Q2 2019 Earnings Call

Company Participants

- Christian Becker-Hussong, Head of Investor and Rating Agency Relations
- Christoph Jurecka, Member of the Board of Management
- Joachim Wenning, Chief Executive Officer, Member of the Management Board
- Unidentified Speaker

Other Participants

- Andrew Ritchie, Analyst
- Edward Morris, Analyst
- Farooq Hanif, Analyst
- Frank Koffinger, Analyst
- Ivan Bokhmat, Analyst
- James Shuck, Analyst
- Jonny Urwin, Analyst
- Kamran Hossain, Analyst
- Michael Haid, Analyst
- Sami Taipalus, Analyst
- Vikram Gandhi, Analyst
- Vinit Malhotra, Analyst

Presentation

Christian Becker-Hussong {BIO 19080254 <GO>}

Thank you, Mary, for the introduction. Good afternoon to everyone listening into our call on the occasion of our Q2 Financial Earnings 2019. I have the pleasure to be here with Joachim Wenning, our CEO; and our CFO, Christoph Jurecka. Procedure is relatively simple and straightforward. This afternoon Joachim will kick it off with his opening remarks and Christoph will continue with just a few explanations on our Q2 earnings. And afterwards, we will go right into Q&A. Joachim, please

Joachim Wenning {BIO 16273429 <GO>}

Thank you very much, Christian, and good afternoon, ladies and gentlemen. It's Christoph Jurecka and my pleasure today to report Munich Re's half year 2019 figures and to also share our view on the outlook for the full year 2019 and the further outlook into 2020 with you. As you know, we are in the midst of, I would call, it a three years race to increasing the Munich Re group result to EUR 2.3 billion last year 2.5 billion euro this year, and finally to reach EUR 2.8 billion in 2020.

And I'd like to anticipate the following: Munich Re is fully on track and I would like to add, businesses are not only running smoothly, they are evolving quite dynamically and they are growing profitably, which is very important for us. And it's unfortunate if you like, but it is, what it is, the big quarter two news have already been out practically with our adhoc communication, disclosing the quarter two result of EUR 1 billion. That was three weeks ago. So since then naturally not too much reading you has happened.

So, in any case, I'd like to give you some more details if you want to have a look at slide three. This highlights that it was almost exclusively the reinsurance business, which has contributed to the extraordinarily positive first half year result 2019, and for the full year, we expect to earn EUR 2.5 billion there off EUR 2.1 billion from reinsurance and EUR 0.4 billion from ERGO. That has not changed; however, I'd like to emphasize that our confidence level with regard to reaching the EUR 2.5 billion this year is clearly higher now after six months than it was at the beginning of this year.

From slide four, you can take, if you wish, some concrete milestones that we have achieved on the reinsurance side and on the ERGO side, to meet our mid-term target. I think on the reinsurance side, it's worthwhile mentioning that it is very crucial for the earnings increase that the reinsurers are successfully growing into the target lines of business and target regions. And this is nothing new to you, we have reported on this many times. So, conceptually strategically everything as is, however, it is important for you to see. And for me, I'm happy to confirm that execution and progress in targeted profitable growth in reinsurance is fully, fully satisfying for us.

And also important for the reinsurance has been our so-called transformation program, meaning to grow traditional business with less resources and show to increase the funding potential for creating new business models. And with regard to new business models, we have already reported in the last quarters that this is running quite smoothly and that there is roughly a handful of such business models already productive, so really producing premium income and also results, but still at low scale, they are now scaling up and it will take some years realistically to really report what the full business and earnings potential of these business models will be.

ERGO, on the right hand side of that slide, you can see has finished or completed very successfully and very quickly, it's so called divestment program in its international organization divesting from mainly sub-critical businesses of marginal relevance and what ERGO has instead achieved is they have strengthened very materially their market positioning in the Indian market. So, via our purchasing 51% of Apollo Munich Health Insurance, HDFC now is also the partner of ERGO in the private health insurers' arena and if you look into a probable second step of this evolution. So, after emerge of these two carriers, then the combined carrier would stand for 8.2% market share in private health insurance in India, reflecting number two market position and number three overall, if we also include the P&C business or health plus P&C, reflecting a 6% -- 6.4% market share. That's very, very interesting.

Otherwise, the group focus on transforming, digitizing, and growing business profitably is paying off fully and delivering increased earnings and at half-time of our three years program, we have fully met our expectations so far. And thanks to the -- I would call it, the new business and the earnings momentum that has been established in the last two years, our confidence level into 2019, but also beyond into 2020 of delivering even further increasing results is higher now, again, then it was at the beginning of the program.

This is something that doesn't easily translate into vendors, but the confidence level is higher. And our ambition is to compare with our international reinsurance peers and our international Europe-based primary insurance peers such that we are among the top three, when it comes to total shareholder return comparison.

And when you look at slide six of the presentation, then you can see since the 1st of January 2018 since we look at these numbers and since we have committed to this, we are in the top three position. And I admit that this time period is a very short one, what is 18 month, but I will have to hide these numbers for another five years to 10 years. To show you longer time periods, I thought, from now on we're going to show it to you. And as it stands, it looks nice.

With regard to our outlook 2019, we have kept everything unchanged. And with this introduction, I'd like to hand over to Christoph, who is going to give you more details. Thank you.

Christoph Jurecka {BIO 17223019 <GO>}

Thank you, Joachim, and, well, good afternoon from my side as well. As usual, I will only give some personnel opening remarks and I will not lead you through the presentation, before we go to Q&A. As Joachim already mentioned, after six months Munich Re is well underway to meet its targets for the full year 2019. We did pre-release already a few weeks ago our strong consolidated result of EUR993 million in Q2, which was helped by low major losses and by high reserve releases in reinsurance. On top of that, I'd like to underline that also ERGO achieved a very pleasing result.

