# Q4 2016 Earnings Call

## Company Participants

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

## Other Participants

- Anasuya Iyer, Analyst
- Andrew J. Ritchie, Analyst
- Frank Kopfinger, Analyst
- Guilhem Horvath, Analyst
- In-Yong Hwang, Analyst
- Kamran Hossain, Analyst
- Michael Haid, Analyst
- Michael Igor Huttner, Analyst
- Paris Hadjiantonis, Analyst
- Thomas Seidl, Analyst
- Vikram Gandhi, Analyst
- Vinit Malhotra, Analyst
- William Hawkins, Analyst
- Xin Mei Wang, Analyst

## MANAGEMENT DISCUSSION SECTION

### Operator

Good day and welcome to Munich Re Preliminary Results Conference Call. Today's conference is being recorded, and at this time I'd like to turn the conference over to Mr. Becker-Hussong. Please go ahead, sir.

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

Yes, thank you, Alison. Good afternoon, everyone. Welcome to Munich Re's call on the 2016 preliminary results and the outcome of the 2017 January renewals. Jörg Schneider, our CFO would start with a short statement and then we will go right into Q&A.

So, Jörg. Please go ahead.

### Jörg Schneider

Thank you, Christian. Good afternoon, ladies and gentlemen. With a net profit of around €2.6 billion, Munich Re is right in the middle of the initial €2.3 billion to €2.8 billion target range. We have largely been able to compensate for the cost of this strategic reorganization of ERGO. Thanks to a sound, underlying performance and helped by a bit of good luck as well as FX gains, we posted a robust result without eroding our substance.

We consider an ROE of 8.1% and a RORAC of 10.9% to be quite pleasing. However, the challenging industry market conditions and prevailing low interest rates are having a visible impact on financial results in the industry. We will not be complacent about Munich Re's good 2016 result and our strong balance sheet will help mitigate some of the underlying earnings pressure going forward.

I am confident that during the next couple of years, we will more than replace lost income by further developing our business model with targeted, innovative client solutions.

The Q4 result of around €500 million was quite decent given substantial major loss burden, and thanks to positive FX effect, we refrained from using the strength of our balance sheet more actively.

Our capitalization remains very robust according to old metrics and continues to provide the basis for high payout. Local GAAP earnings improved substantially over the previous year. This was due to net negative non-recurring effect in 2015. In 2016, the underlying result was lower, Q2 lower reserve releases and higher major losses. This was overcompensated by a lower contribution to the equalization reserve and a good investment result including intra-Group disposal gains.

According to a preliminary calculation, the Solvency II ratio at the year end 2016 amounts to about 260% without transitioning it (03:24). In the fourth quarter, a favorable impact from higher interest rates and FX effects on own funds and SCR was partially offset by the effect of model op (03:39) updates including modeling of negative interest rates.

We want our shareholders to benefit from our good performance. The proposed dividend increase of 4% to €8.60 per share, further confirms our attractive and reliable dividend policy and our trust in Munich Re's sustainable earnings power.

Just a few remarks on the investment result, which stayed at the same level as in the previous quarter. While the reinvestment rate was stable, regular income increased slightly in Q4, Q2 one-off effect.

Impairments on commodity investments in particular gold led to increase net write-downs. Net gains from disposals were somewhat higher. They declined in the reinsurance segments, as we refrained from our active harvesting. But there were higher gains in ERGO's international business, as well as in Primary, Life and Health. The gains in the later segment were offset by losses on hedging derivatives due to booming equity markets and rising yields.

For the full year 2016 given the low interest rate, we are quite pleased with an investment result of €7.6 billion. Our prudent asset liability management and high degree of diversification once again proved beneficial, the ROI of 3.2% matches the return in 2015 as an improved derivative result and lower write-downs, mainly offset attrition of the running yield.

On a segmental basis, however the reinsurance ROI declined a lot, while it increased further in Primary insurance.

Let me give you the highlights by business segment. As expected, ERGO produced slightly negative results for the full year 2016, mainly due to the restructuring charges and investments for its strategy program. For the Q4 standalone, net earnings were positive, helped by a high investment result in all the segments. Furthermore, German Life and Health business benefited from a high technical result and positive tax effect.

