Q4 2018 Sales and Revenue Call

Company Participants

- Christian Becker-Hussong, Head-Investor & Rating Agency Relations
- Christoph Jurecka, Chief Financial Officer & Member-Management Board
- Torsten Jeworrek, Member-Management Board

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
- Vikram Gandhi, Analyst
- Vinit Malhotra, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day, and welcome to the Munich Re Preliminary Key Figures 2018 and Renewals Conference Call. At this time, I would like to turn the conference over to Mr. Becker-Hussong. Please go ahead.

Christian Becker-Hussong {BIO 19080254 <GO>}

Thank you. Ladies and gentlemen, good morning to all of you. Thanks for joining us for our call on the 2018 preliminary financial results and January 1 renewals. Today's speakers are Christoph Jurecka, our new CFO; and Torsten Jeworrek, CEO of Munich Re's Reinsurance business. Christoph will start with a few remarks on our 2018 earnings before Torsten will comment on the outcome of the renewals. Afterwards, we will open the floor for Q&A.

So Christoph, please go ahead.

Christoph Jurecka {BIO 17223019 <GO>}

Thank you, Christian. Good morning, ladies and gentlemen, and a very warm welcome from me as well. I'm very pleased to be talking to you in my new capacity as group's CFO for the first time. I've already met quite a few of you, as you know, and I'm looking forward to getting to know all of you personally and to working with analysts and investors more closely in the future.

Today, I'm very happy to present the financial result which is strong and fully in line with our expectations. In reinsurance, our underlying profitability was sound. And in primary insurance, we are well on track with ERGO Strategy Programme. With net income of around €2.3 billion, we reached the middle of our target range. This was despite an environment that poses significant challenges for the insurance industry as a whole especially in the fourth quarter.

In Q4, we did well despite intense claims activity and adverse capital market developments. A net profit of €238 million benefited from strong performance in our life and health reinsurance, and ERGO earnings, that were also above expectations. The accumulation of major losses left its mark on the P&C reinsurance result but this was mitigated by our healthy balance sheet.

Our capitalization remains sound and provides a strong basis for ongoing high shareholder payouts. The dividend is proposed to be at €9.25 per share which underlines our confidence in Munich Re's earnings power going forward.

Let's now look at the investment results. Given the high capital market volatility in the fourth quarter, the ROI of 2.9% is quite decent. Regular income proved to be resilient and amounted to 2.9%. Significant equity impairments were offset by gains on disposals of equity investments and the net positive contribution from derivatives. The ROI of 2.8% for the full year 2018 is more or less in line with our guidance of approximately 3%.

Let me now give you the highlights by business segment. In life and health reinsurance, the technical result plus fee income came in strong at €165 million in Q4. The full year number of €584 million clearly surpasses our guidance of €475 million. Overall, we can say 2018 was a remarkably good year. It is worth noting the very good claims experience in the U.S. which was counterbalanced in part by the ongoing adverse development in Australia.

In P&C reinsurance, the combined ratio of 99.4% is close to our original full year target of 99%. Q4 was impacted though by heavy outlier loss activity. Major losses in Q4 mainly nat cats like the Californian wildfires, the Japanese typhoons, and Hurricane Michael in the U.S., as well as a series of man-made claims were partially offset by one-offs for claims in prior years that amounted to 4.6 percentage points of net earned premiums for the full year. This again underlines our cautious reserving factors also for single large losses.

Basic loss reserve releases net of commission effects were 4.6 percentage points for the full year, which is slightly above our guidance for 2018. In absolute terms, the release equals the level of 2017. We continue to follow our prudent reserving approach to react immediately to any signs of deterioration, while allowing positive indications to develop more gradually. We consider our reserving situation to be as strong as it was as at the yearend 2017.

On a normalized basis, the combined ratio amounts to approximately 100% for the full year according to our usual and I must say somewhat simplified calculation method. However, we believe that the underlying combined ratio has been quite consistent with our guidance of around 99% for 2018. ERGO exceeded the guidance with a net profit of €412 million for the full year. Even in adjusting for net positive one-off effects, its financial development turned out to be significantly better than anticipated at the beginning of 2018.

At 97.9%, the combined ratio in German P&C business was relatively high in Q4, driven by our again prudent reserving approach and the cost ratio, which reflects ongoing high expenses for various projects designed to sustainability enhance the value of the business.

For the full year however, the combined ratio of 96% fully meets our guidance. The combined ratio of ERGO International amounted to 94.5% in Q4. At 94.6%, the combined ratio for the full year even beats the ambitious 96% target that we amended – or that we have amended from 97% at the beginning of the year. The full year 94.6% came in as a historical low.

Well, that's all for now from my side. In my view, these figures underline again the inherent strength of Munich Re. We'll provide us, as you know, the final results at our analyst conference call on March 20.

And with that, thank you all for listening from my side and I'll hand it over to Torsten for comments on the January renewals.

Torsten Jeworrek {BIO 5724439 <GO>}

Thank you, Christoph, and a very good morning to all of you. I am on slide 6 of the presentation and I would like to lead you through the January renewals. Overall, I would say we reached a very satisfactory outcome in a very and unchanged difficult market environment.

When you look at our portfolio premium wise, volume wise, the renewal in January is a very important one because when you look at the non-life business here on this slide, €20 billion, then the business which was up for renewal contributes approximately 50% to all our non-life business.

When you only take the treaty business which has these three renewal dates in the year, then the contribution premium wise it's already 66%. In terms of the portfolio composition, this business which was up for renewal in January has of course as we know from the past only a minor cat share in the portfolio.

So that means and in other words those treaties in the United States and Japan which heavily were affected by the large loss events which were mentioned by Christoph before. Those treaties were not really in the focus of the last renewal in January now and that will to some extent also explain why we have not seen more significant price increases in January.

I start with some market environment. The market after these very large losses in Q3 and Q4, according to our observation, remains very much unchanged, that means that traditional reinsurance capacity stayed in the market and here is a bit more uncertainty of the alternative capital that plays a role in the market where they used to be before in the United States.

