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Bloomberg Transcript

Q3 2019 Earnings Call

Company Participants

- Christian Becker-Hussong, Investor Relations
- Christoph Jurecka, Chief Financial Officer
- Unidentified Speaker

Other Participants

- Analyst
- Farooq Hanif, Analyst
- James Shuck, Analyst
- Jonny Urwin, Analyst
- Kamran Hossain, Analyst
- Michael Haid, Analyst
- Sami Taipalus, Analyst
- Unidentified Participant
- Vinit Malhotra, Analyst

Presentation

Operator

Good day and welcome to today's conference call, The Munich Re Quarterly Statement Q3 for 2019. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr. Christian Becker-Hussong, Head of Investor Relations. Please go ahead, sir.

Christian Becker-Hussong {BIO 19080254 <GO>}

Thank you, Holly. Good morning to everyone. Thanks for joining us on our call on our Q3 2019 earnings and we really appreciate your time given so many of our peers in the European Insurance industry are reporting today. So in the interest of time, I'm happy to immediately pass it on to our CFO, Christoph Jurecka for his opening remarks. Please Christoph.

Christoph Jurecka {BIO 17223019 <GO>}

Thank you very much, Christian. As usual, I'd like to give some personal remarks before, we then go into the Q&A. Given an otherwise strong quarter after nine months Muenchener has already met its original net earnings targets for the full year. This is based on a very sound operating performance across all business segments. And I saw some preliminary remarks this morning on the quality of our operating results today and I'd love to use the opportunity of this call to convince you that it's indeed a very high quality operating performance we are showing in Q3. On top of the operating result, we also saw a strong investment result, high currency gains and a low tax ratio, which then compensated for the high nat cat and manmade losses, which we also saw, and they were clearly significantly above average.

So finally, in line with our pre-release a few weeks ago, the net result amounted to EUR865 million. As usual, I will start with the investment result. The ROI amounts to high 3.4% for the quarter and 3.2% for the first nine months. Thus, supporting our guidance of approximately 3% for the full year. Adjusted for the seasonal dividend effect in Q2, the regular income remained stable at 2.7%, despite the decline of interest rates.

The reinvestment yield was again 2.1%, also unchanged -- almost unchanged compared to the first half of the year and this was supported by new investments in longer duration sovereign bonds in the US and other non-Euro currencies, as well as some corporate bonds and also again infrastructure investments.

The extraordinary investment result was driven by disposal gains and they were to some extent even unavoidable, given the low interest rates, but also the good equity market performance we saw in the first nine months of this year. The gains on the fixed income instruments mainly resulted from ALM optimization measures in our North American entities, and the gains on equities more than offset the write-downs we had on equities and also the losses we had on equity hedging derivatives, which we usually apply in order to hedge the downside coming out of the equity -- exposure.

Fixed income derivatives and as you know they are partially related to the interest rate hedging program for ERGO's Life back book. They went up significantly and they reflected the weight decline. The weight decline also led to a strong increase in unrealized gains, which then translated into high total return of 12% for the quarter and also for year-to-date, but clearly the low yield environment is currently the main challenge for the industry overall and I can assure you that given how closely we're matched in ALM asset liability position and then given our active portfolio management that we expect the short and mid-term impact on our financials to be manageable. Coming to the currency result. This is of course closely linked to the investment result and this amounted to an exceptionally high level of 228 million in Q3. Interpreting this figures, we have to be careful. This is before policyholder participation and before tax of course.

So the 228 million are not to be interpreted at face value. The reason for the good currency result was mainly US dollar. But on top of that due to ongoing geographic diversification in the investment portfolio, we were able to generate gains in some emerging market currencies as well.

Now I'd like to turn to reinsurance. In Q3, the underlying earnings quality was particularly pleasing in both segments. In Life and Health, we posted a very strong technical result. And in P&C, we observed an improvement of the normalized combined ratio over the previous quarters and to our target level we have for this year. I would also like to mention that we are seeing a substantial premium increase as our growth initiatives are gaining traction. Let's go into the details and here I would like to start with life and health reinsurance. After the disappointing second-quarter, we saw Q3 was an exceptionally strong one in terms of the technical result plus fee income, which was 218 million supported by the restructuring of some treaties. The aggregate pure metric experience has been favorable, particularly in Europe and the United States.

On top of that we also noted an improvement of the claims experience in Australia compared to the first half of the year. But there we once more had to moderately adjust reserves because of a further decline of the interest rates in Australia. So even -- given the less negative result there, the business remains highly uncertain also for the outlook of the entire Life and Health segment for the remainder of the year. And we talked about it very last time -- this will largely then depend on the outcome of the annual reserve review upcoming in Q4.