Now, let's look into the details. Starting with the investment result in Q2, the ROI amounts to a solid 3.1% and support our guidance for the full year, very, very nicely. On top of that, our unrealized gains increased significantly, not only in the fixed income area, but also on equities. We'd use our cash position and continue to actively manage the low interest rate environment and thereby achieved a reinvestment yield of 2.2%, which increased even slightly compared to the first quarter. Nevertheless, we still think that the ROI for 2019, achieving the target ROI for 2019 continues to be challenging. And we also think that it's more likely that we will have to round up to achieve the forecast of 3% and to round down. This is, of course, due to the falling interest rates, but more importantly, also due to the -- our current expectations regarding the realization of valuation reserves and also our expectations with respect to the net balance of derivatives.

Now, let's go to life and health reinsurance, in Q2 actually life and health re, we had a weak quarter in terms of the technical result. The ongoing negative experience in our

Australian business includes debt write off due to the recently introduced protect your super legislation, which has been implemented more widely than we originally assumed when we, for the first time, took a hit on our debt already in Q4 last year. Now, we do not expect any further debt write down from this change legislation for the rest of the year, unless the legislation changes again.

Still in Australia, we continue to observe heavy claims experience in disability business. Our priority remains to work with our clients to rehabilitate the existing portfolio. But for the coming quarters, we must expect an ongoing higher earnings volatility. In Canada, on the other hand, the reduction in technical earnings is caused by the shortening of our duration in the asset portfolio. And this has been now largely accomplished. The mentioned reduction in the technical earnings was more than compensated for by a positive impact on the investment result. So here we are more speaking about the shift of result then of an actual reduction.

Now looking at Life Re overall, Life and Health Re overall. Depending on the experience in the remainder of the year and obviously also on the outcome of the annual reserve review, we see a substantial risk that we will fall short of our 500 million guidance for the technical result plus fee income in 2019. This risk is less pronounced for the operating and net income due to the mentioned beneficial effect of the Canadian duration, shortening on the investment result in the first half.

Now looking at P&C reinsurance we recorded a very good combined ratio of 87.7 percentage points in and also the result has been really very good. This was as mentioned already mainly due a combination of very low -- large nut-cut and also the low man-made claims totaling 4.1 percentage points only in the combined ratio. But furthermore, there was also a range of effects which I think in a high release of basic loss reserve of 7.3 percentage points.

On the one hand, we successfully disposed of non-core books which we had conservatively reserved for. And on the other hand, for the actual versus expected loss development, in some lines of business are so favorable that we felt it would be justified or even necessary to release some of the conservativism into the P&L already now, without and that's important without compromising our reserve strength.

On a normalized basis, the combined ratio amounted to 98.9%, once more driven by adverse claims development in our North American Risk Solutions business and by seasonality effects. Also, this is still above our expectations. This is an improvement compared to Q1, so there is a positive trend. And then we see the underlying profitability of our growth initiatives remaining sound. We still consider a level closer to 98% to be a realistic ambition for the full year 2019.

Now looking at the renewals to -- it for the July 2019, the recent market recovery continued. In particular, there was a significant improvement in prices for reinsurance cover in markets affected by natural catastrophes. However, and as you know, the calculation of price changes as we do it, takes into the consideration increases in loss expectations, in all the markets across the globe where we do expect some higher losses in the future.

And it also includes stable renewals in unaffected regions and markets. So overall prices rose in July by 0.5% and the premium volume was up by 9%. Looking at these figures, we are very happy that we continue to grow into this hardening market. Now coming to ERGO, with net earnings of EUR135 million in Q2 ERGO posted a strong result above the expected quarterly run rate.

The profit of 220 million for the first six month is fully in line with the ERGO ambition of 400 million net result for the full year. In life and health, Germany, the net result benefited from good investment result, as well as from a higher shareholder profit participation. In P&C, Germany, the segment amounted to a very good 80.6% combined ratio, and large losses remained below average expectations in the top of that -- and that's something which is even more important in my view will be benefited a lot from the overall favorable claims experience across more or less all of our books.

On top of that, we have the usual seasonal fluctuations in premiums in the first half of the year, which regularly leads to a negative impact in Q1 and a positive effect in Q2. And this progress, I think that now in Q2 with net earned premiums now being having increased over proportionally.

Finally, the international business of ERGO also delivered the combined ratio fully in line with our ambitions of 95% for Q2, and as announced earlier, the sale of our entity in Turkey resulted in a double-digit or concretely 39 million negative impact on the segment's net income. For the half year, ERGO overcompensated by more than 60 million of negative impact from the now finalized portfolio optimization of ERGO International, which even more shows how strong the 220 million result for the half year of ERGO is.

Now I come back to the outlook. As stated by you Joachim, the outlook for the remainder of the year is unchanged, so we stick to the figures we had in the Annual Report 2018 and more confident to achieve this target now after the first half year then at the beginning of the year, given that we already achieved 1.6 billion at half year.

With that, I'd like to conclude my opening remarks and I'm of course very happy to take your questions in our upcoming Q&A.

Unidentified Speaker

Yeah. Thank you, gentlemen. We can then go into Q&A right away. As always, my usual remark, please limit the number of your questions to two per person in order to give everybody a fair chance to ask questions on this call.

Thank you. Please go ahead.

Questions And Answers

Operator

(Operator Instructions) We will now take our first question from Vikram Gandhi of Societe Generale. Please go ahead.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Hi, good afternoon everybody. Couple of questions from my side. Firstly, it's really pleasing to see you feel confident about the 2020 net income target despite the sharp falling yields. My question would be, what level of interest rates, in your view, would start putting pressure on that target? So that's question number one. Secondly, I appreciate that the results of ERGO International were impacted by the loss on sale of the Turkish business, but it still appears that this is undershooting its target run rate. So it would be great if you can share what good and what would really change going forward on that business?

A - Christoph Jurecka {BIO 17223019 <GO>}

Vikram, Thank you very much for the questions. The interest rate level, obviously, did reduce a lot. And on the very long run, clearly, this is a concern. On the short and midterm, though, and that's -- I think what I already emphasized before as well. We have other levers, which much more influence on our net income compared to the reinvestment yields we can achieve in the current market environment. This would be, for example, assumptions, how much gains are we able to realize how much unrealized gains are we able to transfer into realized gains and then also the result on our derivatives. If you look at our Q2 figures, you will see that, for example, on equities, be nearly benefited at all from the positive market development in the half year because we did not realize the gains, but recorded the losses on the derivatives completely in our results. So if you want the wavered our income in the first half of the year was very conservative.