Regarding alternative capital, we see more uncertainties in their behavior in the – in their capacity they provide for the market. Our explanations are, this is second year in a row that alternative capital is affected which is kind of new lesson for the capital providers. Maybe another explanation is that they wrote a lot of business under the assumption that that business is exposed to cat business on the East Coast, maybe to earthquake to some extent, but many of the aggregate covers in the United States, this year or last year also affected by the wildfires which were from their perspective more of an unexpected loss they have to deal with and because we have now two years in a row more capital than originally assumed remained locked in that needs to participate in the new underwriting years, the capital providers have to reinstate – refill the capital base for the business because their treaties are collateralized.

When I look at the various regions in the world, United States, Europe, Southeast Asia, global business, then in this competitive environment, the markets remained rational, I would say. Rational in the sense that those treaties and programs which were affected by losses particularly in the United States saw reasonable rate increases in the order of, I would say, up to 10% or so particularly, the cat treaties and equipment treaties (00:10:39). Treaties and programs in other regions not affected by larger losses were more or less flat or particularly, in Europe and Southeast Asia, saw price reductions, small price reductions, but price reductions.

And when you look at the primary insurance business in the United States, here we could benefit from an improving underlying market. There were rate changes in many lines of business in the United States which, of course, helped us already now in the proportional business and will help us further in the year for our period business which has not a specific renewal date, and we don't report that separately. In the United States, in Europe, and in Asia proportional business remained pretty much flat, I would say.

I'll switch to the next slide, slide number 7, where you see our traditional chart where we present our portfolio. Left side is the old portfolio which was up for renewal. On the right side is the new portfolio. And all the figures which you see here are adjusted for currency changes, and we started with a portfolio of €9.4 billion and could achieve a premium increase, volume increase of 6.3%, bringing us to €10 billion in total, which is good. And on the other hand, it reflects that I think we behaved rational and responsibly in this renewal.

Taking everything together, price changes, positive price changes in United States, more pressure in Europe and Southeast Asia, our price change according to our calculation was flat, was 0%, and this 0% include exposure changes and higher risk. So, that means when we take higher risk, and we did, we got higher premiums for that. But it does exclude a positive impact from higher interest rates which we generate on the asset side, and it does exclude our positive impact from our internal cost reduction program.

So, all in all, I would say a good result under these circumstances. What does it mean now? It will positive contribute to our earnings in 2019. We have then two more renewal dates in front of us. One is Japan in April. The other one is July, Caribbean and United States, mainly. And for these renewal dates, because of the larger contribution of the cat business in the States, we of course do expect a more positive and more significant price increases, all taking into account the bad loss experienced (00:13:53) in the last two years.

With this in mind, I would like to finish and hand over to Christian Becker-Hussong.

Christian Becker-Hussong {BIO 19080254 <GO>}

Thank you, gentlemen, for your introductory remarks.

We are now happy to take your questions. So, please feel free. As always, I would like to ask you to limit the number of your questions to a maximum of two per person. Thank you.

Q&A

Operator

Thank you, sir. Our first question today comes from James Shuck from Citi. Please go ahead.

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

Good morning, everybody. So, my two questions. Firstly, I'm really just looking for some clarification around the outlook for realized gains particularly as we look forward to the 2020 targets. Now, I tend to think about realized gains net of write-ups and write-downs and excluding ERGO Life because most of those are shared with policyholders, in any case. It looks like that number was a reasonably low number in 2018. I'm just interested in when you look out to 2020, what should we be expecting in terms of a absolute number for realized gains net of write-downs? It looks like it should be around the €500 million level. That's about 20%, 25% of your net profit. So, it's an important number when you think about achieving that 2.8%. I'm just keen to understand how confident you are in being able to realize that kind of level on an ongoing basis, please.

Second question was around the January renewals. So, flat pricing, volume up 6%. I presume the structured and tailored transactions have not been a big contributor this year. When I look at the mix between the new business and the canceled business, it seems that there's been – certainly versus last year, there's been a big improvement or reduction in the cancellation rate versus last year which has helped, but there's also been a big reduction in the volume of new business, so your new business has gone from €2.3 billion to just €0.9 billion. Just looking for a little bit of an explanation about the lack of growth from that side, please. Thank you.

A - Christoph Jurecka {BIO 17223019 <GO>}

Well, thank you for the question. Christoph here. Your question was the outlook for realized gains, and maybe I answer that question right away in more general terms. As you know, we are discussing today our preliminary results and our usual calendar would say that we are talking about the outlook and our further development towards 2020 and beyond potentially in our March conference. Therefore, even if your question is very specific as it is, I would rather refrain from answering it now and would like to postpone that for our March conference.

A - Torsten Jeworrek {BIO 5724439 <GO>}

January renewal, our portfolio remained pretty stable this year, meaning difference to last year, there was hardly or no contribution from tailor-made large or structured transaction of our portfolio. They were included last year in our figures. So, pretty unspectacular renewal, I would say. In terms of business mix, we expect and see a slight change towards more casualty business in this renewal. So, that has to do with some proportional business which we wanted to write. But on a, let's say, basis which was responsible in my opinion, we intentionally decided not to participate or not to entertain to write some large business particularly in the United States this year which were placed and we were aware of covering a lot of, let's say, I would say, commercial liability and commercial motor business because here we have a more careful approach.

You might have read this article in one of the newspapers recently where we decided intentionally to reduce our appetite for that business for reserve reasons. We see more negative patterns in that market. But otherwise, I would say pretty unchanged renewal in most of the business which we had in the portfolio are still in place and only limited opportunities going forward.

The higher share of casualty business will, of course, mean that we do expect more investment income from interest rates from the cash flow of the – and to longer duration of that piece of business which is not included in our reported price change of that renewal.