So finally, despite the high Q3 result, we continue to see the substantial risk that we will fall short of the guidance for the technical result plus fee income, which -- which is EUR500 million as you know. P&C reinsurance -- in P&C, the Q3 combined ratio was 104.7% , reflecting a very high nat cat and man-made loss of 18.4 percentage points in the combined ratio. However, if you look at the normalized combined ratio, we recorded a positive trend and achieved the level of 98.2%, which is as I said, in line with our indication for 2019. We still consider a level much closer to the 98% than where we are year-to-date to be a realistic ambition for the full year.

Now primary insurance, ERGO. ERGO has so far ticked all the boxes for the year 2019 and maintains its stable and pleasing financial development also in the third quarter. If I look at the ERGO year-to-date result of EUR339 million and if I take into account that there are included negative one-off due to the sale of international entities in the portfolio restructuring of 150, so if I add the EUR50 to the EUR339, we would already be very close to the EUR400, which is the target of ERGO for this year.

So having that in mind you could even argue that also ERGO achieved its annual target, its full-year target already in the third quarter, which is another signal, I think, for the very sound operating performance. In Q3, the net result of the German Life & Health business fell short of the very high levels we achieved in the first two quarter and this is to some usual quarterly earnings volatility we see in that segment from various effects, and there are technical and accounting effects, (inaudible) here. And on top of that, of course, also the timing of the realization of unrealized gains to finance the (inaudible).

In P&C Germany, the combined ratio in Q3 amounted to a very good level of 92 -- 92.1%. Our Germany overall continues to make significant (inaudible) with respect to the distribution setup and the product range, all of course in the context of the ESP, the ERGO strategy program. We are all the more optimistic of meeting the 93% combined ratio target by the end of this year.

International, the ongoing favorable development there with a combined ratio of 91.8% is a clear testimony to the successful execution of the already mentioned portfolio streamlining, which clearly aims in strengthening the presence in our core markets and seize opportunities in some dedicated growth areas, as you know. Going forward this should of course further reduce the volatility of the segment's financial performance, which in Q3, of course also again benefited from seasonality effects and Health business, where we know that from other Q3 events as well.

The Group's capitalization remains very sound. The Solvency II ratio amounted to around 230%. As we see the negative impact of the significant interest rate decline in Q3 and this was partially offset again by the strong operating economic earnings. For the full year we now expect the economic earnings to significantly exceed the initial target which was over 2 or above EUR2.5 billion and we expect the economic earnings also to be substantially higher than the increase of the Solvency II capital requirement. So higher than the increase of the SCR. Let's finally focus on the outlook. Based on the experience so far, Q4 could become another nat cat heavy quarter.

The usual uncertainties about developments in major losses and capital markets are therefore even more pronounced this time around. Regarding the outlook for the remainder of the year, and of course as we nearly have achieved our net income target already by Q3, we now expect to beat the 2.5 billion target for 2019 and of course, we are very pleased by the development. Apart from some minor adjustments the expectations for most other key financial metrics have not changed compared to the 2018 Annual Report and also to the half-year result.

With that of course I'm looking very much forward to answering your questions and hand it back to Christian.

Christian Becker-Hussong {BIO 19080254 <GO>}

Thank you, Christoph we can now go right into Q&A. And may I please ask you as always to limit the number of your questions to a maximum of two per person otherwise please go back to the queue. So may I please ask Holly to start announcing the first question.

Questions And Answers

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

Certainly. (Operator Instructions) We'll take our first question today from Kamran Hossain of RBC. Please go ahead. Your line is open.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi, good morning. Two questions for me. The first one is just thinking about the combined ratio, and thinking about how this might develop going into next year. I know in the past you've talked about 97% being a reasonable level for 2020. Clearly there has been a little bit of improvement as the year has gone on to the normalized number. Given that they -- I guess the opportunity to see some funds we do expect that should we guess 97% where kind of growth as you had expected or 98% or a little bit higher than that with a little bit more volume growth than you'd originally anticipated. So that's the first question and the second question, given the way that the earnings had been made up year-to-date, could you maybe just update on German GAAP earnings and kind of how that developing during the year. Thank you.

