FINAL

Bloomberg Transcript

Q3 2018 Earnings Call - Q&A

Company Participants

- Christian Becker-Hussong, Head-Investor & Rating Agency Relations
- Christoph Jurecka, Chief Financial Officer
- Jörg Schneider, Chief Financial Officer & Director

Other Participants

- Andrew J. Ritchie, Analyst
- Frank Kopfinger, Analyst
- Ivan Bokhmat, Analyst
- James A. Shuck, Analyst
- Jonny Urwin, Analyst
- Kamran Hossain, Analyst
- Michael Hermann Haid, Analyst
- Michael Huttner, Analyst
- Sami Taipalus, Analyst
- Thomas Fossard, Analyst
- Thomas Seidl, Analyst
- Vinit Malhotra, Analyst
- William Hawkins, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day, and welcome to the Munich Re Quarterly Statement Conference Call. At this time, I would like to turn the conference over to Mr. Christian Becker-Hussong. Please go ahead, sir.

Christian Becker-Hussong {BIO 19080254 <GO>}

Thank you, Sebastian. Good morning, everyone. Thanks for joining us for our Q3 earnings call. Today's speakers are Jörg Schneider, our CFO. And warm welcome to Christoph Jurecka as well who is going to be the Group CFO as of beginning 2019.

And at this point, I'd like to hand it back to you. And we are happy to answer the first question. So, please go ahead.

Q&A

Operator

Thank you. We will now take our first question from James Shuck from Citi. Please go ahead, sir.

Q - James A. Shuck {BIO 3680082 <GO>}

Okay. Good morning, everybody. Thank you for taking my questions. So, first question really was around the NatCat PYD that you experienced. So, I think you had four points of normal reserve releases in the quarter, but you had a very high level of releases from PYD relating to NatCat. Can you just elaborate a little bit about some of the drivers of that? Most of the markets have actually seen adverse development and some of them more recent losses (00:01:38) to hear about that please?

Secondly, I'm not sure you'll be able to answer this, but could you perhaps just give me an indication of what your capital, your economic capital allocated to NatCat is, and how that has compared historically over time looking for an actual euro billions number is possible on that please?

Thirdly, just around the North America Risk Solutions business, so the normalized combined ratio in the period 99.9% I think Q2 and Q3, you've experienced larger losses in North America Risk Solutions. Could you just elaborate on some of those trends, please? Thank you very much.

A - Jörg Schneider

Yeah, thank you, James. Good morning. Good morning, ladies and gentlemen. First question on PYD, for basic losses, its 4% in line with our expectation. For major losses, it was pretty high. It's a broad mixture of events. They range from one-year old to seven-year old, and I see a long list of items. It's in the ordinary cause of reserve checking here that these come up and this is due to our perhaps and probably pretty conservative reserve setting. So, for example, (00:02:57) a little bit for California wildfire, it was a little bit for New Zealand earthquake and so, and when it comes that is random and now it was relatively high.

And second question on economic capital, I have to look it up when Christoph is speaking later on.

And third question is about normalized combined ratio, our normalized combined ratio, if we adjust for major losses and for reserve releases of basic loss reserve, it is in the order of 100% and this is some percent – 1 percentage point higher than originally anticipated. When we look at the reasons (00:03:43) from our plans come from, than it's mostly man-made losses or NatCat losses, more NatCat than man-made, which are just below the €10 million threshold from which we call it a major loss.

So, as you can imagine, we intensively discussed it internally. It seems to me as being, let's say, 80% random and perhaps 20% real underperformance. So going forward, we continue trusting – continue to be confident that 99% is the current correct adjusted level because there are also a lot of fluctuations from currency and things like that in it. So, one should not read too much in that, let's call it miss (00:04:41). So, we are pretty confident that 99% is the current level and that we are going to improve that. And I come back to your second question later.

Q - James A. Shuck {BIO 3680082 <GO>}

Okay, Jörg. Thank you very much.

A - Jörg Schneider

Thank you, James.

Operator

We'll now take our next question from Vinit Malhotra from Mediobanca. Please go ahead.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Good morning. Thank you very much for your time (00:05:13). So my two questions would be basically more on the volume side. So, on Life Re, you're getting to see quite a bit of a sharp fall again in this quarter. Just want to follow up if this is the same mix driver as we discussed in the 2Q (00:05:33), which was some large structured transactions?

And then on the – on your – just following on this 80% random, 20% underperformance, please can I just ask is this 20% underperformance coming somewhere from the structured transactions or from some growth in the broker business or just a bit more on that would be very useful for us? Thank you very much.

A - Jörg Schneider

Thank you, Vinit. I'll start with your second question. No, it doesn't come from structured business. It comes from primary insurance out of reinsurance. And for this part of our portfolio, it is quite normal that they get hit, for example, by tornadoes or so, and these are not the type of events which then accumulate with the big reinsurance events (00:06:34) and then we call it a major loss. They are just isolated. If such a tornado hits a commercial property or warehouse or things like that, it might be a €7 million or €8 million loss, yeah, so and that is the reason where it comes from and it's difficult to say. I can't be 100% sure where and whether it also has to do with real underperformance or whether it's just random. My gut feeling is it's more random than underperformance, but we have a close eye to that.