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

And Torsten, just to be clear, then so the – you're saying you wrote no tailored and structured tractions in 2019 whereas you wrote the fair amount in 2018. So the volume growth is plus 6%. So I suppose what's the underlying growth year-on-year excluding the tailored and structured transactions?

A - Torsten Jeworrek {BIO 5724439 <GO>}

When you look at the underlying and compare that with last year, actually percentage-wise it's almost exactly the same figure. Last year, we reported, I think if I remember correctly, 19% total growth a year ago. When you exclude last year's big tailor-made transactions, then the remaining and the (00:20:17) growth would have been 6%. So that is exactly the same like this year. And this year, actually, we can't specify it's (00:20:26) not from single mentionable transactions or so. The only case, which is maybe worth to mention it is some positive participation in the Marine business where the market improved. And otherwise, it comes from the regions and a number of many nitty-gritty transactions at the end of the day. So nothing spectacular. And you're right that was to confirm that no tailor-made (00:20:50) structured transactions or unstructured transactions in the portfolio this year.

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

Okay. As I didn't get my first question answered, perhaps I could just ask a replacement one. Just on, I mean, the €3.8 billion of net profit for 2020, I think you've had an indicative combined ratio aim of 97% within that. But the tailored and structured transactions have a negative margin drag, but you haven't seen that volume growth coming through at 2018, but at the same time you have seen an increase in interest rates. How confident are you in 97% being the right number driving that €3.8 billion, or is it a slightly higher number now?

A - Christoph Jurecka {BIO 17223019 <GO>}

Yeah. Again on the outlook, but I'll try to give some flavor around it. Generally, I can confirm, very confident of the €2.8 billion (00:21:53) target. Looking back at the 2018 figures, you see that we are exactly at the midpoint of the target range and we think this gives a lot of support also for the next two years to finally achieve our target and therefore we are very confident.

The €2.8 billion (00:22:10), you're right. We said in that context that the combined ratio would be 97% based on the portfolio we had back then. And I think the 97% is still a fair figure, but I would say that the emphasis is more on the €2.8 billion (00:22:27) compared to the 97%. That's what I would say today. Other than that, I mean, further translating the outlook into what it would mean operationally is something we would be happy to talk about in March, as I said.

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

That's great. Thank you very much.

Operator

Thank you. We now move on to our next question, which comes from Jonny Urwin from UBS. Please go ahead.

Q - Jonny Urwin {BIO 17445508 <GO>}

Hi, there (00:22:53). Good morning. Thanks for taking my question. Just two from me. So I'm just trying to think about why the growth in the large and tailored transactions has moderated. So, I mean, what's changed internally versus this time last year? Is it just that the opportunity didn't arise? And I know they're quite lumpy and volatile. Or is it you're less happy with the profitability of those? And then I guess in that context, are you still happy with the growth that you've put on in the last couple of years?

Secondly, the normalized combined ratio is running a bit higher than guidance and you're noting that underlying is sort of more in line. I'm just thinking about – think about the outlook again, but I'm not going to ask you on the outlook because I know you don't want to answer, but just thinking about the starting point for that normalized combined ratio for 2018, is it still 99% or has it crept a bit higher? Thank you.

A - Torsten Jeworrek {BIO 5724439 <GO>}

Thank you very much. Let me start with large transactions (00:23:52). The simple question, why we didn't see large transactions or in the January renewal is, first of all, they were not available and that is normal, I would say. That is the normal expectation. Large (00:24:11) transaction take a lot of time to develop and to tailor them and they come when they are ready. It was more a coincident last year that we were able to basically write-in (00:24:23) to sign them in line with the January renewal date. It would not be unusual to see large transactions between renewal dates or so, because they are not in the regular renewal pattern.

And I mentioned earlier a bit that maybe the only exception, there may be a very few larger transactions available in the United States and here we have a slightly, let's say, reduced risk appetite to go into portfolios, particularly when you cover back books or so where you saw already adverse (00:25:00) development on the client side. And for that reason, in these very few months, we didn't participate and other ones were not available.

The other question is, are we happy or were we happy, are we happy with large transactions last year and last year's. Honestly, very happy. We are very happy. These transactions which we wrote (00:25:22) last year, the significant big ones, are exactly in line with our expectations. So it means profitable.

And are we happy with our growth in general? And remember we discussed last year the many different initiatives, not only the large transactions, which we reported last year. Honestly, I'm more than happy with the growth we developed. If you ask me, I would say these large transactions and the growth of the specified business initiatives, which we explained last year and I will give an update in March at our Analyst Conference, are very good, very profitable. We have basically a bigger concern about, I would say, standard reinsurance business and (00:26:13) the unchanged market environment. So not the specific large transactions and growth is our concern, but the unchanged market and here is our clear philosophy, we stay disciplined. Thank you.

A - Christoph Jurecka {BIO 17223019 <GO>}

Yeah, the normalized combined ratio of 100% versus the 99%, that was your question. First, I have to say the methodology we apply for normalization is really simplified. Some would even say maybe overly simplified. So what did (00:26:48) we miss when calculating the 100% normalized combined ratio? We have some unusual activity of weather-related losses, which we had a lot (00:26:57) in Q2 and Q3, which have not been taken out by the normalization if you look at the 100%. And we also have some, we call them, basic cat loss activity, also included in the 100% and they also have not been taken out by the normalization. Why is that? Because we apply the threshold for large claims very, let's say, statically. So without any giving leeway for anything, which might be cat-related, but it's then, in itself, smaller than the €10 billion (00:27:28). Also, you could argue that those claims still are related to those large cat events, which we intend to take out by the normalization. Therefore, the methodology does not really capture what's really going on, let's say, in the core portfolio, in, let's say, an underlying view. And having said that, I can emphasize only again that we still think and that's why I mentioned in my introductory remark that the portfolio overall is in line with our expectation of 99% as basic profitability in our book.

Q - Jonny Urwin {BIO 17445508 <GO>}

Thanks so much.