A - Christoph Jurecka {BIO 17223019 <GO>}

Yes, of course, the combined ratio guidance for next year. First of all I have to apologize. You know that we are not talking about the guidance that early usually but the option space you have to mention -- mentioning is very much the option space we are also seeing. We will be giving further details on that in beginning of next year. And of course it will also depend on how the Q4 is now going to involve -- to evolve. We always said that the combined ratio in itself is not a target, but it's something we look at in order to achieve the net income target of EUR2.8 billion. And the optimization amount between volume on the one hand side and combined ratio on the other hand, is something we are carefully looking at when defining how to finally get to the EUR2.8.

German GAAP, so far nothing really spectacular. So German GAAP, I'm pretty much -- what we would have expected looking at the IFRS figure. Generally you know that there is a requirement to fill up the equalization reserve and this is something of course which reduces German GAAP compared to where we are in IFRS. So the usual expectation is long as we are filling up that with -- would be to be somewhat below that. But as far as we see it so far this year absolutely in line with what we would have expected anyway.

Q - Kamran Hossain {BIO 17666412 <GO>}

Great, thanks very much.

Operator

Thank you. Our next question today comes from Sami Taipalus of Goldman Sachs. Please go ahead.

Q - Sami Taipalus {BIO 17452234 <GO>}

Yeah, hi, good morning, everyone. My first question is on solvency. And -- I guess the solvency ratio still remains quite high by industry standards, but it's the lowest it's been I think since Solvency II was introduced. What's your tolerance for where you're happy for this ratio to move and what options would you look at -- to sort of counteract that. I mean, I guess I know that your use of hybrid debt capacity or hybrid debt capital is quite low at the moment. And but I guess on the other hand, would you be willing to issue hybrid effective date to fund the buyback. That's my first question.

Second on US. Just on US casualty and it'd be interesting to hear your thoughts on US casualty loss trends and whether you have adjusted your reserving at all to sort of reflect on the (inaudible). Thank you.

A - Christoph Jurecka {BIO 17223019 <GO>}

Got it. Thank you for the questions, Sami. On solvency, I mean you all saw that it came down somewhat. And that's probably where the question is coming from but on the other hand, the solvency ratio is still clearly above our so-called optimal range. So, therefore, this solvency ratio is not at all of any concern to us and will not affect our capital management strategy going forward. It's very much interest-rate driven anyway. You know that interest rates went up again since end of September. So a certain volatility is something we anyway would have to expect in this figure. And so you see me completely relaxed, when I look at our solvency figure -- even more and that's something I was mentioning in my introductory remark that the Solvency II capital generation is still very positive given the fact that we are expecting to exceed our initial economic earnings targets substantially and then will have economic earnings by far higher than the SCR increase. So in absolute terms, capital generation completely in line with our initial planning or even above.

Q - Sami Taipalus {BIO 17452234 <GO>}

But would you be happy to operate sort of around the [ph]220 or even below [ph]220 temporarily?

A - Christoph Jurecka {BIO 17223019 <GO>}

I mean, did you know that our optimal range starts below 220. We were just, we start to be in the optimal range. And I mean optimal clearly signals that we don't feel uncomfortable, doesn't it. Oh yes. The casualty topic -- we could probably talk about casualty (inaudible). I'll try to cut a long story a little bit short. The -- we are also seeing some elevated reporting on claims in the US casualty area, but to make that very clear it's not at all a surprise for us. It's something which we -- which is more like the continuation of development we have been in for some time now.

If I may remind you in 2017 already we took decisive action on our primary book in the US, by changing the strategy, but also by strengthening reserve somewhat. In '18, we took action on our reinsurance book where we saw elevated loss (inaudible) loss reporting in '18 already that was something which was not at all visible overall. Because still the positive experience was by far exceeding the bits and pieces in small books and pockets where we had to take action, but we did do so already in '18 and also in the year '19 in line with our usual reserving strategy, which is of course to react immediately wherever we see some kind of more negative indications than expected that we react immediately. In that sense, we did react throughout all the quarters in this year already. And again, nothing visible overall because we're talking about a limited part of our book overall and the positive indications we're getting from other US casualty books and is still exceeding the negative experience in some of them.

So I'll leave it with that for now with casualty. I hope it's clear enough.

Q - Sami Taipalus {BIO 17452234 <GO>}

Great, thank you.

Operator

Thank you. Our next question comes from Vinit Malhotra of Mediobanca. Please go ahead.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes, good morning. Thank you for the opportunity. Two questions please. First one is so just on the normalized combined ratio. It must be a pleasing number, the 98. I mean we have to go back several quarters maybe two or three years to get a number with the 8, the 98. And this was in a quarter, which was quite well talked about for lots of attritional, lots of man-made. Could you just comment on how we got here in this quarter, do you think it's because this time the man-made experience was just on the other end of the large loss definition. So you could quantify it as large loss? Or is it the Risk Solutions which help out more than usual.