In Q4, the combined ratio of 100% in Germany was caused by higher major-claims and increased prudency in industrial liability reserve and an elevated cost ratio due to investments in the context of the ERGO program. The combined ratio for the full year amounts to 97%, well below our 98% guidance. And this includes 1 percentage point impact from investments in the strategy program, that are immediately recognized as an expense.

The combined ratio of our international non-Life operations improved to 99% for the full year on the back of a better performance in major markets. In Q4 however, the ratio of 100.4% suffered, among other things from reserve increases in Turkey. Furthermore, there were changes due to closing ERGO Belgium to new Life business. Markus Rieß will present the key points of the future strategy of ERGO's International business at our Analyst Conference in March.

Owing to a strong performance in Q4, Munich Health comfortably exceeded the full year net profit guidance. This is due to good underwriting performance including various technical effects and a high investment result, which benefits from the release of some prior years conservatism. Munich Health fully met its ambition for 2016 with a combined ratio of 98.5%. As recently announced, we desponded the business segment with effect from first of February.

Turning to reinsurance, starting with Life, the very strong technical result of almost €170 million far exceeds the normal quarterly run rate. As in the last quarter, the result benefits from technical one-off effect and favorable reserving adjustments. The contribution from North America and Europe was strong, but earnings from Asia was somewhat weaker compared with previous quarter. For the full year, at almost €490 million, the technical result comfortably surpasses our ambition, despite large single claims in the first quarter.

Moving onto P&C reinsurance, the combined ratio was 101.9% for the fourth quarter. This was largely down to above average major loss activity, and it was only partially compensated for by reserve releases accounting for 5.7 percentage point, net of commission effect in Q4.

The full year basic loss net reserve releases were 5.5%. As an outcome of our annual reserve review, a higher release which have been possible. But we deliberately decided to maintain a high level of prudence in our reserve. I consider our reserving situation to be at least as strong as it was at year end 2015.

On a normalized basis, the combined ratio has continued to increase amounting to 100% for the full year according to our usual and somewhat simplified calculation method. On the one hand, this reflects price reductions experienced in the 2016 renewals. But on the other hand, there were larger weather related basic losses, for which we give no credit when adjusting the ratio, as well as the usual noise from things like business mix effects. Therefore, we believe that our actual combined ratio is at a level which is more or less consistent with our guidance of 99% for 2016. In the current soft market, we have not given up our underwriting discipline, our initial estimates are probably a bit conservative.

Market conditions for the renewals of our reinsurance treaties at 1st of January 2017 were once again challenging, yet price erosion continued to slow. Terms and conditions were largely unchanged. Thanks to our active cycle and portfolio management, we limited portfolio price decreases to 0.5%. We withdrew from business that no longer met profit expectations mainly large quota-shares in China, but we also expanded profitable business both by seizing new opportunities and strengthening existing client relationships. Overall, we posted a reduction in premium volume of almost 5%. The projected portfolio profitability is still above our cost of capital.

Thank you, ladies and gentlemen for listening. I'm now happy to take your questions.



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

Yeah. Thank you, Jörg. As mentioned, we go right into Q&A now. My usual request, please limit the number of your questions to a maximum of two per person. Thank you.

# Q&A

## Operator

Thank you, sir. We will take our first question from the line of Kamran Hossain from RBC Capital Markets. Please go ahead, sir.

## Q - Kamran Hossain {BIO 17666412 <GO>}

Hi. Afternoon, everyone. Three questions. First one is just on the HGB earnings. Last year the utilization reserve cost, I think is €0.4 billion from memory. What is the quantum of that decline when we think about HGB earning to 2016. And when we look to 2017, does that number turn positive next year? That's the first question.

And the second question, just on the reserve releases for the full year in P&C, obviously they've come in 5.5% which is higher than the 4% at the beginning of the year, but it's lower than the 6% that you mentioned at the Q1 statement. So, in terms of a 0.5%

difference, is that additional prudence that's going into next year, or will it be rolled over into 2017 or will it just sit there in buffer. And any thoughts around how you think about that would be really helpful? Thank you.