Your first question about the decline in the gross premium income for Reinsurance Life, this is foreign exchange effect, €400 million and €1.9 billion of decline on organic decline and this is exactly how you say this is the same reasons as in the second quarter and that these are the major structured transactions, which came to an end over restructured. So, no new reason. And overtime, you will see also more large transactions, because they are still on our radar, yeah. So, this will be - also in future will be a good source of new business like, also by the way in Q3, where we had various new treaties (00:08:14) in the UK, also new longevity contract. So, we are still open for that kind of business. It was just (00:08:24) the two contracts we were talking off and which caused the decline, they were just gigantic, yeah. So, therefore, it's visible, but it's not a structural and sustainable reason. Thank you, Vinit.

Q - Vinit Malhotra {BIO 16184491 <GO>}

All right. Thank you.

Operator

We will now take our next question from William Hawkins from KBW. Please go ahead.

Q - William Hawkins {BIO 1822411 <GO>}

Hey Jörg, hey Christoph, thank you very much. (00:08:52) the year-on-year experience for natural catastrophes, because you've had - 3Q has obviously been heavy in both years, but last year it was monstrously heavy at about 70 points. And this year even if we adjust for the run-off, 18 or so percentage points could have been a lot worse. So, if you're thinking about the big decline in those two big numbers, can you give us any kind of view about how much of this is kind of market related, just that there were - (00:09:18) was less? How much of this is a share of primary versus reinsurance?

You were just lucky because not much of it hit the layer. And is there any element where you actually kind of think, well, actually we've just been better underwriters and we've avoided bullets, or is it all just kind of random? But given that we've gone from 17 to 18 (00:09:34) before the reserve development, how do you kind of audit that improvement year-on-year in large loss experience?

And then secondly, in ERGO, to the extent you've made this policyholder assumption change in the German life business, does that have a future impact on earnings as well, and if so how much? And then related to that given what you've just done for the 2018 guidance for ERGO, how much should we be taking up future years for ERGO's performance relative to the existing plan targets you've set? Thank you.

A - Jörg Schneider

Thank you, William. Before I hand over to Christoph, let me start with your first question about the NatCat experience. I understand quite well your reasoning, yeah, and the losses are always also a result of underwriting, and therefore, if I have huge outlier losses can also be the consequence of a very aggressive underwriting behavior. I don't believe that to be the case. The structural changes in the portfolio between 2017 and 2018 are of minor relevance, and on that occasion, I can also answer the questions from James with regard to the property casualty risk. On a stand-alone basis, it's €6.3 billion, of which 40% is basic losses and €6 billion is major losses, and the tendency is slightly up adjusted for currency.

So, it jumps up and down mostly with currency because there's a lot of foreign currency yen and U.S. dollar exposure in it. But there's not a strong trend, but a light trend. But it's not a major development to higher risks. So, therefore, our experience in 2018 with the large losses is absolutely in line with our expectation for Q3, including the run-off, and I would also recommend to take the run-off into account because this run-off doesn't come randomly, but is also a consequence of quite cautious reserve setting and when you look at our major loss burden for current event, you must see that or you should see that also together with this positive experience on the outliers of yesterday.

With that to Christoph.

A - Christoph Jurecka {BIO 17223019 <GO>}

Thank you, Jörg. Well, thank you for the question. Before going into the question, I just wanted to highlight how much it is a pleasure for me to be in this hall today. I have been involved in Investor Relations Security (00:12:31) of Munich Re in the past couple of years quite often already, and I met many of you before. And I enjoyed it always very much.

So, I'm looking forward to seeing you more often in the future, and as I said, I enjoy very much being already here today together with Jörg, which is a great experience anyway. Coming to your question now, this is kind of a difficult technical – I'm sorry, now I have to give (00:12:57) for that. We are talking here about the assumptions, which we use in IFRS for the distribution of gross profit between policyholders and shareholders. This is at first step only an (00:13:10) IFRS assumption, which we take. And this assumption has been devised by the plan and the planning exercise we do every year.

So we look into the profitability of the future, and we look in that plan how much profit we are going to allocate to shareholders or to policyholder going forward, specifically in local GAAP, which (00:13:30) the profitability of this book anyway. And there what we saw is that given now that the risk capacity of companies (00:13:39) increased so much, those are the – they are much (00:13:44) than they have been a couple of years ago.

What we saw is that the profitability going forward is higher, which will allow us to give higher portion of the profit also to shareholders going forward. Therefore, we have this one-off effect now from the change in this assumption, which is based on the future planning. But going forward, the earnings assumptions are even higher than they have been in the past and this is exactly depicted in the assumption which we are changing now. And therefore, I would not expect any negative downturn now from changing the assumption at this stage is more the opposite that we are able to take this – to have this one-off effect now in our account is signaling that we are expecting higher profitability (00:14:24) going forward.

Q - William Hawkins {BIO 1822411 <GO>}

(00:14:28) I understood that I was trying to ask how much (00:14:30)?

A - Christoph Jurecka {BIO 17223019 <GO>}

How much, you mean, going forward is the positive impact would be on the life figures?