And the reason also I'm asking is because when you're confirming the 98 -- you're at 99 today for nine months. So it really need say 93, 94 level to get to 98 range for the full year. So that's the first question please. Second is just on the very large FX and thanks for your clarification that it's not just US dollar, but also emerging markets, and it's also pre-policyholder. But yeah, I mean --- is there some risk management questions being also asked about how to -- whether you should be taking such a open currency position. I mean just from the outside, for example, the US dollar last moved by this kind of magnitude in 2Q18, and 2Q18 was a small EUR40 million FX gain. And this time you had the similar move, got EUR228 million. And even I appreciate the ERGO. I mean the ERGO Life is probably EUR70 million or EUR80 million, EUR90 million in this 228. So there is also other parts. So just want to understand how you view the risks that come on the FX open. Also on the (inaudible) positioning and on the asset side, but mainly on the risk your view from the FX side. Thank you.

A - Christoph Jurecka {BIO 17223019 <GO>}

Yeah. Well, thank you for the questions. In normalized combined ratio, I think it's mainly really the operating improvement we are seeing. So we have been talking about the measures we are implementing in some of our businesses with solutions; you mentioned that also. For quite some quarters we under (inaudible) increase in tariff levels, things like that. And we always said it will take some time until this really earns through the portfolios. Now we're one quarter more ahead, so we see positive effect from that.

On top of that, it was not a particularly bad nat cat, so a small nat cat quarter which also held, and then of course growth and the last couple of renewals we saw in the channel reinsurance business also supported the development. And this is why I'm -- was kind of optimistic when given my introductory remarks also for the remainder of the year, because many of these trends are not one-offs, but they are just continuing. And if then on top of that, you would assume normal -- the normal kind of seasonality, which we have in Q4 that some nat cat activity is reduced. We still think there's a chance that we will get much lower -- much closer to the 98 even if that would mean that for single quarter we would need maybe not 94, but maybe 96 or 97 and then we would be already much closer to the initial target of 98.

And then of course what we take from that is also some positive momentum for next year of course. But again that's something we'll talk about more beginning of next year then.

FX, that's a very interesting question and indeed if you're seeing in '18 movement, dollar movement of (inaudible) happened last time the effect was smaller and there are a couple of reasons for that. First of all, I'd start with ERGO, what ERGO has is they use foreign currency investments to increase the running yield, and as the liabilities, mainly your liabilities, they have to somehow hedge the liabilities, also hedge the FX exposure and not to have this FX mismatch. So what they did is they -- to certain extent increase the dollar exposure. But what they did on top of this, they changed the hedging strategy. In the past, what they did is more or less they did hedge the spot FX price.

And now they have a zero cost color around the FX. So which means around that midpoint of the FX rate, they can benefit from the movement but of course it could also go against them. Now, the good thing which happened here is that once they change the strategy, the US dollar started appreciating. So timing wise that was just by coincidence probably very well done. But given the risk capacity also the ERGO life and Health carriers have, we feel -- we feel much better -- in a much better place such a zero cost color hedging strategy because also the expected values of course do have a much cheaper hedging strategy by doing that. And as you can see the ERGO Life and Health FX. This 94 out of the 228. This is kind of a substantial portion of the overall development already. And then again this is shared with policyholder and after tax, -- also those on net impact is much smaller anyway. So this is the ERGO part. On the reinsurance side, the difficulty we have when we talk about hedging, our FX exposure is that there is not a single number for our exposure. It's very difficult to quantify it. Actually, because there are so many accounting standards around which are not all the same, but not even similar some time.

So if you ask me, if you could take out FX exposure even more, I would ask you according to which standard -- to Solvency II, to IFRS, to local GAAP, to maybe some local GAAPs we have in some companies outside of Germany, because not all of the exposures of course and MRG [ph] exposure. And -- sometimes the huge deviations in the FX exposure, we have depending on how you value the liabilities, the US dollar liabilities to give you an example, and the valuation differences are quite substantial.

So what we have to do is we have to take the position, a position somewhat in between all these accounting standards, meaning we cannot completely hedge one of them and then having the others with extremely large open exposures, but we have to somehow optimize it to find the optimal point between all of these restrictions according to all these different metrics and this gives us traditional (inaudible) -- traditionally in the long US dollar position for IFRS, in reinsurance and that's why we benefited that much from the US dollar increase this time.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Many thanks, very elaborate explanation. Thank you.

