you see an underlying combined ratio. While I think it's fairly good at 82% as a combined ratio, I am not going to complain about too hard for the third quarter, we would expect it's slightly better than that. But you're right; these 2 things are completely connected.

Operator

The next question comes from Carolyn Randall [ph] from Bloomberg.

Unknown Attendee

Just an overall question about 2012 so far, what we've seen with Swiss Re is a bit of a trend of investment gains, reserve releases and all in light of benign nat cat losses, I guess, which should enable Swiss Re to show very good results this year so far. Do you think Swiss Re will be able to replicate that next year also? Can you give this maybe a little bit of an outlook there?

George Quinn
Group Chief Financial Officer

You have to tell me what the nat cats are going to be next year Carolyn [ph] for me to give you a very reliable indicator on that. I guess the serious answer would be that I think you are absolutely spot on, that we have a number of positive developments on the results that are relatively hard to replicate. So that means we are cautious on the topic of reserve release. We don't entirely predict reserve release but we've had the benefit of substantial reserve releases over the last, I guess, 2 years now. On the asset side of things, we're trying to take an economic approach to asset management, so we focus on the risk that we perceive in a particular asset class and will shift if we think it's in the interest of the company and its shareholders and its clients and then these interest rate times that generally means it will trigger investment gains. Benign nat cats I mean we've had a good run up till the end of the third quarter. We're going to be paying claims for sure in Q4 and Hurricane Sandy, so that's going to be a sizable loss. I mean if you look at last year, I think last year is a good example of what you can achieve even with significant volatility. I mean the company had very substantial losses from both New Zealand and Japan. We had then had Irene, we had Thailand floods and yet the company still produced around 10% ROE. I think it's not enough to reflect simply on the one-off positives. The underlying performance of the firm is very, very strong. I think that's a good position to be in next year. I think if we look at some of these things that will come along for us, I think as you know, we're going to have significant growth from P&C Reinsurance business because of the expiry of the core share with [indiscernible]. That we're expecting or hoping to see an improvement in the Life & Health side and of course our Corporate Solutions business is producing great gross rates with good performance and performance that we expect and improve over time. I think the firm is well positioned for next year but the normal volatility of things like nat cats and reserve releases, I can't predict for any given year, but I am convinced that the underlying performance is going to be strong no matter what we see next year.

Operator

The next question comes from Thomas [ph] [indiscernible].

Unknown Attendee

Yes the question goes to the quality of the investment assets and I see you still have quite a number of securitized products like mortgage backed securities of different kinds and also of bank obligation or bank bonds. What can you tell us about the ways that you try to secure that you don't have any quality problems there?

George Quinn
Group Chief Financial Officer

It's a good question Thomas [ph]. I mean the challenge always is to try and find the right balance between risk in the portfolio and return. I mean if you look at our overall portfolio, we have 62% of the invested assets and either cash short term or government bonds. And I think if you look at our ROI, our return on investments, it's relatively low because of the relatively conservative stance that we've taken. Having said that though, the portfolio will not be without risk otherwise it will have no return. On the credit side, we have about $23 billion in corporate bonds. You're right that we still have exposure to securitized and in fact this is not just our legacy of the past, we've actually added some additional and securitized exposure both this quarter and in prior quarters. So I think over time you see this increased risk moderately in the portfolio. I think compared to the peer group, we are conservative, which we think in the current volatile environment is a good place to be, but of course it causes a lower ROI. But of the time being, I think we're happy to accept the lower return, with lower risk given the volatility.

Unknown Attendee

Maybe a word, George, to the short term investments. What about counterparty risk there?

George Quinn
Group Chief Financial Officer

Yes, the group as an approach to counterparty risk that looks at all counterparty risk across the entire business. So we aggregate and report by counterparty. For example, if I think of a bond invested, maybe invested in bond issued by some major industrial company, we may also have insurance relationships with that company that means they owe us or we owe them from time to time. We aggregate all of the individual exposures to the aggregate risks the counterparty, we have limits not only by individual name but by country or geography and so I think we have a good system to monitor and look at the exposures that we take. If you look at the predominant exposure on the corporate bond, the corporate bond portfolios is pretty well diversified and in fact as you know, it's managed externally, principally by 2 major corporate credit managers.

Operator

Ladies and gentlemen, there are no more questions at this time.

Rolf Tanner

Okay. Well with that, ladies and gentlemen, I will conclude Swiss Re's media conference call. If you have any follow up questions, please do not hesitate to contact me or relations. Thank you all for your participation. Operator, we will now conclude the call.

Operator

Ladies and gentlemen, the conference is now over. Thank you for choosing chorus call and thank you for participating in the conference. You may now disconnect your lines. Good bye.