Operator

Thank you. Michael Huttner from JPMorgan has our next question. Please go ahead.

Q - Michael Huttner {BIO 1556863 <GO>}

I've got, I was going to say, two questions. Thank you very much and well done on raising that dividend. That's really lovely. And so, the first question is on the – you said your reserving strength has unchanged and the reason I ask is you've released not only – was it 5.8% or 5.6% of normal basic kind of 5.8% reserve releases, but you also had 8.1% coming from the large claims portfolio. So the way I look at it there's a total 13.9% of total reserve releases, which seems huge number. And so there, I wonder in that context whether you can explain why you, despite that, you still think the reserving strength has unchanged? Mathematically 13%, 14% on €20 billion, that's €2.8 billion, seems (00:29:10) a lot.

And the second is on Solvency (00:29:16), so you've got a 250% number. Can you remind us what the moving parts are if we were to normalize? Because you are quite conservative. You don't have the volatility adjusted (00:29:27). You also have a very low level of debt and you don't include any excess reserves (00:29:35). And I just wondered how to think about it versus your peers, which obviously do include all these items? (00:29:43). Thank you.

A - Christoph Jurecka {BIO 17223019 <GO>}

Well, thank you, Michael. Yeah, (00:29:50), yeah, I take from your question that you look at what happened in Q4 as being something rather exceptional and I don't think it is. Our usual (00:30:01) reserves a little bit of conservatism, which over years then develops. And in case we are sure enough that it's time to release it, then it's released again. So that's the usual cycle as you know. And then, the cycle applies both to basic losses as well as large losses. And as you know in Q4, the seasonal topic more or less in Q4, we are looking into the reserves, having all the internal reserve assessments, the discussion with the board about reserve strength and so on.

Having said that, it's also mathematically very easily possible to have an unchanged reserve strength because basically, it means if you take out something, you also have to take it in. And then, the missing piece in the equation is that we of course look into all our portfolios and compare the actual development with the assumptions from prior years. And that's something which then completely - makes the link complete between what we had prior year, this year's reserve strength at the same time, what we were able to release.

Also, as you know, last year and also this year, we had relatively nat cat activity, last year much more than this year. And this of course, given what I just said that we put into the new reserves always some conservatism means that last year, we were conservative, this year we are again and if you want (00:31:35) somehow again this year, but at the same time benefited already somewhat from what we did last year.

So I hope this clarifies the overall picture somewhat. But again, I would like to underline that that's not at all exceptional, that's a longstanding position, I must say (00:31:55) to look into the reserves according to the process and that's exactly what we did again now in Q4.

The Solvency II ratio 250%. Well, difficult to say. (00:32:12) saying, I should normalize now for what our peers are doing. Actually, I would love to know what our peers are doing in detail. I don't - of course (00:32:22) something where we know and our estimate is that our ratio would be roughly 50% higher if you would include some traditional.

With respect to excess reserve, I would happy to understand what our peers are doing and how to include them in the ratios. As far as I know, that's not something which is easily to be negotiated with the auditors and also the regulators. But then, I am very happy to learn from you, other than that (00:32:51).

Q - Michael Huttner {BIO 1556863 <GO>}

And on the volatility adjusted?

A - Christoph Jurecka {BIO 17223019 <GO>}

(00:32:54)?

Q - Michael Huttner {BIO 1556863 <GO>}

On the volatility adjusted?

A - Christoph Jurecka {BIO 17223019 <GO>}

That's something we do not calculate regularly, because deposits would be quite what would be - would be quite burdensome because it's a lot of work to do with the whole calculation twice. Therefore, I can only give you a rough sensitivity which is then also close to what you know anyway from interest rates and its sensitivities.

Including a static volatility adjustment, I think it would bring us maybe 5, maybe little bit more points in the Solvency II ratio. If you know (00:33:27) which really lift up the ratios for some of our peers is the dynamic volatility adjustment and this is much more difficult to estimate because this would mean that (00:33:37) valuation models, you need to implement the volatility adjustment depending on the interest rate path you're in the specific scenario you're looking at and that's something we (00:33:51) never implemented it. We don't know really what the impact would be. But if you ask our peers what the impact is for them, maybe it gives you a sign or an indication how large it could be for us as well, but we do not have any internal data about how large it might be.

Q - Michael Huttner {BIO 1556863 <GO>}

Excellent. Okay. Thank you so much. Thank you.

A - Christoph Jurecka {BIO 17223019 <GO>}

You're welcome.

Operator

Thank you. We now move on to a question from Vinit Malhotra from Mediobanca. Please go ahead.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes. Good morning. Thank you for the opportunity. So just – so, I'll stick to two questions and maybe ask about outlook on one aspect only, but let's see. So, in the fourth quarter, in the normalized of 101%, I understood from speaking to the IR team that there was these aggregate covers effect, as you mentioned as well, Christoph, the basic losses which were cat losses really. And of course, aggregate covers have been in demand recently from the primary side to manage volatility. So, should we be a bit more concerned about the possible effect of these random frequency aggregate type losses coming in and polluting the normalized combined ratio in future as well? So, I just wanted to get your sense of how much you're thinking about it.

And second question is for Torsten. Thanks for talking about this uncertainty of the ILS marketplace. But I was just wondering, your more positive outlook for April and July obviously is driven by them being nat cat affected. But, is there any assumption in your mind about the behavior of the ILS marketplace? In other words, if the ILS marketplace were to slow down a bit, then would you be more positive than you are now or would you be neutral about it compared to where you are now in your mind? Thank you very much.

And I'll give the outlook question out. It was more about the outlook for nat cat reserve releases, but I appreciate if you'd say to me that it's (00:36:21) rather than now. Thank you.

A - Christoph Jurecka {BIO 17223019 <GO>}

Thank you, Vinit. I'll start with the aggregate covers. We're talking about a small portfolio, very small portfolio and we are and continue to be cautious with that (00:36:37) reducing than increasing what we have here.