Operator

Thank you. Our next question comes from Farooq Hanif of Credit Suisse. Please go ahead.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi, there. Thank you very much. Just wanted to ask about the German ERGO German Life policy participation issue. I'm wondering whether with the recovery in bond yields in Q4. This could actually reverse and that you will find yourself in a position where you can make the end of your commitment lower than you thought in Q3. And then the second question is you talked, I mean you mentioned that you're going to come back on the growth versus margin question at the end of the year, but qualitatively do you think in the environment that you're seeing now, there is -- there are areas where you can grow with very good margins. Thank you. Sorry -- referring to P&C rate. Thank you.

A - Christoph Jurecka {BIO 17223019 <GO>}

Yeah. Well, thank you for the question, gives me the great opportunity to talk a little bit about ERGO Life and Health. Because what I saw, is that already -- the operating earnings level, there's quite a difference between the consensus and the figures we have been releasing today.

The first effect, I have to mention is the already mentioned FX effect due to the US dollar exposure also within ERGO. This FX result is shown in our P&L structure below the operating earnings, but at the full face value. So the deduction of the shareholder share on that part of our earnings takes not place where it should take place in the FX result itself, but higher up in the operating result already, higher up in the P&L. And if you look at 94 million FX result ERGO Life Health and on average 90% -- 85% is policyholder participation on that. This already explains the first 80 or so million of difference between the consensus and the actual operating earnings we have been showing for that segment.

The second topic is policyholder participation -- we have been mentioning that. Last year in Q3, we had a big one-off of changing in the policyholder participation for our Life business as the assumptions. This really has been a one-off, so this is nothing we can expect to happen again soon. There are always smaller changes to policyholder participation assumptions given that the results also wavering a little bit from quarter to quarter. These are very small comparatively small effects. So I would not overestimate any potential impact from that for Q4. But what happened on top of what I mentioned already in Q3 is that we just had the usual quarterly volatility hitting us a little bit here. Q1 and Q2 have been rather exceptionally high.

And now the Q3 is a little bit lower than average expectation, but this should not be over interpreted in the context of what we expect for the full year. What are the reasons why Q1 and Q2 have been higher and Q3 now lower. First of all, the quarterly result development depends a lot on when you realize gains to finance the (inaudible). That's a big driver of the quarter distribution. Secondly, in the second quarter, we changed the policyholder assumptions for the Health business -- a one-off in Q2. And now in the third quarter, we had some rather technical accounting topics, which came in as a negative one-off in Q3 which burdened the result a little bit on top of not having the positive aspects again, which we saw in the first quarter. What are these? These are really kind of technical accounting (inaudible) technically. We have some consolidation cost allocation effects, things like that. On top of that, we had a merger between two of our German companies. And the merger came also with some P&L effect, a small negative EUR10 million to EUR15 million effect negatively in the quarter. And then the variety of other topics, which overall added up to a somewhat negative deviation compared to what an average contribution of a quarter would have been.

Now, finally, what would be our assumption for an average contribution? Where would it be? Well, the average somewhere between what we saw in Q1 and Q2 or what we did see now in Q3. I hope that clarifies a little bit what we have been seeing in ERGO Life and Health. But that's pretty much -- that's the picture, we see. Operationally as all these things I've been talking about is things which are easily accessible. So we could realize (inaudible) or not, or you have an accounting implication of a merger or you don't have it. So these are all things overlying the operational development. The operational development in our view is just stable and continues to be as expected. So favorable.

Sorry, the growth question. Yeah, you know the part of our strategy is anyway to have selective growth in areas where we think or where we see attractive margins and attractive market conditions. And there are some and more specifically, following the last when you will, where we already did see some positive momentum, we continue that -- to see that momentum not across the board, not everywhere, but in certain regions and certain lines of business. For example, driven by large loss experience on underperformance in the primary business, where we are looking at, for example. So, yes, there are areas -- and we would look into -- in this overall more positive momentum, we generally are seeing just not everywhere.

Q - Analyst

Okay, thank you very much.

Operator

Thank you. Our next question comes from Jonny Urwin of UBS. Please go ahead, your line is open.