Q - William Hawkins {BIO 1822411 <GO>}

Yeah.

A - Christoph Jurecka {BIO 17223019 <GO>}

I mean it's difficult to say. Of course, it's very much interest rate depending and so on. Rule of thumb would be that – I mean if you've changed the share that the shareholder gets by roughly 50%, so the increase is maybe max 50% of what we're expecting in the past. (00:15:07) this translate via very complex calculations into IFRS. So, it's not easy to really translate it one to one into an IFRS planning, and anyway, it would be too early now talk about future earnings expectation and we're not giving any new future projections right now.

Q - William Hawkins {BIO 1822411 <GO>}

Helpful. Thank you.

A - Christoph Jurecka {BIO 17223019 <GO>}

Thank you.

Operator

We will now take our next question from Thomas Seidl from Bernstein. Please go ahead, sir.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah, thanks. Good morning. I thought actually you answered the life question, but your last comment make me come back to this point. I mean on the Solvency II, you're not recognizing any change that basically assumes you're just anticipating future profits and although you're saying a 50% in shareholder allocation (00:15:58) legally in Germany, right? So if you could comment on that.

Secondly, on the equity impairments, can you comment what happened in Q3 and should we also expect more to come given that actually October was the peak of the equity underperformance?

And the final question is, maybe a confirmation of my understanding, you had dividend policy last year, you told us in March normalized results by €2.2 billion, sounds like you're getting at least 10% increase this year. You paid €1.3 billion (00:16:32) dividend last year. Should we then all expect a 10% higher, so at least €1.43 billion dividend if this increase in earnings happens? Thank you.

A - Christoph Jurecka {BIO 17223019 <GO>}

Thomas, thank you for asking again, I was not very clear. It is not 50% of earnings the shareholder gets because this is of course not allowed in Germany (00:16:56) so you're completely right here. I was talking about 50% in addition of what we had in the past at maximum and this is only back of the envelope calculation given the fact that in the past for IFRS purposes used as an assumption 10% shareholder split out of the cost surplus (00:17:14) and going up to 15%, and as I said, this is then completely independent IFRS judgment (00:17:19), independent of interest rate movements and all those kind of additional technical effects which might occur. So, really back of the envelope, rule of thumb, and don't take that seriously at this stage. But,

(00:17:32)

...50% more, sorry.

Q - Thomas Seidl {BIO 17755912 <GO>}

And why no impact on Solvency if this is basically also happening in the future?

A - Christoph Jurecka {BIO 17223019 <GO>}

Well, you could - I mean, you have to differentiate. Solvency, we are very much looking at the legal entity base, whereas here we're looking at the segment base. On the legal entity base, we have two carriers in Germany, one is Victoria Life. There, we changed the assumptions already some years in the past, because the Victoria has been closed the new business already nearly 10 years ago from now. I believe there will be a change and will be implemented end of the year, and we are having different cycles timing wise when to reflect that kind of changes in IFRS versus in Solvency II, but be careful, in IFRS, we have been much more cautious than the Solvency II. So, the positive impact we are seeing here in IFRS is relatively seen much larger than I would expect on the Solvency II. Therefore, it's probably something which will happen at the end of the year, but potentially not even really visible for you.

A - Jörg Schneider

Thomas, Jörg here. On equity impairment, so the impairments were (00:18:46) pretty high, but they were not all on equities, but also on alternative investments in one case and that was quite a substantial amount, yeah. So, we changed an assumption and since it's a very long-term engagement, therefore we had to write it down. And the impairments on equities were partially due to the rule once impaired always impaired and partially due to the rules at six months or 20% rule. And that's - with that, it is also clear that we are exposed to impairments potentially in the Q4. So, if we do it on today's stock prices, stock market, then there would be additional impairments but not huge amount, yeah. So, we can digest it easily.

Second question on the dividend, it's too early now, yeah. So, we never did it that we predicted dividend level in the quarter of November because we still have one-and-a-half months to go. And we saw in October already that it's quite a lively natural catastrophe season, winter storms could be ahead of us. So, therefore, please bear with me that we don't say anything about dividend. What is clear that with growing earnings, we want to grow the dividend and but only to a level that where we are confident that it's going to be sustainable. Thank you, Thomas.

Q - Thomas Seidl {BIO 17755912 <GO>}

Thank you.

Operator

Our next question comes from Andrew Ritchie from Autonomous. Please go ahead, sir.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Hi, there. I wonder if you could just give us an update on German GAAP profit generation year-to-date. I'm assuming there's quite a lot of moving parts to do with the catastrophe losses, but also the real estate revaluation, I'm not sure how that affects German GAAP. And secondly related to that real estate revaluation, I mean, obviously, you've got an extra €1.5 billion of unrealized gains. Do you plan to harvest that or what is the kind of strategy on the large stock now of unrealized gains on real estate?

And the final question, I still a bit confused on exactly what you're saying about ERGO Life profit in IFRS terms. I think the forecast for 2020 assumed life, I think from health (00:21:23) breakeven. I guess you're saying, just to be clear now, that it won't be breakeven now, it will be contribution to profit? Thanks.