A - Torsten Jeworrek {BIO 5724439 <GO>}

I continue with the ILS question if that was okay. What will it mean for the remaining year was the question. My quick answer is, I don't know. So it's a bit speculation now but what we can imagine and where we see some early indication is the following, the ILS market played and still plays a big and all important role, first of all, region-wise in the United States, mainly on the East Coast and then in the retro market. The retro market was the most, in my opinion, is the most visible signal, if you want that here is some capacity of the ILS market (00:37:33) or changed. This didn't have an impact on the available capacity for the tradition - of the traditional players. Not yet. But it remains to be seen whether those players who depend more on retro will have to reconsider their capacity in the cat business during the new year or next year. That's the first question.

Second point is, from their perspective, the price loss in the wildfire event in Q4, there were some indications that ILS markets withdrew or changed capacity away from the aggregate covers which basically produced these losses more towards the traditional cat excess. So, that was one observation.

Third point is, when you look at the two remaining renewal dates for April, I would say, whatever the ILS markets will do will hardly have any positive or negative impact. (00:38:49) renewal is Japan and in Japan, they have never been played (00:38:53) in the past and I don't expect them to go or to be accepted in the Japanese markets in this year or in the coming years.

For the other renewal date, July 1, we have to open our eyes and pay attention because here the U.S. cat business is up for renewal and this is going to be more interesting whether or to what extent the alternative markets will only shift their capacity or whether they will also withdraw (00:39:24) capacity in total. So that is a bit open. But at least there is uncertainty in a lot of capacities bound (00:39:32) so keep your eyes open, I would say.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Thank you.

A - Christoph Jurecka {BIO 17223019 <GO>}

Thank you.

Operator

Thank you. We now move on to Kamran Hossain from RBC for our next question. Please go ahead.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi. Morning, everyone. Two questions for me. First one is coming back to reserve releases, I guess your guidance is naturally (00:39:54) to be 4%. They've been above 4% for the last seven years. I checked that number this morning. So my question is, why wouldn't you increase this number? I guess, is this the right time for a step up because I guess we have this continued debate about your normalized combined ratio (00:40:12) clearly has a dampening effect?

And the second question is just on, I guess, the geographical mix shift at the January renewals. It looks like you've taken a little bit more in North America, but prices were flat. Could you maybe kind of run through how North America increases netted off against European declines? Thank you.

A - Christoph Jurecka {BIO 17223019 <GO>}

I'll start with your question on the 4% up front loading into the reserves. I talked about the simplified approach we are taking before and part of this simplified approach is also that we use the 4% which is a headline figure easy to recognize for everybody. You will recognize that this figure clearly has to depend on portfolio mix of things which changed over the last 10 years, over the last seven years, which are changing from year-to-year. But as we're all used so much to the purpose and I think we stick in the past to the 4% and I think everybody is used so much to that assumption that there is no need really for changing it, although I agree, in the past with various years, where finally, the (00:41:26) turned out to be higher than the 4%.

A - Torsten Jeworrek {BIO 5724439 <GO>}

Yeah. Regarding renewal (00:41:36) portfolio mix your (00:41:39) expectation is right. Indication is for Europe, we saw small rate reductions in the – flat or small rates reduction, I would say in the casualty business to sort of flat or slightly improved rate in the property (00:42:05) business and in casualty and in property on the excess side, minor, that means minor means zero to minus-5% rate reductions.

So, Europe was among the worst markets, I would say, meaning, highest price pressure and not many positive opportunities. In the United States, it's a bit the opposite, I would say. Here, we had flat or positive developments on the proportional side, although benefiting from slight commission reductions and from rate reductions in the primary business and we had then, again a mixture of absolutely flat or only slightly improved renewals in the last three programs in property and up to 10% or in the order of 10% price increases on the loss-affected business.

Our only negative or major negative point in U.S. casualty is the non-proportional casualty business in the United States, because the reason is not a deterioration in the price per se, but the prices does not increase sufficiently to compensate for the underlying sharp inflation increase in some of the casualty lines of business. And that is the reason why we decided to take capacity out and you saw that in one of the reports that we had a bit of a negative view in the current market environment on non-proportional casualty United

States. Rest is unspectacular. Honestly, it's always a plus, around the plus-minus zeroes, I would say.

Q - Kamran Hossain {BIO 17666412 <GO>}

That's great. Thanks very much (00:43:56).

Operator

Thank you. Andrew Ritchie from Autonomous has our next question. Please go ahead.

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

Hi, there. Firstly on ERGO, in the commentary, Christoph, I think you're encouraging us to think of a higher ongoing run rate contribution from ERGO. I mean, sadly today we don't have a lot of detail to test that assumption. So, when I look at it, it looks like the P&C Germany is in line with your guidance. International is very strong possibly unsustainably so and Life and Health has benefited from positive non-recurring effects throughout the year. So, what really is the underlying run rate of ERGO in 2018? And what is the basis of you encouraging us to think that it is beating on an underlying basis? Thanks. That's first question.

Second question, a lot of your (00:44:57) around the world have been increasing their normalized cap budgets, particularly in the U.S. I mean, (00:45:04) on your normalized combined ratio? Do you think maybe it's the case that your cap budget, particularly nat cat budget needs to be revisited as you're seeing a number of peers do and as I said most of your clients doing? Thanks.

A - Christoph Jurecka {BIO 17223019 <GO>}

Andrew, let me start with the first one and I'll leave the second one then to Torsten. (00:45:30) felt you're right, I was pointing at a very good year 2018 also operationally. I didn't really point into the future if this already means that in the future we would expect higher contributions other than what we (00:45:48) what would be the plan of our strategy program anyway. Again, that would be a question on the outlook which we are happy to answer in March.

Looking at 2018 results, what makes me confident? Well, the difficult thing here is that we are talking about various one-off effects and they are not all in Life, Health Germany but they are relatively massively there, but also we've also others. And if we would do a quick calculation just writing the largest of them only onto a list and then some effect because they are offsetting each other and end up with some of what the overall one-off effect would be ERGO, I'll end up with a figure of, let's say roughly €40 million or so positive.