Q - Jonny Urwin {BIO 17445508 <GO>}

Hi, there. Thanks. Thanks very much, thanks for taking my questions. So, just one on the normalized. I want to casualties, so normalized 98% very, very good. So I can't ask the usual question around why are you behind guidance. So I've got another one for you. Going into next year, I mean what's the risk -- the recent elevated losses -- it kind of means that any attritional loss ratio improvement that we see could just be funding a higher nat cat in man-made budget. So is, can you comment on that, just more philosophically. Thank you and then just on casualty, what is the kind of notification pattern to a reinsurer on like -- casualty claims trends. I mean for you guys to sit to see it, would it mean that you'd need to see actual paid loss deterioration from the primaries, which I don't think we're seeing at the moment. So, any color would be great on that? Thanks.

A - Unidentified Speaker

I'll start with the second one. If you could only rely on the paid information by the primary insurers that would be very late. So clearly that's not what we are looking at, but we are looking at reported losses, already in the primary level. But on top of that we of course also have the advantage that we have a primary presence in the US as well. And so we have some direct access to the market on top of what we are getting from our clients, which also helps us to understand the development much better -- much closer than if we were only relying on the information we get from our clients.

So it's a mixed picture, but of course, what we try to be as close as possible to all the developments which are ongoing in order to be really a front-runner in reacting, when necessary. And as I've been mentioning before we already started in the '17 on our primary books to (inaudible) react. At a point in time when the -- let's say, the public communication about the issues has been much less than today. The normalized combined ratio and I think your question was, if you would use it to go for more cat-related business. That's generally a question of risk budgeting and strategic planning.

We are not that far into the planning so far this year. So that's something again -- it's much easier to talk about it in beginning of next year. Given the fact that also internally we have not completely made up our mind yet again in the context of growth versus profitability. And then of course when you talk about growth, it's not just growth, but also of course the discussion where to grow and if cut is a part of that growth or not is something we will -- will look deeply into and then make up our mind and be able to talk about it beginning of next year.

Q - Jonny Urwin {BIO 17445508 <GO>}

Thanks, that's not quite what I mean. So, I mean, just given cash and man-made, is a bit elevated again in Q3. It has been elevated for last couple of years. Do you think there is a risk that any attritional loss ratio improvement that we see from current price improvement is kind of offset by higher cat loss?

Q - Unidentified Participant

I think it's difficult really to finally answer that question based on a limited number of years of experience. So we're looking into our stochastic modeling, which is many, many more years of course on the modeling there. And if I look into these models everything what is happening this year, but also the years before, is still in line with what we would have expected. So we wouldn't say that this is -- so exceptionally high or it's so out -- outstandingly unexpected to have no typhoons or hurricanes in the order of magnitude we are seeing. So currently I would not see that. But of course there is a general difficulty in capturing a long-term trend and so we will continue to carefully absorb what's going on there.

Q - Jonny Urwin {BIO 17445508 <GO>}

Brillant. Thank you.

Operator

Thank you. (Operator Instructions) Our next question comes from Thomas Fossard [ph] of HSBC. Please go ahead, your line is open.

Q - Analyst

Yes, good afternoon. Two questions from me. The first one is could you shed a bit more light on the strong capital generation that you reported so far? What is the main driver of the maintenance (inaudible) prices. That will be the first question. The second question is looking at the IFRS numbers on nine months basis and making of all the positive and negatives elements. It looks like actually you're very close to the initial EUR2.5 billion net income target. So it is lso your perception or actually due to the strong operating results that you were mentioning in your introductory remarks. Actually, you're getting even more confident that the EUR2.8 net income for next year is becoming a very -- become a more cautious guidance. Thank you.

A - Unidentified Speaker

Capital generation. You know that the details are only being released by us with our Q4 release, but it will not surprise you that it's a combination, very much driven by operational good performance. And on top of that of course also good equity markets, FX result, all the positive developments we see in the IFRS. Of course, also reflected and what we see in our economic earnings with -- the only opposing trends being the interest, which is clearly and that's what you see in the Solvency II ratio, which is clearly reducing both the economic earnings, but also increasing at the same time the Solvency II capital -- the SCR -- the solvency capital requirement.

IFRS -- I think it will be premature to in any way interpret being now in Q3 and with a very good performance this year to already influence our assessment how hard or not hard it is to achieve the 2.8. We are happy with where we stand. We see some constructive trends in the market, which is clearly helpful. But on top of that, we always -- that 2.8 is an ambitious target and I still consider this being a bit ambitious.

Thank you. Can we have the next question please.

Operator

Certainly. The next question comes from Michael Haid of Commerzbank. Please go ahead.