## A - Jörg Schneider

Thank you, Kamran. First, on HGB earnings, the contribution to the equalization reserve was more or less in line with last year's, a little bit lower. And it will most probably turn positive in next year, but that depends on the development of our losses – of our loss ratio. But, the tendency is quite clear, the various – for the various lines of business, we are close to the maximum, yeah. So there is not much more to contribute and to inject here in that reserve. So it will be strong support for distributions going forward.

Second, reserve release is 5.5%, lower than 6% which we indicated during the year. Let me frankly admit that we got a bit nervous at the beginning of the year was a very weak first quarter. And then we said to ourselves and then to the public it is highly unrealistic to expect us to miss our profit target for the year. While at the same time, sitting on very substantial, yeah, I would say, estimation grounds, you can also call it, buffers on the reserve. And therefore, we said, it is unrealistic to assume that there will be a lower release than 6%. The year turned out to become much better.

We had as always a wide estimation range and because of the closing activities, and we stayed at the high-end of what is digestible from an adequacy point of view (16:11) and therefore, one could have released much more, but we didn't. Perhaps you can say, because it was not necessary. But this is not a message of lower confidence in the reserve. We preserve the strength of our balance sheet. So if inflation spikes for example, or if pressure from current underwriting prevails in future, then there is very strong basis from the reserves going forward.

## Q - Kamran Hossain {BIO 17666412 <GO>}

Fantastic. Thanks very much.

## A - Jörg Schneider

Thank you, Kamran.

## Q - Kamran Hossain {BIO 17666412 <GO>}

Thanks.

## Operator

We will take our next question from Mr. Andrew Ritchie from Autonomous. Please go ahead, sir.

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

Oh. Hi, there. Two quick questions. ERGO was more or less breakeven or slightly loss making in 2016. I think, please clarify that's after €300 million roughly net of restructuring charges and investment. The guidance, I think, was €130 million of expected net profit for 2017, what is your confidence still in that kind of recovery? Can you give us any sort of vague update as to the progress so far of any of the restructuring and the investment programs? So just a revisit of the ERGO guidance number, first question.

Second question, in the renewals, there is quite a lot of big movement obviously of cancellation. I think, you cancelled 14% of the business, and you grew new business, 12%. What areas was that growth of new business in and does this capture any bespoke business, bespoke transactions or are you kind of treating that separately? I am surprised you haven't commented a bit more on the opportunities there in renewals? Thanks.

## A - Jörg Schneider

Thank you, Andrew. With regard to ERGO, so the restructuring charges for 2016 including what we call investments that are the expenses, which go directly into the result were on a net basis €250 million, roughly. And our guidance for next year €130 million remains unchanged.

So progress is absolutely according to plan, we are lagging behind only for a couple of projects, but overall we are very satisfied with the first results and with the first steps. The negotiations with the staff representatives have come to a successful result, and also the combination of the sales forces went pretty well. And new business is in line with our expectation, slightly above what we anticipated in the cause of the strategy program.

So things are going well, are going into the right direction. And for the profit guidance, we do not have better indications now, as the €130 million which we indicated in June last year.

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

And so, without – €50 million less restructuring and investment (19:35), is that right?

## A - Jörg Schneider

Overall, it's more or less in line, yeah.

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

Okay.

## A - Jörg Schneider

So that was quite close to what we indicated. And then, new business, what we gave up is, for example, major quota-share treaty. So this stands for a bulk of the reduction in volume, which we have had. And as you know, these treaties are high-volume low-margin, that means for our profitability, they have a lower impact.

Where could we grow? Some new business in casualty U.S., some in property U.S., some other business in China also and in the UK. So if I see the list of individual cases, it's a broad and highly diversified portfolio of new business, sometimes only expansion of business with existing clients, sometimes new business opportunity with new clients. So overall, that's the reason why we are rather satisfied about the outcome of the renewal.

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

Okay. Thanks.

## Operator

We will take our next question from Guilhem Horvath from BNP Paribas. Please go ahead.

## A - Jörg Schneider

Guilhem.

## Q - Guilhem Horvath {BIO 18460437 <GO>}

Yes. Thanks for taking my questions. The first one is on the North American renewals and the pricing there. I am a bit surprised to see that you still have an erosion in terms of pricing, despite the fact you had a couple of very large not-good (21:23) events there. So, can you comment a little bit on the pricing trend in this geography?