On the other hand, this means that if we would realize a little bit more. Of course, we would be able to compensate lower reinvestment yields on the short and mid-term as just what I said. And therefore, I'm very optimistic that our target for this year, but also for next year will be unaffected by the actual interest rate environment. The second question on ERGO International. I'm not sure if I completely understood the question. So I mean, Turkey, we are close to closing this chapter. And then on top of that, we are really very optimistic to continue with profitability, like what we currently have. This is, of course, depending on the market cycle. We are -- and specifically, in Poland, we see some signs that the cycle might deteriorate going forward. But other than that, and that's also something you could see if you -- what you see looking into our presentation on the Q2 figures, you will see that the cost of Altior international books are all showing combined ratio still below 100 of them even below 90. So that's a very stable and profitable environment we are in.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Sorry, if I can just come back, my question really was, even after accounting for the loss on the sale of Turkish business in Q2, it appears that the business is still achieving below the target run rate on a quarterly basis. So my question really was even netting out for this one-off, it appears as if there's still more to do and more to come, most likely from this business? And what could do it I mean, this results already include the ready to combined ratios that you highlighted. So that was my question.

A - Christoph Jurecka {BIO 17223019 <GO>}

Okay. Thank you. Now the 95% is completely in the target. When I look at the combined ratio. And if you look at net income, you have to keep in mind that it's not only EUR 9 billion on Turkey, but also already in Q1, we had a EUR 22 million negative one-off due to the sale of other operations in the course of the portfolio optimization. So the negative one-off is EUR 60 million roughly, which ERGO International had to bear in the first half of the year. If you would adapt the figures for that effect, ERGO International would be clearly in line with our expectations or even a little bit ahead.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Okay, thanks very much.

Operator

We will now take our next question from Andrew Ritchie of Autonomous. Please go ahead.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Hi, there. One easy one and one hard one, I think, the easy one, what is the risk-adjusted price change. So you've given us the risk-adjusted renewals rate change, what would be the nominal rate change before taking in account of higher loss costs for July and year-to-date, if possible? On ERGO Life, I guess, where the situation now, presumably, where there could be quite a big divergence in the direction of economic earnings, which are clearly under pressure versus nominal IFRS earnings, is it actually the case that your IFRS earnings may -- earnings power of that business may be going higher because you're having to realize more games now to continue, I think, to state appreciate as I said our addition is lessened by the new corridor approach, but as interest rates fall, that goes up again. So I guess, maybe just some help on the IFRS profit generation of the life business. And I think it's the case of the run rate maybe higher, which obviously feels counterintuitive, given where the interest rate environment is going to help us there would be helpful. Thanks.

A - Christoph Jurecka {BIO 17223019 <GO>}

Yes, any I would completely concur with you. The first one is the easy one, the second is the difficult one. On the easy one, I'm sorry, I cannot give you an answer. We only have in our system, these claims adjusted risk-adjusted figures. And we would have to go back into each single treaty to find out what the cost price increase would have been. And that's not something we regularly do. So actually, we don't know, and I'm not able to give you that figure. But you can see how deeply in our DNA, this is risk-adjusted steering and pricing is incorporated, but we would not even know the nominal price increase. So maybe this gives you an indication how we look at things. Now coming to evolve ERGO Life, ERGO Life, indeed, there is a disconnect between economic earnings and IFRS.

And that is one of the reasons I will looking forward to get IFRS '17 because the disconnect can only be can only be smaller. I'm not sure if it would be fully closed, but at least, it can be only smaller. What happened actually is that we got a new methodology for the calculation of the sets that our last year, which is called the corridor method. And this change in methodology, independently of the interest rate level, led to the effect that we now have to build only roughly 1/3 of the amount, which we would have to have built given the old methodology. And this effect is much bigger than the change in interest rate.

Therefore, we now will realize for our life books in tendency less than in the past. Now you'll ask why it has resulted higher than that? Well, some of the reason is that we did our homework. And in the course of the process, when we discussed, if you were to dispose of our life books or not. And I think we commented on that already some times, we deeply analyzed how we could improve the in force management, improve the way we manage the book overall, we separated it from the new business.

All those activities we implemented came along also with an in depth analysis, how we can increase the shareholder return out of these books for and as a result, some of the shareholder ratios could be increased. And we did some of that last year already. And this was done in Q3 last year. So it's not fully earned full yet. So if you compare our figures now compared to prior year, there's still effect from that. On top of that, in Life & Health, we had a kind of one-off. I'm not sure if one of us will be wide work here because we also increased the shareholder share on our health business in Germany. And this is not because some sense accounting methodology because what's happening there is that we more and more are focusing our business not on supplementary health insurance, where the rules are not as tight as for the competitor we cover in Germany, which gives you more levy to give the shareholder higher benefits from the overall earnings amount you're making in that business.

And we now over in a situation that we were -- given the development, which is ongoing for many years already, but it has been so pronounced that we now have to also change the IFRS assumptions according to the shift in business mix. And therefore, an effect of roughly EUR 30 million now in Q2 is maybe kind of one-off due to has changed assumption in health. So overall, yes, Life & Health continues to be complex. Also the difference is due to economic earnings are indeed, not easy to explain, not easy to understand. And as such we can only get better with IFRS 17.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Sorry, just to be a, you wouldn't anticipate the shareholder participation ratios is coming under pressure, at least for the next -- at least for the -- your planning horizon, which appears to be 12 months only on the total target?

A - Christoph Jurecka {BIO 17223019 <GO>}

As much as we are aware, no we do not see any pressure there? No.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Okay, thanks.

Operator

We will now take our next question from James Shuck of Citi. Please go ahead.