Q - Michael Haid {BIO 1971310 <GO>}

Thank you very much. Good morning. Two questions, both on German Life Insurance, German Life and Health, actually. The investment income was surprisingly high to my understanding, as you said it was driven by FX gains, losses on equity derivatives on interest rate derivatives, you must have had some gains. And still I'm surprised by the high amount of realizations of capital gains. Remember that you already financed (inaudible) our requirements in the first half. And I was particularly surprised because 90% of total investment income you have to give to the policyholder.

So, is that the restriction at the moment or do you have so much -- so elevated capital gains in Life and Health -- German Life. Second question regarding the new business margin, I know that you don't provide new business margins in German Life on a quarterly basis, but I'm just interested at this current low interest rates. You still write profitable business -- new business in Germany?

A - Unidentified Speaker

So first question, looking at the overall segment Life health altogether is sometimes unfortunately a little bit misleading I must say. There are life companies in there and then of course -- there's also the health part. But already within the life companies it's various companies which sometimes makes it a little bit more difficult to really see what's happening there. So I'm very happy to give you some more -- some more insight there. On the health side, specifically, we have been benefiting from FX. That's something we discussed already. On top of that very much also by equity markets, because they have a comparatively higher portion of equities in the portfolio. And to make that digestible also with -- from a risk capacity perspective and having in mind the shareholder share, many of these equities are being hedged by derivatives. And the derivatives in an environment where the equities only go up, they produced losses. And so realizations in the health companies happen to at least somewhat offset the losses of these derivatives.

Again coming from an ALM perspective, but also from a perspective that according to local GAAP, we have also to steer the regional -- the interest in a reasonable manner. So this is the realization on equities part, very much driven by the derivative losses we have on the equities in the same portfolios. In the life book, realizations are much more driven by (inaudible). As you said, a lot of that happened in the first half of the year already and nothing really happened in Q3. And that's a small portion probably still to be realized in the fourth quarter. So the realization on fixed income is not in the life business to finance (inaudible) has not really been a driver in Q3.

But what we saw is of course the gains on the derivatives and we have to hedge the low interest environment in the traditional life back book, where we have the relatively high guarantees. And you know that we do that with derivatives and some of these derivatives at least are full valued mark-to-market at least according to IFRS, not so much to local GAAP. And so with IFRS, we benefit from them. And this also of course increases the return. And that's already the whole story. It's a little bit difficult to really see it. I must admit when we mix up this different companies -- to life traditional companies, the life new business companies and the health companies, and then to travel and then the ERGO direct [ph] companies.

So, but the story in itself is really very much well adjusted. New business margin -- this very much depends on the business mix. As you know there are some products, which are relying much more on the interest rate level in the profitability than others. The mobile metric products we have, the less we will be affected by the low interest rate. I do not have a clear view. I must admit on the business mix so far in that year. Therefore it's extremely difficult for me now to give an estimate what the overall amount is but clearly, and that's where you are coming from with an interest rate with the German bond is between minus 0.3 and minus 0.5 (inaudible). Clearly the challenge to offer savings type of products with a reasonable profitability. On top of that I am afraid I cannot tell you much more today. And I have to -- have to postpone a more detailed answer to Q4.

Q - Analyst

Perfect, thank you very much.

Operator

Thank you. Our next question comes from James Shuck of Citi. Please go ahead, your line is open.

Q - James Shuck {BIO 3680082 <GO>}

Hello, good morning. So two questions from me. The first, you're just returning to the US casualty. Would you mind just talking a little bit about some of the trends you're seeing on smaller commercial and larger commercial. So leaving aside perhaps some of the mega awards that you see, but just thinking about how the social inflation is filtering into the larger commercial segment and perhaps a smaller commercial segment in the US in particular.

And also be interested in getting any insights into your excess of loss retention rates and how they have evolved over time. So perhaps thinking about how that's changed in the marketplace and also for yourself. Secondly, there's an interesting dynamic going on at the moment between primary pricing, particularly in the US and reinsurance pricing. Obviously a lot of business that you write is proportional. It's easy to think that that's just because primary pricing is going to go up, that that's going to benefit you in the same way. But things to consider in terms of the mixed business and -- etc, those sorts of things but also ceding commissions. So just also -- just interested to get your insights into that dynamic and the association really between (inaudible) reinsurance pricing and how you expect that to play out. Thank you.