A - Jörg Schneider

Let me start, Andrew. Good morning. First an update on German GAAP, real estate valuation is even for IFRS in off-balance sheet item. That means that even on our balance sheet as investments or other assets, the real estate is at amortized cost, and only as far as we did impairments in the past, we write it up and that happened by the way, we had to write the real estate up with a net effect of €100 million under IFRS. That means we wrote it up in the balance sheet as well as in the P&L. Apart from that, under German GAAP and under IFRS, it's purely off-balance sheet valuation reserve.

You see it in our disclosure where off-balance sheet reserve on real estate go substantially up. The number is by the way €1.9 billion gross minus write up is €1.8 billion off-balance sheet. And if we apply deferred taxes on it then it's on a net basis €1.3 billion and this €1.3 billion is also a positive economic effect under Solvency II. So, you will see that and you see it already and this is quite pleasant increase of our Solvency II number in Q2. It has an impact of 9 percentage points on our Solvency ratio just from this updating of market value. And...

(00:23:34)

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

It has no effect on the HGB balance sheet, then it's also off-balance sheet from the HGB (00:23:41)?

A - Jörg Schneider

That is correct. But we can realize it. We can also realize it internally if we want. That means if we transfer part of that real estates within our group, it wouldn't have an IFRS impact due to the consolidated view. But it would be beneficial for the distributable earnings under HGB.

Second important item under HGB is the equalization reserve. After the events of 2017, we have to refill the equalization reserve and this is an expense of close to €1 billion for 2018. So, this is a very important factor also for the earnings.

But on the other hand, the equalization reserve also make over underwriting result absolutely resilient against adverse movements in the main lines here. So, it has pluses and minuses and it has a very important tax deteriorate aspect (00:24:51), which might become more interesting with rising interest rate. So far with the German GAAP situation, it's in good order. We have our distribution capabilities. We have additional possibilities to improve the situation even further. So, I'm not worried about that, but we have an eye on it.

So far from me, then Christoph on ERGO.

A - Christoph Jurecka {BIO 17223019 <GO>}

Yeah. Andrew, thank you for the question. Now, I mean the more you dig into that life topic, the more difficult to get them, sorry for that. This has all to do also with the way we finance our new business. As you know, we have – let's say, we have two buckets of life insurance carriers in Germany. We have three of them basically, which we call Life Classic, which you put into one-off. So, there will be no new business anymore. And then we have a carrier, which we call ERGO (00:25:55), which is a carrier which will carry all the new business going forward. And now the one-off we're talking about is only coming from the Classic Carriers. And as I said, there will be higher earnings going forward, which now are reflected in this one-off effect, which is also a catch up due to conservative IFRS doing in the past when we had to increase the wiz capacity of those carriers.

Now what's happening if we close ERGO Life, so one of the Life Classic companies in addition to Victoria for new business, and therefore, they bring this higher earnings and therefore we have this one-off there. At the same time, we will have more new business in the ERGO (00:26:42) Carrier, the other carrier, and there the shareholder will have to contribute more to financing the new business. And this will offset the higher earnings we are having from Life Classic to a certain extent. And then, again, very much depending on volume, on interest rate, on the specific business mix we are going to sell until 2020, and so we have two effects, one positive one from the classic from one-off companies and one negative one for the financing of new business out of the ERGO (00:27:12).

And those effects are going to more or less equalize each other. But depending on volume and size and interest rates, there might be upside or downside. Therefore, I would say it's too early. I mean the potential there is upside, I wouldn't rule that out, but it's clearly too early and then would be premature to concretely talk about upside today and to confirm any higher earnings target of the life for the year 2020 or afterwards. This now is really one-off coming more from a catch-up effect from in the past, maybe IFRS

(00:27:48), we have been more conservative or too conservative compared to where we stand now. And this assumption we are changing now, we change (00:27:58). Maybe that's the additional flavor you find interesting.

So, in 2012, we decided to be more conservative and now given the fact that the risk capacity is better, given the fact that we are no longer having new business in those companies, we're able to go back to the initial assumption until 2012, and therefore, nothing really happened. Only in the interim period, we have been more conservative than we are now, and now going forward, (00:28:23) carrier, which has to finance new business and there will be an additional burden, which will then overall – most probably will overall bring us in the position that the cost (00:28:35) can further support our earnings guidance. Potentially, there's upside, but this is bit premature to go deeper into that.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Okay.

(00:28:45)

Thank you very much. That's great. Thanks. Thank you.

Operator

We'll now take our next question from Jonny Urwin from UBS. Please go ahead.

Q - Jonny Urwin {BIO 17445508 <GO>}

Good morning. Thanks for taking my questions. Just one left actually so – just around your growth profile in P&C Re, I'm sorry (00:29:03) – are you still confident in the profitability of the growth that you put on in that division? I mean from the outside one could argue that the underlying performance is struggling a bit as a result. And what's your growth outlook for 2019 (00:29:16)? Thank you.