And the second is in terms of investments and the fact that you still have reinvestments yield which is concerns (21:35) quarter on quarter and I'd like to have your view on the fact that we are now evolving in an environment which apparently shows little bit higher yields. So, are you trying to cut short a little bit of this or – yeah, do you have a little bit view on that? Thanks.

## A - Jörg Schneider

First on the North American renewals. We see a further stabilization in casualty business there. And rates are mostly flat, and with a positive impact from the – with a positive impact from interest rates the overall profitability is quite satisfying at the moment.

With regard to property business, rates are slightly down, according to what we see between 2% and 3%, I can say only. And the impact from Hurricane Matthew doesn't seem to have been very high, yeah. But we must see anyway the loss burden more on a global basis in our view.

What we also see agricultural business rates to increase, moderate decreases for Latin America, for Canada and Australia. This is the picture what we see at the moment, yeah. But, overall, a very diverse picture with very limited changes between 2016 and 2017. Thank you.

## Q - Guilhem Horvath {BIO 18460437 <GO>}

Okay, thanks. And the investments?

## A - Jörg Schneider

And the second, the investments. We do not change our investment policy, that means moderate risk, highly diversified based on economic matching of assets to liabilities. Hence, we can at the moment – we can at the moment harvest some of the better yields especially in the United States, but it also depends on the duration of the portfolio, and we are currently in the course of slightly reducing the duration of the portfolio overall. Yeah, so that means that all these effects level out each other somewhat.

## Q - Guilhem Horvath {BIO 18460437 <GO>}

Okay. Interesting. Thanks.

## A - Jörg Schneider

Thank you.

## Operator

We will take our next question from Xin Mei Wang from Morgan Stanley. Please go ahead.

## Q - Xin Mei Wang {BIO 16662657 <GO>}

Hi. Good afternoon. Two questions. First is a follow-up on the reserve release question. Were there any areas where you had to strengthen reserves. And just given from your commentary about high level of prudency, but also potential for higher inflation, going forward, is the 4% number still the right number to be thinking about?

And my second question is, Jörg, I think you were quoted in the media earlier with regards to M&A and exposure of ERGO internationally. Can you expand a bit on which segments Life, P&C and geographies you are willing to consider, and how large your appetite is there? Thank you.



## A - Jörg Schneider

Thank you, Xin Mei. With regard to the reserve, there are no buckets of major reserve strengthenings, yeah, so it's not the one big one or so, it's ups and down here and then overall a very favorable view with what we call actually reported losses versus expected reported losses, still with a very wide difference.

And with regard to M&A, there's nothing new, I would say. We would very much like to make a fantastic deal, but we do not see one out there. And with regard to our growth ambitions, it's also about acquired growth, and it can be in the primary insurance field, internationally, still interesting for us, Eastern Europe, and Southeast Asia, but Markus Rieß will come back to that in the course of Analyst Conference, but please do not expect any sensations here, yeah, it's a lot also about consolidation and concentration, and it's about developing what we have already plus some additional acquisitions also to strengthen our position in markets where we have been already strong.

And what we would also very much like is to expand our specialty insurance activities written out of the reinsurance organization, what we call risk solutions, especially when there are special - when we can acquire special knowhow, which we can leverage on the broader Munich Re platform, and which could fit ideally to the knowhow of our group. This is what we are actively searching, but as you know, the markets are not easy because we think that the current prices for M&A, which we see in the auctions, do not adequately reflect the risks we are currently faced with, also from a global perspective.



## Q - Xin Mei Wang {BIO 16662657 <GO>}

Okay. Thank you very much.

## A - Jörg Schneider

Thank you, Xin Mei.

## Operator

We will take our next question from Vinit Malhotra from Mediobanca.

## Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes, good afternoon. Thank you. Vinit from Mediobanca. Just two questions, please. One is on - yeah, could you please update us on the state of the derivatives in the group particularly as you mentioned as well some write-downs on commodities and gold. And in that context, the confidence in the reserves for the inflation, is that because you have assets hedging inflation or is it just because the reserving assumptions are probably much higher than where we are now, if you could just clarify that question, please?