A - Unidentified Speaker

Yeah. Well that's again something we could talk about hours about that. With respect to the mega trends I don't think there is anything we see what you are not aware of. So that's -- I mean, everything is the social inflation and everything is captured in the term more or less and then the larger topics, which have been discussed a lot like the opioids or child abuse (inaudible) all these kind of things also developments we're observing. I don't think there is anything you have not heard before given what I read recently in market publications and so on and so forth.

So I don't think I have to go in more detail into that. Looking at our casualty book overall, clearly, our target is to have as much. Coming to your excess of loss question. We have some excess of loss books as well. And these are the ones where we potentially think they might be more affected than others, because proportional with relatively high trigger points is something where we still think that our position is comparatively good, but the excess of loss part is clearly the part of our book, where we are looking into more carefully. All in line with what I said before, that overall is digestible and then the volume of that particular book also in the context of overall casualty book is really limited.

Coming back to your question on proportional and renewal (inaudible) of course, it's first of all, highly relevant for us what is the pricing and the profitability assumption of the primary insurer, before talking about set up a proportional structure at all. There we see positive trends in some loss affected business and some areas, more specifically on casualty. I don't think that the price increases we saw so far are already high enough to capture the social inflation adequately already. So then needs to happen more. And on top of that, it's a negotiation between reinsurance and primary insurance, about commission structure and how to share -- hopefully then achieved profitability between the two. And that's something which is done on a case by case base. I don't think I can give you any more light other than -- this is clearly something where also the reinsurer has some levers to additionally improve his pricing compared to what we already see on the pricing of the final effect.

Q - Unidentified Participant

Okay, thank you.

Operator

Thank you. We're now going to take a follow-up question from Farooq Hanif. Please go ahead.

Q - Farooq Hanif {BIO 4780978 <GO>}

Apologies for prolonging the call, but just a quick comment if possible on what you think politically is going to happen with April [ph] 2020 review.

A - Unidentified Speaker

Another one. Another long one. Politically, I don't know actually. I'm not even sure -- probably a little bit early to answer that really. We now, as you know, after the Solvency II 2020 review document we received that -- what is the questionnaire, let's call it questionnaire has more than 800 pages. So it's already kind of burdensome to work through that. We are currently doing that -- assessing the various options. And then I think what's happening there -- we'll -- after all the data has been taking place and so on and so forth. What's happening -- or will be happening thereafter is the same like what happened when Solvency II was first introduced, that then the debate on the political level were just on the start. And so I think it's a little bit early to really see what the outcome will be or how different players will then be positioning themselves. Because I just do not think that we are well -- analyzed it already well enough what's on the table right now, not specifically as a company, but the whole industry. And on top of that, also the political parties, the political players involved. So a little bit early, maybe.

Q - Farooq Hanif {BIO 4780978 <GO>}

It was worth a try. Thank you very much.

Operator

Thank you. We will now take a follow up question also from Vinit Malhotra. Please go ahead.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes, good morning. Thanks very much. Just a quick numbers one -- the nat cat reserve releases. So even if I just total up the the (inaudible) of 740, say 740. And you have 577 million reported. So that's quite a decent idea of nat cat reserve releases. Are you happy to quantify whether there are significantly more than this calculation or just the difference in these two lines is a good enough guess. And I just also want to say this came up during conversations today with investors (inaudible). Thank you.

A - Unidentified Speaker

I apologize that I will not comment on your calculation and we will not disclose more this time on the prior year development of our large losses. Why not, because it's just so much business as usual. We are conservative in our large loss estimates as well and as much as we see new large losses and this business is usual to us. It's also a business as usual that we released some of the reserve we have in the -- we have put up for the large losses in the last couple of years. And this (inaudible) completely unchanged, so completely stable and also I think you can pretty much rely on that. But we will not -- we won't further quantify that because it's just part of the overall development, and the stable part.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay. Appreciate that. Thank you very much.

Operator

Thank you. That will now conclude our question and answer session. I would like to hand back to our speakers today for any additional or closing remarks.

A - Unidentified Speaker

Yeah, thanks to everybody for participating in our call. I have just a last remark for you in order to make you aware that we will meet next time, of course, next year for discussing our full-year 2019 earnings. The difference compared to previous years, though, is that we will no longer split the earnings release into two separate events. So we will not have any longer a separate renewal communication. At the beginning of February, we will merge the former Analyst Call and the renewal call into one, which will happen at the end of February, and I hope that is in your interest as well. So thanks very much for listening. For further questions, please don't hesitate to call the IR team. Thank you. Bye-bye.

Operator

Thank you. That will now conclude today's conference call. Thank you for your participation. Ladies and gentlemen, you may now disconnect.