A - Jörg Schneider

Jonny, not so easy to answer. First of all, the slight underperformance doesn't have anything to do with the most recent growth here. It comes from a totally different angle and totally different part of the portfolio. Our growth appetite is intact, so we want to increase the momentum of the group, not only to concentrate on risk aversion (00:29:50) and risk controls, but also to explore new growth opportunities, but not in a stupid (00:30:00) way or an innocent way. So, it's exactly in areas where we seem to have very good data and where we know what we are doing, and especially, the structured large transactions might be a good source of growth where we have a decent profitability. It could come along with perhaps a little bit of dilution of combined ratio, but only slight dilution, yeah, because sometimes it's personal lines (00:30:31), it's less volatile than the NatCat business is for example, and therefore, we can well live with a slightly higher combined ratio. But if we look at it on economic basis, then this is really well-performing business and we haven't had bad experience in the last couple of months with it. Thank you, Jonny.

Q - Jonny Urwin {BIO 17445508 <GO>}

Great. Thank you, Jörg. Thank you.

Operator

We'll now take our next question from Sami Taipalus from Goldman Sachs. Please go ahead.

Q - Sami Taipalus {BIO 17452234 <GO>}

Yeah. Hi. Good morning, everyone. So, my first question is on the PYD, so on the cat losses. And I was just wondering if – it wasn't quite clear to me what drove this – what are you saying that you found new surplus here or was it a surplus you kind of saw (00:31:26) existed? I guess, what I'm asking here is whether this contributed to Solvency II capital generation in the quarter or not?

And then my second question is on the North America Risk Solutions business, which I think had quite significant impact on the normalized combined ratio. I'm just wondering what you're seeing in terms of pricing here, if you're seeing rate increases that in response to the loss experience here? Thank you.

A - Jörg Schneider

Thank you, Sami. With regard to the PYD for the major losses, I emphasize major, it's not only cat, it's also some impact from man-made. Did we know about the surplus, not that we have it always in our sleeve and that we take it out whenever we needed. All these losses under observation and we tend to be more cautious with bad experience in comparison to good experience, we tend to get good experience, more time to develop and the more we get confident, the more we tend to release reserve. I frankly admit that it was highly welcome in Q3 because we had this strong impact from the major catastrophes of the quarter and it's fully as to capital relevant. So, we have the same loss and loss peak and loss estimation under Solvency II as we have under IFRS. It's just the valuation which is different that is mostly the discounting effect, but these don't play a major role in these short-term oriented losses, not long tail (00:33:11) business.

And second question on North America Risk Solutions, it's difficult to identify a trend here. What we do is a broad mix of activities, so it's not to – the biggest part has nothing to do with the large industrial business, it's a totally diversified portfolio of Hartford Steam Boiler, American Modern, and other parts of the group. Therefore, they – why do we find them attractive, because they are somewhat immune from these general trends and are not fully correlated with the overall cyclicality of business. Therefore, my best estimation is here that price developments are going sideways (00:34:11) and not upwards here. Thank you, Sami.

Q - Sami Taipalus {BIO 17452234 <GO>}

Great. Thank you.

Operator

We'll take our next question from Michael Huttner from JPMorgan. Please go ahead.

Q - Michael Huttner {BIO 1556863 <GO>}

Thank you very much. And so, on the pricing, I just wondered if you could maybe give a slightly broader picture. Yesterday, at the conference, the CEO of (00:34:34) expressed his hope, which I think (00:34:38) that pricing would go up a little bit, but any indication (00:34:44). And on the PYD, I may be wrong, but I think this is the first time I've seen it – the numbers reported in this way with a NatCat being shown net of a PYD effect. And I just wondered why this choice, why this change, or is an underlying change, was this – it seems it's different? I mean – and that's all I can say about that.

And then on the life reinsurance, and so, I think underlying excluding one of (00:35:24), it's always difficult to distinguish what is and what isn't. You seem to be running already a bit ahead of the €475 million for your guidance. My guess is somewhere around €520 million, €550 million. With already indications that next year would be better and I just wondered if you could give a little bit more granularity on that, if I'm right? Thank you.

A - Jörg Schneider

Thank you, Michael. So, a broader picture on pricing, I can only confirm what we hear from other sources of the market. It's sidewards movement. Overall, we don't expect a decline in pricing more or less nowhere. But on the other hand, we hope that the impact from the NatCat events of 2017 and 2018 will play a role, which would translate into price increases, especially in the loss affected areas, Caribbean, Latin America, Japan. So, overall, we are cautiously optimistic. At least the downward trend should come to an end. And also my firm belief is that the interest rates must play a role. And when we have an interest rate for 10-year, U.S. Treasury is around 3% then (00:36:48) investors have an alternative and now are not desperate for going into uncorrelated risks, although the alternative capacity will remain in place, but not with the strong growth momentum it had in the past.

Second, with NatCat, we always gave the numbers net of PYD, but the PYD didn't play such a big role as in this quarter. Therefore, we were so vocal this time and emphasized the strong impact in order not to – let's say, not to underestimate (00:37:32) we had from the Q3. So, it's important that we also share with the market and especially with our clients that these were very serious events, and in Q4, we have more of that.