Which brings me to the conclusion that if I look at the full year result ERGO for 2018 and I deduct the €40 million, I would still be above the original guidance which was €250 million to €300 million and I would be – there would be still a gap between where we end up and then what the initial guidance was and the initial guidance was derived from our strategy program.

So, in essence, this means we do not really have to go into all the different one-off effects which we have picked, because it's rather clear if we take out all of them, we are still above the guidance. Why are we having still many one-offs? Maybe that's the last remark I'd like to make. As you know, ERGO is still in heavy restructuring mode and basically have two reasons for one-offs. One reason is that it's still are changing the way we run our business. So for example, we are selling companies internationally. We are restructuring the German Life business bringing books from one company to the others.

Many of the things we are doing have implications on the balance sheet and the P&L. That's where let's say one group of one-off effects is coming from. The other group is things which you would also find if you look at our competitors. Those are things related to guidance we get from tax authorities to one-offs given because regulators are changing the way they look at certain things, so regulatory-driven topics to put it in a very general way.

And the first class (00:48:14) quite some effect into our result, but also the second one and both together (00:48:23) €40 million and not more than that. I think the message is quite clear.

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

Yeah. Just to be clear, Christoph, you're not normalizing the international underwriting profitability which I think you described does in the beginning historically – historically low combined ratio, you're not normalizing for that in the €40 million.

A - Christoph Jurecka {BIO 17223019 <GO>}

Well, I don't have to. The €40 million is just one-offs. I don't normalize for the international result. But even if you say we have been exceptionally lucky in that, then there's still the gap between our results and the initial guidance is so large that you could still argue (00:49:00) operational outside of luck, ERGO was doing well in 2018.

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

Okay. Thanks.

A - Torsten Jeworrek {BIO 5724439 <GO>}

Okay. I continue with your question for the cat (00:49:13) budget. We looked into that. And to summarize it, I'm going to go into details. We don't see a reason to revisit it or to increase it. Absolutely not. Why not? First of all, when – it's not, I think, feasible anyway to look at one year or two years and then to make, let's say, clear or a good calculation on the expected value of all cat budget, over all the return periods and over all parts of the world. That's the first part, but we looked into that. And if you ask me in what direction would our cap budget develop over time and according to our model, the real experience is well captured in our 8%. That is a portion of the cat budget part of the 12%. So, mostly likely, no change.

If we had to change it, then probably more downward than upward. The only, let's say, small question mark is, on the cat budget side, the modeling of the wildfires, so not the modeling of hurricanes or so. That's the modeling of wildfires. And here, we saw some in the past that was Canada, that was United States, we had some further of these which were not mentioned in the past in Chile and South Africa and other parts of the world. So that is underway, but we'll of course compare it with hurricane or earthquake or Japan also not have this huge impact on the cat budget side.

And the other explanation is pretty simple. In absolute terms, over the last years, we increased our cat exposures in various parts of the world, also in the United States. So, you could argue, doesn't it have an impact on the cat budget, in general. In absolute terms, yes. But we grew the cat budget less compared with the significant growth from other businesses. So that means, in relative terms, the 12% refers to the total non-life premium. In relative terms, we will not end up with a higher figure, if at all, then more in the lower direction than in the upper direction. So, no reason to change that. 00:51:41**

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

I guess - sorry, just to follow up, isn't there a risk that you're picking up more mid-sized, particularly with some of these old lines (00:51:50) share where you're not necessarily picking up large cat exposure, but more mid-sized sort of cat private (00:51:58) exposure?

A - Torsten Jeworrek {BIO 5724439 <GO>}

Yes. And why not, I would say. We would be happy to pick them up if we find the right price in that business. So, cat budget or the contribution or the composition of cat budget is, of course, mainly driven by European winter months (00:52:19), very big scenarios. That is normal. But this does not mean that we don't price the mid-sized scenarios and the lower scenarios in the right way. So, it's a matter of price, not a matter of cat budgets in my opinion.

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

Okay. Great. Thank you very much.

Operator

Thank you. We now move on to Sami Taipalus from Goldman Sachs for our next question. Please go ahead.

Q - Sami Taipalus {BIO 17452234 <GO>}

Yeah. Hi. Thanks for taking my question. The first one is from the life and health reinsurance business actually. You had always a very strong technical result there for 2018, but there seems to be a couple of sort of always (00:53:01) going on there, some favorable experience, I think mainly in the U.S., but also some headwinds in Australia. Could you just give a bit more detail there, where you feel the run rate is and how it compares to your target of €475 million? And then my second question is on the pricing disclosure. Is it possible to just give the pricing change year-on-year, including the impact of interest rates? Thank you.

A - Christoph Jurecka {BIO 17223019 <GO>}

You're right. We exceeded the €475 million quite significantly in life and health reinsurance this year. Supported by claims development as well as also profitable new business in life but also very much in health.

To give you some flavor, Australia, disability has been difficult, not for the first year this time. So it's still disability in Australia, also there's upcoming legislation which potentially makes the business more difficult for us in Australia with complex, so-called super-annuitization, where it's getting more difficult for us going forward with our in force (00:54:21).

So that's Australia, and U.S., we had a positive development on mortality. And so that's something where I would be reluctant, to say, that's a long-term trend. It's more, if you know the opposite that mortality improvements have been quite under pressure in the U.S. So, therefore, this is more kind of a good claims development and – but that still needs to be seen if our portfolio deviate substantially from what we see for the overall population in the U.S. right now. Yeah, that's it, more or less.

Q - Sami Taipalus {BIO 17452234 <GO>}

But it sounds like on aggregate when you when you toss it all up, you're pretty much running where you expected to be. Is that fair?

A - Christoph Jurecka {BIO 17223019 <GO>}

Maybe a little bit higher but I wouldn't be too pushy right now.