Q - James Shuck {BIO 3680082 <GO>}

Hi, good afternoon. First question around the new money yield, please? So the Q2 reinvestment rate, 2.2%. What is the current reinvestment rate, please? And can you just shed a little bit light on what you're buying and whether you would consider buying negative yielding assets in the current environment? Just looking out to 2020 as well, should we sort of expect a return on investment of around 3%. Obviously, the current yield will trend down, but would you look to supplement that with realized gains to maintain it broadly while the high 2s or close to 3 kind of level? That's the first question.

Secondly, on the nat cat exposure. If I look at your P&Ls, at least through 2018, there's been quite a big increase in U.S. hurricane in relation to your tangible book value. When I look at the renewals, it doesn't seem as if it's already coming through in the PC Re premium, at least when I look at the nat cat premium as a percent of the PC Re level. So could you just add a little bit of light in terms of what's happening around the U.S. hurricane exposure, what incremental capital have you actually deployed in that area year-to-date, that would be very helpful. Thank you.

A - Christoph Jurecka {BIO 17223019 <GO>}

Yes. Well, the most recent reinvestment figure we have, actually, is the 2.2% for the healthy quarter two. What did we do to achieve that? First of all, I think it's important to notice that we really do not reinvest a lot of our money short-term because the duration is far along, which clearly helped. Our investment activities are concentrated on diversification. We try to go more into illiquid titles as we did in the past. We have some geographic diversification, having some more corporate bonds also. So diversify a little bit more into the investment universe, wherever it makes sense. And thereby, we were able to achieve this 2.2. You also should not forget that we are reinvesting to a certain extent, outside of the Jerusalem, to large extent, also outside the Jerusalem wherever interest rates are also higher.

Also given our U.S. investments. So that this is basically what's happening there. And going forward, we'll continue to make the best out of a really poor market situation, but I'd like to highlight again what I already said before, don't overestimate the impact of reinvestment on our -- on a short-term meaning 1 or 2-year basis. Now to -- coming to nat cat and specifically the hurricane exposure as a relation to the renewals. I can confirm that we somewhat increased our hurricane exposure although magnitude would not be big, maybe 5%, something like that so not a game changer at all. But where we were able to generate very good and interesting rates. We were open to increase our proportion of our stake in the business. Now your question was, why don't you see more of that in the renewal figures and the price change of 0.5%.

Well, you have to be aware of the fact that in this July renewal, the U.S. business is, of course, included. But by far not the largest part, we have roughly 30%, even a little bit lower of different newlin the U.S. And then even in the U.S., it's casualty, its properties. It's different business lines. Some of them are proportional other IXL. And therefore, adding all these different pieces up there is a relatively large dilution effect. If you compare what we are seeing on nat cat with what you hear from other players, I can confirm you that we see absolutely the same development in the market. So as we've been commenting before, price increases in loss-affected business, this is something we absolutely see as well. But then looking at our overall portfolio, the figure gets diluted, as I said.

Q - James Shuck {BIO 3680082 <GO>}

Can I just very quickly just circle back on the new money yield, EUR 2.2 million in Q2, it must be around 1.5 or so now, what one would think. Are you actually buying negative yielding assets, single a covered bonds, these sorts of things, or are you starting to think about alternative asset classes, trying to diversify out of that or indeed changing the risk profile?

A - Christoph Jurecka {BIO 17223019 <GO>}

So overall, our risk profile has been stable and whether Q4, I've been commenting that we feel very comfortable with your one risk profile. So we have no plans of changing our risk profile overall. Does this I mean, does this mean that we are not at all looking for one of the other security with a total waiting or something. No, we would be looking into this, of course, but the overall risk appetite is unchanged. And yes, of course, we also bisect negative yield because in this environment is unavoidable. And the overall mix will not change so much. As I said, the reinvestment volume is rather limited, and that's what gives us a certain leeway, how to cope with this overall not so pleasing situation.

Q - James Shuck {BIO 3680082 <GO>}

Okay, thank you very much.

Operator

We will now take our next question from Jonny Urwin of UBS. Please go ahead.

Q - Jonny Urwin {BIO 17445508 <GO>}

Hi there, Just two for me, please. One on P&C Re and one on Life and Health. So P&C Re, it's the usual question about the normalized combined ratio of rate. So you've not missed that guidance over the last 10 quarters. And I appreciate that the normalized combined ratio is clearly simplistic and that you often encourage is not to place too much emphasis on this ratio. But given this is now a clear and prolonged trend. At what point does this become a concern fee, meaning that you feel the need to take more action, particularly around the North America risk book? And then secondly, on Life and Health Re, is the action that you're going to take on the Australian disability book through the rest of this year aimed at bringing you back to sort of run rate of EUR 500 million technical result, or is it to bring it to a higher level?

A - Christoph Jurecka {BIO 17223019 <GO>}

I'll start with P&C Re, the famous normalized combined ratio. I mean, first of all, what you're saying, like the trend continued. I'm not even sure what trend did you actually mean because at least we have a trend that the normalized come ratio goes down, admittedly, not down to the level we were expecting before. We are now in Q2 at 98.9, but at least already, that's at 98, which is better than where we were Q1 is there of any concern for us. Basically, that has been your question. And in a sense that we are implementing measures in that sense, it clearly is a concern and has already been for some time already last year.

So actions have been taken. And this is the reason why we are still positive that we will get closer to the 98% until the end of the year. Now what has been the actions it's different things. If I look at on the reinsurance side, which clearly is also depicted in the normalized combined ratio. There are various effects, we, of course, have the price changes from the last couple of renewals, we have also growth which will help by diluting the cost base we're having. We have cost measures, as you know, having been implemented. This all should then help us get normalized combined ratio go down going forward. And then we have the West Solutions business in the U.S. And here again, also rate increases, we have been working on rate increases quite some time.

As you might be aware, there has to be a filing for rate increases in some of the U.S. states at least. So it takes some time and you get the approval, and then it takes some time until you re-underwrite the portfolio. All these measures are underway, but it will take time until they fully take effect in the specific book we are talking about. On top of that, we have also some growth in that area of our business. And then in some portfolios, we also took corrective measures in the sense, cleaning the portfolio, we are underwriting and various measures of that kind. All in all, this should lead us, as I said, to a combined ratio, much closer to the 98 million. And I'm as curious as you to see in Q3 and then in Q4, how close we can get to the 98.