And life reinsurance underlying, that's difficult, what is one-off (00:37:48), what is underlying. You're absolutely right. It's difficult to distinguish. You always have positive and negative experience and losses on our business that means also major losses on (00:38:01) our business. Are we ahead of our target? Yes, somewhat. But business continues to be volatile on an IFRS basis. And we also want to keep open the option to do recaptures. They are not recaptures with a major burden for the IFRS reside (00:38:23) in the pipeline right now. So – or at least I don't know about it, but we willingly accept some volatility of IFRS earnings to the benefit of the economic position. And I think that will also be important in future.

The expectation for 2019 going forward, I really don't know whether the new basis can be higher than the 475 (00:38:56). This is also to do with the fact that the translation from economics to IFRS is somewhat strange with regard to the locking of assumptions and unlocking when you reached some trigger points and things like that. So, some of our peers, and especially, Hannover Re at the Capital Markets Date (00:39:19) has intensively discussed that and we can only confirm that there's always some artificial impact from this accounting rules, but we don't have major holes here. There will be issues here and there, but not to a large extent. And therefore, we are confident that we can grow the profitability in Life and Health Re (00:39:42).

Q - Michael Huttner {BIO 1556863 <GO>}

Okay. Thank you.

A - Jörg Schneider

I think these were your questions, Michael.

Q - Michael Huttner {BIO 1556863 <GO>}

Wonderful.

A - Jörg Schneider

Thank you.

Q - Michael Huttner {BIO 1556863 <GO>}

Thank you so much. Thank you.

Operator

We'll now take our next question from Kamran Hossain from RBC. Please go ahead, sir.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi. Good morning, everyone. Just one question for me. So in the statement, you talk about raising subordinated debt. I guess even with this, given maturity of, I guess, your existing debt, you have suboptimal leverage. Jörg, if you give some advice to your successor on how to optimize the balance sheet, what would you say that if he decides to bring you back to the consultant? Thanks.

A - Jörg Schneider

Yeah. Interesting. Yes. Thank you, Kamran. I don't like debt. I frankly admit that. And perhaps this is one tiny reason for Munich Re not having an enormous load of debt on its balance sheet. It has also to do with our HGB German GAAP situation that distributions must always have an eye on the distributable revenues and revenue reserve, but an leverage ratio of zero would be definitely wrong, and if we wait for 21 and 22 for the next quarter dates (00:41:04) for our outstanding subordinated loan, then we would be at zero.

Therefore, we should have a decent level of leverage, and it's better to diversify also the issue and repayment date, and therefore, I would very much like to come out with – and use of (00:41:28) subordinated loan very soon, also to somewhat diversify our refinancing and to diversify our exposure to markets. The ideal leverage should be most probably higher than that what we have at the moment. So, to go to moderate levels, which probably still below the average PA (00:41:53) level, but somewhat higher than our current ones would be in my view very responsible guidelines, yeah. Thank you.

Q - Kamran Hossain {BIO 17666412 <GO>}

Thanks very much.

Operator

We'll now take our next question from Ivan Bokhmat from Barclays. Please go ahead.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Hi. Good morning. I have three questions. The first one is on the underlying combined ratio in P&C. I mean you're running at around 100% right now. And I was just wondering whether you have any observations on how the path to 2020, the 97% target is going to look like or whether the target is still relevant?

And then a couple of questions on the volumes, so, first of all, in the P&C, I mean, we've noticed that the growth had continued. We're also hearing about large blocks of casualty business being brought to the market in the U.S. I'm just wondering whether that would fall within your current risk appetite and whether we should expect Munich to keep increasing the casualty business?

And then, finally, you did mention Hannover Re and their approach to Life and Health business. They seem to be giving up some volumes, which may come to the market. I'm just wondering whether this is also something that you would be ready to consider? Thank you.

A - Jörg Schneider

Ivan, thank you very much. We look at everything, yeah. But let's start with your first question underlying combined ratio P&C around 100 path to our, let's say, mid-term path to 2020 or so, we stick to our financial ambition for 2020, which would be net profits in the order of €2.8 billion, half coming from ERGO – half of the increase coming from ERGO, the other half from reinsurance and also still our best estimate for 2020 for the combined ratio with a slight reservation with regard to business mix effect would be that we can go down to 97% in spite of our current, let's say, little underperformance that we are not at 99%, but one point higher.

The one point I had explained is more random than structural. That means we need another 2%. First effect would be expense reduction that is ongoing. The voluntary program has been finalized with a very good success. So, we could really reduce our workforce and are currently in the process of reducing the complexity, and I'm confident that this will be a very good move and that we will be able to have a bit more agility also due to this development.

Second effect is new business deals, which leads to volume growth, which will help to drive down the admin expense ratio, and perhaps there's a countervailing effect which could come here and there from the fact that they come along with a higher combined ratio themselves. Personal lines, a bit more stable business, but I don't want to overplay that cards right now. So that effect is a tendency, a slight shift from casualty to property, which had been planned, but and that brings me to your second question, we are open also to large blocks of casualty business, but we had never erratic changes of our risk appetite for casualty.

According to my observation, we've had a very consistent path with regard to casualty business, especially also heavy casualty business. So, therefore, we looked with a lot of expertise which was out there. The big question mark always comes from the adequate level of reserve, but let me add here our experience with our casualty reserves, I touch wood now, is very good, yeah. That means that the assumptions of the colleagues in charge, which are extremely experienced and careful experts had been right in the past and found to be confirmed (00:46:24), I can't say that for the eternity, but at least the track record is very good.