Q - Sami Taipalus {BIO 17452234 <GO>}

Okay. Okay. Great.

A - Torsten Jeworrek {BIO 5724439 <GO>}

And our pricing this rate change or pricing disclosure, you are right. I mean, we are unchanged in a way that we do not include interest rate development. In that sense, our disclosure is not an economic – it's not a disclosure of the economic terms in total. We, from time to time, gave an indication what the impact on the interest rates and the expected income from the asset side is. And you can have this figure that is close to 0.5 a percentage point of the premium, which we renewed in the January renewal. So give this an additional information if you wanted.

However, even the interest rate or the expected change of the investment income from this renewed portfolio, is not an economic figure, even if you include that to our asset. Why not? Because, first of all, it does not include the consumption of risk capital and therefore, the impact from the pricing models. And usually, you would say, I consume risk capital for the risk I take on board in my portfolio. And the economic feedback would be, what is the change, so to speak, on a risk capital or called ROIC (00:56:55) basis or so. And that is very different and they're not comparable anymore between the companies.

Second, we don't include our cost, our own costs which are part of, let's say, combined ratio expectation which we were able to generate or to publish after the end of the year. And therefore, we decided only to give the figure which makes basically the old portfolio with the new portfolio somewhat comparable. And we have no plans to change that, but we are happy to give additional information on top if you want. The figures between the competitors and companies are not comparable anyway, because everybody uses a different standard here. Thank you.

Q - Sami Taipalus {BIO 17452234 <GO>}

Okay, thank you.

Operator

Thank you. Next question comes from Ivan Bokhmat from Barclays. Please go ahead.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Hi. Good morning. I've got two questions. The first one is on the investment side. You've mentioned that the reinvestment yield has dipped to 2.1%, which was temporary due to some de-risking. Perhaps you could share at what level you expect to be reinvesting in first quarter. Is it close to the 2.5% you disclosed in the past?

And secondly perhaps a clarification question. You didn't mention that the reserve release from major claims did include some 2017 events. Could you quantify that and perhaps give a little bit more color on how the overall claims for Harvey, Irma, and Maria developed? Thank you.

A - Christoph Jurecka {BIO 17223019 <GO>}

Okay. I start with the claims. There we as usually would not go into that level of detail when talking about our releases, so I'm sorry but I can't give you any more detail. On the investment side, it's still early for Q1. So, I mean, your question is heading at that where are we going to reinvest in Q1. And interest rate environment is still not without challenges. And right now, we are still looking for opportunities to invest and also are looking timing-wise, to find the right point when to go into longer investments again, also given the still volatile environment.

Our current assumption would be that we might be able to achieve maybe 20 basis points higher in Q1, but it's extremely early to tell where we are at the beginning of February. So, the outcome might be completely different from what I'm saying right now.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Perhaps a little follow-up on this one. In the previous call, Jörg mentioned that you don't expect any further headwind on the regular income and that was 2.8% yield for 2018. Could you just confirm that statement?

A - Christoph Jurecka {BIO 17223019 <GO>}

I think what is important to note is, is that the volume we have to reinvest quarter by quarter is rather limited compared to the block of investments we're having. And therefore, it will be premature in any way to judge from one quarter or two quarters reinvestments, how the overall block would develop. In that sense and as Jörg's statement has been only three months ago, of course, we can easily confirm that because the reinvestments quarter by quarter anyway doesn't make that much of a difference.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Okay. Thank you very much.

Operator

Thank you. Frank Kopfinger from Deutsche Bank has our next question. Please go ahead.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Yes. Good morning, everybody. I have two questions. So, my first question is on the price development on the zero percent. And also taking into account that your major losses and if I adjust also for this prior year developments, then your major losses had been 16.2% for 2018 which is clearly above your budget, be it on the nat cat side but also on the man-made side.

And against this background, how satisfied can you really be on your price development at this stage and the question is how satisfied are you and whether it's really enough to argue with a slightly higher interest rate level?

And then secondly, on your solvency ratio, you touched earlier but I would be interested in whether you can provide some moving parts how to come from your, I think, your last point was above 260% to the 250%, taking into account what was driven by market movements, your bond issue obviously but also on the reserve release, whether you can shed some light here?

A - Christoph Jurecka {BIO 17223019 <GO>}

Okay. I'll start with the Solvency II question. You're referring - year-on-year, we have some increased Solvency II ratio,. I think it was 244% a year ago, we're now at 250%. This includes already capital management measures, as you know. And so, part of the drive of the increase is also supporting this loan we were issuing in - I think, it was November. The operating impact is positive all preliminary figures I must admit. It's positive and we have then, also from an economic impact year-on-year, a rather stable development.

If you compare it, compare to last quarter, then of course we also see now our economic solvency ratio, the reduction of capital markets which came with some reduction since Q3. What we also have is of course that we included the capital management measures again in our figures. So, the €251 million includes the increased dividend now and also as Solvency II is wanting us to do it, also includes continuation of the share buyback of the same order of magnitude like what we did last year according to what Solvency II is asking us to do, independently of the fact that of course no decision has been taken at this stage, and as usually, we will only talk and decide about share buybacks in March.

A - Torsten Jeworrek {BIO 5724439 <GO>}

Kopfinger, back to your question how satisfied are you was surprising. And if I understood the question correctly, you compared a bit, let's say, the kind of contribution of the various factors of our last year result, taking into consideration the higher contribution from reserve releases and the loss activity above the 12% cat losses from the new losses against our statement. It is what is a satisfactory renewal at the end of the day.

Maybe two statements. One is the renewal for our portfolio was satisfactory under the circumstances and environment of the current market. So that means, of course, we would all like to have better market environment, but we maneuver in this market environment quite well, meaning that we have the right ambition to identify and develop structure, new business, not only business in these renewals, but also non-tricky business or tailor-made business which write in between. That is positive, because we have good appetite and don't make mistakes, at least not to my knowledge here.