A - Joachim Wenning {BIO 16273429 <GO>}

Okay. This is Joachim. Let me take the Australia question on Life Book. I think our actions that we are taking, now they are primarily targeted at keeping the gap between actual losses and expected losses, very limited. So to manage the downside of this. This is an exercise that is ongoing. And I think, purely financially, and from a pure accounting perspective between now and the year-end valuation, we want to have the best possible understanding of what the most recent legislation would probably or possibly mean in terms of future loss expectations. Now that will then be taken into account in 2019, beyond 2019 then in 2020, '21, '22 and so on. The Australian, the Australian run rate should be unaffected by the 2019 one-off. And even before the contribution of the Australian Life book to the total EUR 500 million of Life and Health was immaterial. That means once 2019 has cleaned the surface, the effects beyond 2019 should be very limited, and the underlying trend in the Life business outside Australia is a positive one, like EUR 500 million and then increasing over time.

Q - Jonny Urwin {BIO 17445508 <GO>}

Thank you.

Operator

We will now take our next question from Sami Taipalus of Goldman Sachs. Please go ahead.

Q - Sami Taipalus {BIO 17452234 <GO>}

Yeah, hi, thanks for taking my question. Just maybe sticking on Australia for a little while, was there anything new in this quarter in terms of changes to your actual best estimate view of the situation and the claims development there? Was there any impact on, I guess, on the summer's two position or the economic position of that business? I mean, also, would you be able to tell us actually how much to track from Australia and what the technical result would look without it? Number one. and then number two, slightly bigger picture question. You talked about increasing productivity in the traditional P&C reinsurance business. Could you just elaborate a little bit on that? Is that just -- are you just referring to the cost measures that you're taking there, or are there some other actions as well, but you're taking. I don't think you report the admin expense ratio anymore separately. Could you just give an update on how you're progressing there?

A - Joachim Wenning {BIO 16273429 <GO>}

Thank you. I'm happy to take both questions. So what's new in Australia Life. Let me start making care what's not new. So you know that we have a legacy book, which has -- back in 2011 for the first time and then another time in 2013 caused some issues, which we then reflected due to via reserve strengthenings. So that legacy book is still there and is in run-off, if you want. And that runoff now this year has seen higher-than-expected losses. That's not fundamentally new, but it's, if you like, an adverse development in that current year 2019, and that is one part of the deterioration. What's really new is legislation, and legislation, which in a nutshell is facilitating adverse lapsation of policyholders and to take that into account and to try to quantify of how much of this will impact the future losses or reduced the embedded value of the remaining portfolio. That's a very difficult exercise, frankly, with quite some uncertainty into it. And that is exactly the exercise that is outstanding that we want to finish between now and year-end evaluation. So at this point, we cannot possibly give you a quantification of its impact. Otherwise, we would have done so. Your second question.

Q - Sami Taipalus {BIO 17452234 <GO>}

Again, can I just follow up on the first one, just to clarify, so you're actually -- you're actually looking at changing the best estimate numbers. This is not just the usual sort of issue that you get sometimes in Life and Health reinsurance, where you get the actual versus expected, that's adverse and ongoing?

A - Joachim Wenning {BIO 16273429 <GO>}

We are reviewing our best estimates, correct?

Q - Sami Taipalus {BIO 17452234 <GO>}

Yes. Okay, Great.

A - Joachim Wenning {BIO 16273429 <GO>}

To your second question, which is P&C related and production and productivity related. So production means like how is it evolving? How is top line evolving? How is business growth going? And the business growth is there. So the business is growing, and more importantly than just growing, it's growing exactly in the targeted regions and in the targeted lines of business. That is so important to us because growing just broadly is not an art, the art is to very selectively grow into the areas where you believe that the return for the risk that you take is attractive. So that is nice, that is production increase. Productivity is with regard to our resource reductions. So the growing business doesn't require increasing resources on the country, we have been able to reduce resources while we were growing, and this is what we mean by productivity or efficiency gains. Okay. I could quantify them. We did that. I think last year, when we said between 2018 and 2020, we wanted to take out more than EUR 200 million of admin expenses.

Q - Sami Taipalus {BIO 17452234 <GO>}

Yes. Great, thank you.

Operator

We will now take our next question from Kamran Hossain of RBC. Please go ahead.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi, two questions. First one is just on the risk solutions, your commentary in your presentation talks about adverse claims development. Could you maybe give us a little bit more color on the quantum of impact on what sounds like it is reserved to serration hundred quantum? And then will it involve? The second question, just to come back to the normalized combined ratio. At what point do we start to adjust it to increase a level of reserve releases, which is above 4%. It sounds from, again, from your commentary, your baking in plenty of surplus and the level has been above 4% through to 2011. So that, to me, is a pretty long-term trend. So any indications or ideas around that would be helpful. Thank you.

A - Christoph Jurecka {BIO 17223019 <GO>}

Thank you, Kamran. Risk Solutions, I would say there's 3 aspects we have to keep in mind. First of all, there's the usual seasonality, which is not critical at all. And that's something we always, for example, in Q2, some time others. So that this is completely in line with our expectations. And clearly, also no measures to necessary there. Then we have larger losses, but below our threshold of EUR 10 million. And some of them are at bit luck now but now after so many quarters, we clearly also and some time ago, when we start to look into the underwriting and about the business mix. And if collective measure needs to be taken there.

That's the second aspect. And then we have some limited books, where also the core profitability is not high enough so that repricing or re-underwriting exercises are underway there. So it's a little bit a mix of various topics. But as I said, measures have all been taken and we should get closer to the EUR 98 million as already said before. Now your second question on the normalization of the 4%. I actually love that question, I must say. I mean, we had a lot of discussions around this normalization in because in the last couple of quarters. And then also in meeting with you guys, 1 or the other, at least, also were regularly, we did have discussions. And my commentary also was that this normalization we are doing is by far to simple to be really meaningful in a sense.