So, when we look at these portfolios, we do it with, I think, enough – yeah – how should I say, common sense plus expertise. Last question on additional life business which might come to the market, we are also open. We look also at big blocks wherever they come from. But in the past year also, let me carefully appraise (00:47:00) the track record and sometimes there were big blocks on the market. And I admit that I asked myself at that time why aren't we more aggressive couple of years ago with this or the other major transaction, and they were always reservations, they were always very good reasons in place while we didn't pick it up at the same price as others did, and it turns out here and there to be beneficial. So, therefore, I trust that the colleagues will do what they will know what they do here. So far with that, Ivan, that answers your questions.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Yeah. Thank you very much.

A - Jörg Schneider

Thank you.

Operator

We'll now take our next question from Frank Kopfinger from Deutsche Bank. Please go ahead, sir.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Yes. Good morning, everybody. I have two questions on ERGO. First question is on coming back to the life topic, but from an other angle, you just started a joint venture with IBM, my understanding is that the costs which are initiated are related to this has not yet been reflected within your plans, or maybe you could give any further color on this where you stand and where the project is going with respect (00:48:26) to costs? And related to this, whether you see still there had been once the decision made that you are not going to sell your (00:48:34) portfolio, but just would like to (00:48:38) your comments on whether this is really off the table or you could reconsider to start this?

And then secondly, as we saw (00:48:48) just some cleaning up within your international business with the Dutch entities, whether you can comment whether there is more to come on the international side in respect to cleaning up your portfolio there?

A - Christoph Jurecka {BIO 17223019 <GO>}

Yeah. Well, thank you very much for your question. Yes, you're right. We're working on the migration with a joint venture you know that together with IBM, and I must say we are making good progress there. So, the project has been set up and people are really working, and the IFRS activities have been launched. You know this is a multi-year project. So, no early results to be expected anyway, but now we are up and running and the train is out of the station. Let me put it that way.

Of course, we would never start an activity like that without having a business case and planning and knowing the costs and the revenues are coming out of that exercise. So, clearly this has been incorporated in our plans, and so, I can take any concerns from you that we did started without knowing the costs or without incorporating them in our plans. They are all fully included in our plans with an investment phase in the beginning and the project phase, and then of course on the long term, we will benefit from efficiency gains out of that activity. So, this is completely included in the plan.

With respect to one-off, as you can imagine, given what I just said, we are fairly busy right now in our migration project. So, I can say for – at this stage, it's really off the table. We have been decided to offer that platform and at the later stage also to the market. Right now, we are concentrating on the migration of our own policies onto that new platform. So, for now, we are fully investing and fully concentrating on that activity and this is a strategy we decided to go for and that's what we are implementing right now.

International, you're right. I mean portfolio optimization is an ongoing activity where we did some steps until Q3, but this exercise is for sure not over now. And so, there are further activities to come later this year potentially or next year. So, we continue to work on that. Sometimes you also depend a little bit on market circumstances, regulators, whatever kind of things. So, recent activity we started as you know when we kicked off the whole ERGO Strategy Programme, but this is still ongoing and it did not come to an end until now.

Even for the fourth quarter, it might be the case that there will be some additional transactions, and if you look at our earnings outlook for the end of the year, which we increased, you might also see that this increase is not, let's say, the most bullish one in the world, potentially you could have been more aggressive here. So, we already included there a certain portion of caution (00:51:55) in that outlook for the year end and the expectation that further transaction is going to happen in the fourth quarter.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Okay. Thank you.

A - Christoph Jurecka {BIO 17223019 <GO>}

But it is not given. So, as I said, we are working on that, so don't take this for granted, but we are working on that.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Okay.

A - Christoph Jurecka {BIO 17223019 <GO>}

Thanks for the question.

Operator

We'll now take our next question from Michael Haid from Commerzbank. Please go ahead.

Q - Michael Hermann Haid {BIO 1971310 <GO>}

Thank you very much. Good morning. Two questions. Also sorry for that on ERGO Life. You apparently reduced the policyholder participation in gross surplus (00:52:32) from 90% to 85%. This will definitely get you some negative press (00:52:38) tension, which possibly comes in addition to the negative press (00:52:42) you received last year regarding a possible disposal of your (00:52:50). I think also competitors may take advantage from that. Are you not afraid that this will hurt your new business generation at ERGO (00:53:01)?

I understand that some of these expenses - that you save (00:53:08) expenses as you have no new business in traditional life, but you basically give this to the shareholder and that's possibly also difficult to communicate to the press and to the policyholders. And the second question, retro protection in P&C Re, how much did it play a role in the Q3 results?

A - Christoph Jurecka {BIO 17223019 <GO>}

Yeah (00:53:33). Thank you very much for the question. It's a great opportunity for me to reconfirm that we're not doing that on cost of our policyholders what we're doing right now. But what we do is we change financing streams in between the different life carriers we're having. You have to consider that in our Life Classic companies like (00:53:52), which we are now going to finally close for the major block of the new business, that the cost will be much lower going forward, and for that cost reduction, everybody is going to benefit, including also the policyholders of course. And therefore, there are offsetting effects. We are increasing to a certain extent the payout to shareholders, but at the same time, due to the reduced cost base, everybody is benefiting, and for the policyholders, altogether it should be more or less equal.