And the second is, as I mentioned, for the standard business, we stay disciplined and don't take very aggressively priced business on board which would not be justifiable. So that is more general statement.

Regarding, let's say, earnings composition of last year and which factor drove the result, my answer would be the following. Don't take too many single observations or so out from the result and draw conclusions for the new result. If you normalize, or let's say, question certain positive contributions like the releases from last year's cat losses to HIM losses for instance, then also take into account that, as Christoph mentioned, we always build new conservatism into the new loss reserves, build on the basic loss side, build on the cat and large loss side. And that is something which we, of course, can't and do not want to quantify. And therefore, you don't see that. That is one thing.

And the other thing is, the unusual fluctuations from large and cat losses like last year also and the year before, of course, don't mean anything about the long-term profitability of that business. That can only be derived from the really expert models and they are no prominent reconsideration, verification or so. So, all in all, I would say the price and the profitability of the portfolio is good. The market environment is challenging and for that reason, again, we can and I am very optimistic that we are on the right path to deliver and contribute a decent and good performance for the coming years. Thank you.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Okay. Thanks.

Operator

Thank you. Michael Haid from Commerzbank has our next question. Please go ahead.

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

Thank you very much. Good morning. Just two questions. First question also on pricing, one of your competitors mentioned that they feel that global warming is not sufficiently reflected in the current pricing and in the current risk models. And when I look at your normalized combined ratio of 100% and if I take out the primary insurance out of reinsurance, then the normalized combined ratio is probably significantly higher than 100%. Why don't you push for higher price increases in nat cat related business? I mean, you are one of the market leaders, you can do that.

Second question on equity investments. You reduced your equity exposure in the fourth quarter, what is the rationale behind this? Is it more tactical? Is it strategic? Is it more lasting or do you plan to come back?

A - Torsten Jeworrek {BIO 5724439 <GO>}

Michael, let me start with the first one. Is global warming reflected in the pricing? Yes or no? It depends I would say. It depends what you expect from global warming and which kind of regional implication or changes you anticipate or will anticipate in the future. So the answer is not so clear, in my opinion. We have, let's say, one consideration which is the time horizon. And the time horizon of course will mean for many regions that we will see changes in the risk and the exposures driven by climate change. And of course, here the models have to be permanently be updated over time to take account and to reflect this kind of changes.

What is, in my opinion, not possible and not wise would be to make, let's say, rough speculations and price changes in the models for expected global warming, which we think will come in 20 years from now. Global warming is a gradual effect. It's big and bad for the society because if you don't act against it, you can't change it anymore. But on the insurance and reinsurance side, we have to, let's say, make the gradual and very regional changes to take into account the local impact of that. So in that regard, my answer is mixed, I would say.

One of the global warming impacts where we believe we see changes are the wildfires. And here, as I mentioned before, we do update our models but it would not be right, I think, to change the model for wildfire losses in the United States or North America then in European windstorm or somewhere else so that is not possible.

Why don't we push for higher prices? Because we are on a global competition and reinsurance is a syndicated business, as we all know. And we play a role, but we try to achieve what is possible to be achieved and market price at the end are result of demand and supply like in any other industry, and that is what reflected in the prices today.

A - Christoph Jurecka {BIO 17223019 <GO>}

Michael, equity investments, you're right, we reduced our equity investments somewhat about 1 percentage point, 1.5 percentage points. I wouldn't say that's a strategic move given the fact that we are still around – including our hedges still around 5% and came from somewhere around 6%. So, that has not been a strategic move. It's all about risk management or risk mitigation and the reduction of volatility in Q4. So, I would not rule out also that this quarter would also slightly go up again, but that's all still up for discussion.

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

What triggered this reduction in equity investments then? You say it's risk management, but what exactly?

A - Christoph Jurecka {BIO 17223019 <GO>}

I mean, as you know, we have a fair mix of how we can cope with falling markets. We have a quite substantial derivative portfolio, which automatically kicks in once equity markets go down. On top of that, we, of course, also discuss when markets go down if you are still happy with our exposure or if you need to somewhat reduce the exposure. And that's what's happened in the course of Q4.

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

Okay. Thank you very much. Perfect.

Operator

Thank you. We now move on to questions from Vikram Gandhi from Societe Generale. Please go ahead.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Hello. Hi. Hi there. I got just one question. Can you give us a sense on where your excess or the redundant losses (01:12:44) those figure would be for P&C re at the end of last year? I think the last time we disclosed this figure was at the Solvency II briefing back in November 2015 which was about €2 billion post tax. So any update there will be useful. Thank you.

A - Christoph Jurecka {BIO 17223019 <GO>}

That's a figure we do not regularly really – neither analyze nor disclose. So the basic assumption only can be stable because we said our overall reserving level is stable. But that was rather an exceptional exercise what we treated in the introduction of Solvency II. So, no news I would say with respect to that question.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Okay. So if I can just come back, when you say it's stable, we should be thinking in percentage terms, right? Not in absolute terms because the volume has been growing since then?

A - Christoph Jurecka {BIO 17223019 <GO>}

Well, I mean that could be a long debate because volume is growing, the mix is changing over the year. Overall stable means in a more, let's say - more actual sense that the level of prudence is unchanged that that's how we would state that. So that's probably somewhere in between absolute terms and relative terms. I am sorry to only be able to put it that way. But it's really the level of prudence we have in our reserves is stable. That's I think the correctest way to actually make that statement.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Okay. Okay. Thank you.

Operator

Thank you. We take our next question from Thomas Fossard from HSBC. Please go ahead. Had an interruption (01:14:39) the participant has just removed himself from the queue. And at the moment, we have no further questions queuing.

A - Torsten Jeworrek {BIO 5724439 <GO>}

Okay. Thank you. Then I may step in and just say thank you for joining us. Further questions, please don't hesitate to come back to us and we are looking forward to meet you all again on March 20 for our next analyst call. Thank you very much. Bye-bye.

Operator

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