But on the other hand, it's transparent enough because all the parameters also simple to crap. It's really easy. And the answer I got for many of you and also from other people I've been talking to is please stick to the simple world, because it's much more transparent and easier to explain anyway and we anyway will add our judgment on top of the normalization you're doing. And as the 4% is something, which is an integral part of this normalization exercise, I do not have it all. Independency to change this 4% right now because you will anyway make out of it, whatever do you think is appropriate. And talking to you, I think many of you already have quite a good understanding what the 4% mean?

Operator

We will now take our next question from Farooq Hanif of Credit Suisse. Please go ahead.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi, everybody. Good afternoon. You commented on the areas that you're releasing reserves and because you just thought they were far too good and you still remain well reserved after releasing. Can you give us some idea of which business areas they are? And whether you now feel you're in the right position or there could be depending on experience some more part as it were to reduce? And then coming back to the question about your P&C Re growing in the right areas. You seem to also suggest that this reduction in resources in the traditional business is being reinvested into new business areas. So clearly, we're talking here presumably about partnerships or fiber. Can you give us a sense of the growth there and the proportion of your business and kind of a trajectory that you see -- at what stage are you going to be talking about this much more meaningfully. Thank you.

A - Christoph Jurecka {BIO 17223019 <GO>}

So I'll take the first question on reserving. Actually, I don't think I can give you a clear answer, which books are effectively because there's not a pattern or anything at all to be to be visible here. As part of our usual quarterly closing process, we go over all of our books, and we have a very intensive actual versus expected controlling with respect to claims payments and we're looking into all our books. And at this time, the outcome of this exercise was just that in some of these books, we had to take measures already earlier. So we did that. Now going forward, our current assumption is, as always, 4% for the quarters to come. But can I rule out that we will have similar observations like we in Q2 now in the other quarters as well, though I cannot rule that out. But clearly, the assumption for the rest of the year is 4%. As the assumption for the full year was already 4%, so nothing has changed there.

A - Joachim Wenning {BIO 16273429 <GO>}

Yes. With regard to your second question of limiting or saving resources on the one hand and investing into new business models and the other so first of all, what is important is it's not that exactly the amount that we are saving resources on the traditional side, is exactly the amount that we are investing into new business models. It is just philosophically, on the one hand side, we are divesting, on the other side, we are investing. That is the meaning of the transformation program. To be even clearer if we didn't saw any good investment opportunity, we would also be happy only to resource reduce -- resources on one hand side and not make any investment or if we saw 10x more and higher investment opportunities, we will be willing to make these investments for the sake of good new business.

So just to make clear, it's not an exact one side equals the other. You asked for what type of investments are we undertaking. Well, first of all, the size of the investments per annum they happen to be around EUR 100 million per annum or above that. So it's not EUR 500 million, it's not EUR 10 million either. It's EUR 100 million plus, I would say, for the time being. And part of that money has been going into building an IT infrastructure, data infrastructure, which we didn't need for traditional, but which we need for new business models. That's one side. And the other is for self Building value propositions, which we then offer distribution or primary risk areas to enable their businesses. Or in partnering with start-up companies, where we just plug our risk area, value proposition into their distribution platforms. Broadly, I think that's it.

Q - Farooq Hanif {BIO 4780978 <GO>}

And any sort of sense of the kind of the -- these partnerships, for example?

A - Joachim Wenning {BIO 16273429 <GO>}

You mean -- you said the Cyber?

Q - Farooq Hanif {BIO 4780978 <GO>}

The Cyber and also the size of the -- and the volume of revenue that you're getting from these partnerships, for example.

A - Joachim Wenning {BIO 16273429 <GO>}

Okay. So if you -- let me give you rounded figures. So in Cyber insurance/reinsurance, we have roughly a 10% market share worldwide, and that is a little less than EUR 0.5 billion of premium income per annum. That is where we are standing. And we are pretty much growing with the market roughly with a market share of 10%. It's a little less than EUR 0.5 billion, but let's round this figure. And the -- and some of the other new business models, which are the partnership models they are roughly producing another EUR 0.5 billion of our a little less at this point in time. So if you want to take the sum of all of that, then roughly EUR 1 billion comes from new risks, new business models, top line.

Q - Farooq Hanif {BIO 4780978 <GO>}

That's excellent. Thank you so much.

Operator

We will now take our next question from Ivan Bokhmat of Barclays. Please go ahead.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Hi, good afternoon. I've got a question on the P&C re and the pricing outlook. What a lot of your peers have indicated that the price momentum has been accelerating through the year. For you, the July renewals showed a bit smaller price increases. And in fact, if I apply the price increases you've gotten that January, April and July for 2019. I think the blended increase is smaller than you got last year. So I'm just wondering how you think in that view of the 2020 combined ratio improvement? And what should be driving that? And then secondly, perhaps just a follow-up on the first question asked. In terms of the risk-adjusted price increase? Maybe you could give kind of a qualitative argument or Ultivo and what regions and lines of business, did your view of risk change most.

A - Christoph Jurecka {BIO 17223019 <GO>}

Yes, pricing outlook. Actually, I don't think we see a totally different market out there than our options to -- we see a slight upward trend in pricing, generally. And given that we have the biggest booking that we are ever were more or less. You see some dilution effects. And this is kind of natural, so no problem at all. And of course, we enjoy the positive tailwind from that price increase. What happened is that we have various reasons why we think this tailwind will continue also in the upcoming months, that has a lot to do with the U.S. business, also with the primary business is there, then the claims experience, we were seeing in that market, specifically the last two years. The continued loss creep we have in the Japanese market, for example, all these things some limitations on is on retail, where capital is still there, but some of it might be locked in all these kind of things all together make a market environment, which we think is slightly more positive than it has been a year ago or two years ago.