So, it's not about taking money away from the policyholders to put it that clearly here and this is specifically important in the context you were also making with ERGO (00:54:41), which is our new business carrier, because we want (00:54:45) to have attractive products and (00:54:47) now has to carry the acquisition costs, which we took out of ERGO (00:54:57) we have to pay that, that the proportion the (00:55:02) shareholder has to pay also increases for (00:55:05). So, the shareholder overall is more or less redirecting financing streams, but not so much taking out more money of the overall block of life companies if you take into consideration (00:55:19).

If you look at altogether, it is not that much of a change. What we did change though is that we changed the financing flow, that we reduced the acquisition costs in one carrier, that we increased it in the other carrier, and we balanced the effects for the shareholder by increasing the policyholder – the shareholder distribution out of (00:55:40). And this all then translates and changed IFRS assumptions because you said 10% to 15%, we've increased it, but that's only the IFRS assumption, which is deducted from a local GAAP planning (00:55:51), which is much more detailed and has much more – that we look much more into the details also what exactly is happening between policy and then shareholder.

So, this 10% or 15%, as you know, is a very high level picture only of what's really going on a local GAAP basis in the respective companies. And therefore, I want to also emphasize again that now the risk capacity of those companies is so much higher that we also decided to go for that higher (00:56:23) IFRS assumption now, but we only take a change back, which we did in 2012. And we are back to normal now. It's not that we take out more money than we would have done 10 years ago. It's only back to normal. It's not aggressive in any way, and therefore, I would like to reemphasize it's not on cost of the policyholders, but it's really an activity and the one-off out of the restructuring of our life business overall.

Q - Michael Hermann Haid {BIO 1971310 <GO>}

And the 2012 – sorry, the 2012 change that was also basically only the IFRS accounting?

A - Christoph Jurecka {BIO 17223019 <GO>}

This was also IFRS and this was the opposite change, right.

A - Jörg Schneider

And for me, Michael, reinsurance, property-casualty retrocession, that was your question, the impact on the Q3 result. So, I have adjust for the nine months here or let's – as a rule of thumb, we see some 1.5%. That is the cost of our retro, and I don't know by heart how much additional expenses we had from the reserve releases. But what we give here are net numbers. That means for the losses net, the impact from retro will be minor. It's just the proportional elements of retro, which is typically coming in form of sidecar, not the accelerated retro (00:57:59). It's affected with these types of losses. And the impact for the losses for the reserve release is there will be small impact because the New Zealand earthquake was very large for example, but these numbers which we gave you are net of retro. Thank you.

Q - Michael Hermann Haid {BIO 1971310 <GO>}

Thank you very much.

Operator

Thank you. We will now take our last question from Thomas Fossard from HSBC. Please go ahead, sir.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes, good afternoon. Good morning. Last question for me would be, could you provide the year-to-date combined ratio of the Risk Solutions business, please? I think that at the full year 2017, you provided a combined ratio full year, which was at 106.7% and with a long-term average at 92%, so just to better understand that what has been the deviation so far this year? Thank you.

A - Jörg Schneider

Thomas, I don't have it here, but it will be little bit lower than that for the traditional combined ratio. Therefore, when you see the 97.3% for the nine months combined ratio then I would assume that Risk Solutions will perform in the order of 95%, but I'm not absolutely sure. What I can clearly say is we don't have an issue.

Q - Thomas Fossard {BIO 1941215 <GO>}

Thank you.

A - Jörg Schneider

Thank you, Thomas.

Since this was the last question, as far as I understood, kindly allow me to briefly say a few words of farewell, because I will not steal your time by making a major roadshow now. And I hope that my colleagues from IR will invite me when you come to Munich next time and have some drinks in the evening. Then I would very much like to join you there, but kindly allow me to briefly say a few words of farewell here.

You have always been demanding, but extremely fair and helpful to me, and I have always had great respect for your work, and I have always enjoyed working and discussing matters with you. I would therefore like to thank you sincerely for your continuing support. What we have presented to you has always been the result of accomplished team work from many colleagues from Munich Re from finance and other departments and from our IR team and also from our colleagues with ERGO. So, this will continue to be the case and as an (01:01:04) excellent successor, I'm sure that you will do a good job and that you will appreciate him too. And most importantly, please continue to support Munich Re. We are far way from being perfect, but this is a great company, which deserves your trust.

With that, thank you very much, and back to Christian.

A - Christian Becker-Hussong {BIO 19080254 <GO>}

Yeah. Thank you very much, Jörg. I know you don't want to hear it, but I say it anyway. Thank you very much also on behalf of the entire IR team for the just fantastic cooperation over the last many, many years. As always, a great pleasure and we will certainly miss you. But, of course, we are also looking forward to work with Christoph. So, thanks for joining us and see you all soon. Bye-bye.

Operator

This concludes today's call. Thank you for your participation. You may now disconnect.