But then again, we have a big book. There's a lot of proportional cover in it as well. It's not all XL. And then by really having significant increases in some markets, especially the loss-affected ones, we end up with a figure, which is 0.5% of your overall book. And of course, the good point in that is that the resilience when market would go down again, it's also higher. But on the other hand, being the largest player. It takes much more time. And for us to show a higher price increase rates than what we're currently doing. So no concern from our side. And actually, our qualitative assessment is that this renewal has been a very good one. So your second question was with regard to where has our risk view changed. Interesting question. Difficult question. I would say, broadly, it has broadly, it has not changed. And the risk view has not changed. What is, of course, constantly evolving is our view on how attractive or sufficient or the rates being paid for certain risks. And there is a few areas where this has evolved over time. But frankly, I will feel very, very unhappy to talk about that in this broad audience because this is of quite some competitive relevance.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Thanks, I appreciate it.

Operator

We will now take our next question from Frank Koffinger of Deutsche Bank. Please go ahead.

Q - Frank Koffinger

Good afternoon, everybody. I have two questions. My first question is also coming on apologies on the normalized combined ratio. So when you originally introduced your combined ratio targets. I think you did not factor in price increases. Now that we saw some price increases. Last year, we see some this year, you also initiated some cost initiatives in are insurance operations. However, your normalized level is still close to the 99% level. And the simple question is how happy can you overall give with this development? And where are really the drivers going forward to push the combined ratio down. And then secondly, on your German Life & Health business, I was surprised to see a negative currency effect there. So it's a German business, which was quite substantial with EUR 45 million. Can you comment on where this is coming from?

A - Christoph Jurecka {BIO 17223019 <GO>}

Thank you very much. Frank, I'll take both of them. To answer the first question, my personal happiness depends much more on our net income than on a normalized combined ratio. So your question was how happy can we be with a normalized combined ratio, I think we can. But anyway, our happiness is not so much relying on the normalized combined ratio. The concept in itself as it flows, as you know. And topics like reserve movement and so on are only to some limited extent, really correctly captured in that. On top of that, when we took defined targets. We always said that the combined ratio has not the same relevance like the net income but at the same time of quest, you're right, we did not incorporate any price increases back then when we did the calculation, but as always, there are many moving parts, when you make a multi-year plan for a company.

We also did not incorporate interest rate movements or equity market development. So there are many moving parts. And I think we can be very happy where the net income currently stands. And in the normalized combined ratio, also the trend starts lower figures. So the trend here is also trending so overall, I think we are making good progress here. Life & Health, the currency effect, our ITest German business, so it can only have to do it has only to do with the investment results, these companies are delivering. You know that a major part of our assets is allocated to these 2 segments, and they have some investments outside of the European Union outside of the Eurozone, and therefore, they are affected by currency movements.

Now the floor we have in the way we do the accounting here is that this currency effect is not shown as part of the investment without what should have been shown, but very low on the single line in the P&L and what you also have to keep in mind that the absolute figure looks very big. But if immediately, if you would look on the local GAAP basis into these books. The policyholder share would they are a major part of the currency losses here anyway, but also on the upside. So this is just a usual part of the investment activity, only the way we have to show it under IFRS is somewhat a little bit strange.

Q - Frank Koffinger

Okay, thanks.

Operator

We will now take our next question from Vinit Malhotra of Mediobanca. Please go ahead.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes. Good afternoon, everybody. Thank you. Several topics have been addressed. Just one topic, overall, if I can now ask is this -- and you mentioned that the one reason why you have confidence for 2020, despite low rates or interest petite use of the balance sheet. Now there is the reserves, there are the underlying gains, but these come at some kind of a cost Esentai man, if you, for example, realize too many games, then you get lower future investment income. So as a management team, how comfortable or how do you view these things? And the reason I ask is about in the past, I remember conversations have been different, have been more like a uniquely, why don't you realize all games as so many of them there? And is -- how do you view this balance sheet levers in order of importance in order of strategic importance or do you think that they are already unnecessary? Just any commentary to help us understand how you view these would be very appreciated.

A - Christoph Jurecka {BIO 17223019 <GO>}

Thank you, Vinit. That's something we could talk about for hours, probably a very interesting question. We won't -- I can promise. Well, I mean, first of all, I think we never that we were going to use our balance sheet for achieving our target next year. Because you also have to keep in mind, we are looking at a steady state here. So we are also refilling our P&C reserves as we speak and that you release some out of it. And I have been highlighting already before that the reserve strength overall is unchanged this quarter, like it was at year-end. Therefore, I would also this quarter not speak of a use of the balance sheet, and I would continue to say so also going forward.

The -- yes, the second question, the -- we -- the reserves we have on the balance sheet. I mean, I talked about P&C a little we also have, of course, plenty of them on the asset side. And if you want now in Q2, we did even built them up further because we could have realized much more gains in equities than we did. But we took only the loss on the derivatives on equities, which we hold to hedge the equity exposure, but we did not realize the same amount of equity. So if you want, we didn't even build up the reserves on our balance sheet. So it is the opposite of using it. We did not use it. But we will build it up in Q2. And I understand your question in a sense like how much buffer do we want to build up. And I mean, I don't think that the release is a very simple answer to that.

But looking at the volatility we have at the equity market at this stage. And then the discussion we had before on the ROI and the potential implication on the return on investment. Going forward, now that the fact that we have negative input rates in so many geographies already. I feel kind of confident that also on the asset side, we have been not as pushy as we could have been in realizing gains. And I mean, to having the privilege to show already very good result and excellent result and at the same time, having built up reserves on the balance sheet. I mean, there could be any better place for CFO to be at. And therefore, my happiness to come back to that very much live with having a good result and at the same at the same time, a strengthened balance sheet.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Can I just ask one more but I did have to -- two, sorry. In the P&C, so we saw very strong growth in 2018, and we talked about it the U.S. initiative on regional growth over the last year, for example. But this year, the growth has kind of it mellowed and they could be because of the base effect, but then renewals are still 6, 7 may YTD that kind of range, 8% maybe 7% on YTD volume. When shall we expect this to come in with towards the end of the year in the P&C Re growth please? Hello.

A - Christoph Jurecka {BIO 17223019 <GO>}

Vinit? I'm not sure if I'll answer the question correctly, but I think your point was that growth was a little bit more limited this year compared to last year. And this might have been true that we have been more selective, but we never said that we would just take ever piece of business, we could potentially take. And therefore, I think that there's nothing specific to comment on here. As I said, with the renewal and plus 9% of premiums, we are very happy. And on top of that, last year was maybe also augmented to certain amount by some large deals, but nothing really to be observed here.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes. No, my point was the renewals have been running higher this year than the growth we have seen this year in the GWB of P&C Re. So maybe there is -- maybe will come in later or?

A - Christoph Jurecka {BIO 17223019 <GO>}

I'm not what sure what will come later?

Q - Vinit Malhotra {BIO 16184491 <GO>}

The renewal -- the fact that renewals are running 7% range, but we are only seeing 1% to 2% premium growth now, so we see them next year maybe?

A - Christoph Jurecka {BIO 17223019 <GO>}

Yes, there's always kind of a delay. So yes, you are right. But also the premium level will be up. So that's a certain delay of course, yes.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay, thank you very much.

Operator

We will now take our next question from Edward Morris of JP Morgan. Please go ahead.

Q - Edward Morris {BIO 16274236 <GO>}

Okay, thank you for taking my questions. A couple of things. I just wondered if you could quantify on low rates. I know we've sort of danced around this topic. But can you tell us what the current yield to maturity is on the fixed income portfolio? And if rates stay where they are today, what is the sort of year-on-year headwind that you face for your investment income all else constant. And the second question is sort of linked to low rates, thinking about it more as an opportunity, obviously, you have quite significant debt capacity. I wonder if with rates where they are today, does it make you any more likely to think about acquisitions or maybe using some of that debt capacity on your balance sheet to enhance ROE a little bit?

A - Christoph Jurecka {BIO 17223019 <GO>}

Well, thank you very much for the questions. I think the first question was the attrition if the investment yields would stay where they are, how much or how I would potentially go down then. And clearly, there's not a single-tool answer because of the various effects to be to be kept in mind here. So as I said before, the result on derivatives, the realization. We are going to have anyway because the high amount of unrealized gains we now have result in just higher realization due to the fact that you cannot touch any single security we're having without realizing gains because all of them are carrying unrealized gains now.

But in a very simple terms, our duration is around 8 9, 10 depending on the books we are looking at and then the difference currently between our in-force asset book and the investment yield, maybe it's 0.8 maybe 1 percentage point, that order of magnitude. So by doing the simple back-of-the-envelope calculation, you come to an attrition of maybe 10 basis points per year. But which, as I said, will be offset by countering measures like also higher investments and illiquid investments like other topics we are looking into currently and then as I said, the higher realizations. So overall, as I said, short term, a very limited effect. And on the long term, it will have higher impact. Second question is the debt capacity. We have capacity for more debt, that's not new. It's got cheaper now, even cheaper than it was already a year ago.

On the other hand, as you know we have restrictions on local GAAP equalization reserves and so forth. So, therefore, it's not straightforward to change the financing structure we are currently having. I would be happy to have more debt in case these restrictions would not have been here, but they are. And then I cannot get off the hook from them. Therefore, at this stage, I don't think we'll -- there's room for any other action. What continues to be true is that we think we have enough room for strategic opportunities. And if opportunity might come up, then we would be very happy to take them. But that's more or less independently of the interest rate because that was already the case before.

Q - Edward Morris {BIO 16274236 <GO>}

Thank you. Very helpful, thank you.

Operator

We will now take our next question from Michael Haid of Commerzbank. Please go ahead.

Q - Michael Haid {BIO 1971310 <GO>}

Thank you very much. Good afternoon. I have two questions. First question -- sorry, I have to come back to the P&C reserve releases, you kind of made me believe that you actually were forced to release redundant reserves. Normally, I would rather believe you have a lot more discretion to decide to keep reserve buffers on the book and put this into whatever IBNR reserves. Is it fair to assume that on a broader basis, these reserve releases were actually runoff profits. So from claims, which were actually settled, or is this a wrong assumption, asked differently, why did you not try to maintain the reserve -- to keep the reserve buffers on the book? Second question, the combined ratio in Germany is very simple, it was excellent at an excellent level. Any one-offs there? Anything unexpected because that combined ratio is just extraordinary, extraordinarily good.

A - Christoph Jurecka {BIO 17223019 <GO>}

Well, Michael, thank you for the question. First of all, as always, looking at reserves, it's various effects, and each book is different in its nature. And then the development is different. So that's not a single-tool answer, but what is correct, that we felt quite under pressure to do something and that we felt it was adequate to react right now, not wait for the end of the year because the indication was so clear and you're right, there's a lot of discretion. But sometimes, you come to the very end of how far you can go with you this question. And that's all I will tell you about that. About Germany, you're right, the combined ratio in Q2 was exceptionally good, and it was the best combined ratio, i.e. so as far as I remember, over Germany. Reasons, first of all, low large losses.

Which is, of course, given that we had some storms in Germany in the first half of the year has something to do with luck. But what has less to do with luck is that we have a very sound profitability across various books at a Germany where also the attritional part of the claims development developed very positively. And then thirdly, you know that we have the seasonal shift of premiums between Q1 and Q2 at average Germany, which meant that we had higher premiums in Q2 and lower premiums in Q1. So the higher earned premiums in Q2 also supported this exceptionally good combined ratio.

Q - Michael Haid {BIO 1971310 <GO>}

So what is then the expectation going forward for the combined ratio in Germany.

A - Christoph Jurecka {BIO 17223019 <GO>}

The year-end guidance is 93%, our run rate after 6 months is 91.9%. So we are clearly below that, but still 6 months to go so we would not change the outlook now.

Q - Michael Haid {BIO 1971310 <GO>}

Okay, thank you very much.

A - Christoph Jurecka {BIO 17223019 <GO>}

You're welcome.

Operator

This conclude today's question-and-answer session. I would now like to turn it back to your host for any additional or closing remarks.

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

Yes, Mary, thank you very much. Nothing to add from my side. Pleasure to have you had with us this afternoon. Thanks for your questions and hope to see you all again very soon. Thank you, and bye-bye.

Operator

Ladies and gentlemen, this concludes today's call. Thank you for your participation. You may now disconnect.