And very quick question also on New Zealand earthquake. Was there any revision to the prior event in 2010 or 2011, in today's €250 million or it's all from just this one event. And even if you could just comment also on there were some changes at the EQC Act was being reviewed, and apologize I haven't followed that that closely, but maybe you could just provide us with update, please? Thank you.



## A - Jörg Schneider

Yeah. Thank you, Vinit. First derivative, we somewhat took down our derivative in the portfolio. The main reason was that our inflation sensitivity was remodeled and was - the outcome was that our inflation sensitivity on the liability side is lower than originally anticipated, and we reacted to it by taking down the inflation derivatives. Therefore, they do no longer play a major role there, there is some protection on the asset side, but not an enormous one. The confidence really comes from the fact that, we are very highly reserved and that we could easily absorb also a higher loss inflation going forward.

With regard to the New Zealand earthquake, our very high estimation for this loss is influenced by the prior earthquakes of 2010 and 2011, but only in the sense that we learnt a lesson at that time, because at that time, at the beginning the losses were underestimated, built on - based on very high building standards we had there, some buildings were looking as if they were not damaged and turned out to be a total loss then later on. Then, the building standards were brought up, and therefore, we see a pretty high exposure in such a case of an earthquake, and that might have influenced our very high estimation here.

Another reason is that a lot of that business has been written out of Australia where we are – where we have a very strong market share. And typically in New Zealand the declines have relatively low self-retention. And all these factors bring up our own loss to this very high level, which is fully in line with our market share, but I would like to underline here our local market share, not our worldwide market share, so it can well be above than our worldwide market share, so far with the New Zealand earthquake.

## Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes. Thank you very much.

## A - Jörg Schneider

Thank you, Vinit.

## Operator

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

## Q - Michael Igor Huttner {BIO 1556863 <GO>}

And I had one question on deals, how much could you spend? And I know, you wouldn't say, but maybe you could give the answer in terms of the leverage you could go to and where you are now? And then, on the HGB results, you kind of didn't answer, I think, one of my colleagues said, oh what were they (31:34) and you kind of said, no, no, no, fine. What was the number, because you said significantly above $3 billion, and I just wondered whether you could give more clarity on that because clearly it influences our thinking on how much you can afford in distribution going forward as well? Thank you.

## A - Jörg Schneider

Thank you, Michael. Your first question, was it about M&A, how much we can spend?

## Q - Michael Igor Huttner {BIO 1556863 <GO>}

Yeah, exactly. Yeah, yeah.

## A - Jörg Schneider

Well, we could – it depends, yeah. So, we can finance a lot. We have a very low leverage which we could increase. Our appetite for stretching it is somewhat limited, and...

## Q - Michael Igor Huttner {BIO 1556863 <GO>}

You're at 13%, aren't you? In the past, you were just 17%...

## A - Jörg Schneider

Even lower.

## Q - Michael Igor Huttner {BIO 1556863 <GO>}

Even lower, okay.

## A - Jörg Schneider

Even a bit lower and that's a very high capacity for additional raising of hybrid debt for example, but we do not intend to do it at the moment. And with regard to major M&A, nothing is in the pipeline at the moment, and we have not changed our approach to it, yeah. So we very much look at the numbers and see whether it is really value creating, if not only empire building, so you can rest assure that the discipline prevails also in future. When there is a once-in-a-lifetime opportunity, we would do our best to move then. HGB, the result for 2016 is $3.4 billion, so pretty high.

## Q - Michael Igor Huttner {BIO 1556863 <GO>}

Okay. So pretty high.

## A - Jörg Schneider

Thank you.

## Q - Michael Igor Huttner {BIO 1556863 <GO>}

Thank you.

## A - Jörg Schneider

Thank you, Michael.

## Operator

We'll take our next question from Paris Hadjiantonis from Credit Suisse.

## Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Yes. Good afternoon, and thanks for taking my questions. I have two today. Firstly, on Life Re, the result – the technical result is a lot better than your €400 million guidance, and I was wondering whether or not this is sustainable or if there are some kind of one-offs in that number?

And then, secondly, we haven't really talked about outlook for 2017. Maybe it's a bit early, but if you could give us, maybe a kind of a directional guidance versus your full year 2016 result? Thank you.

## A - Jörg Schneider

Thank you, Paris. Life Re, there are some one-offs in the number. Like always, we have huge reserve movements, we have reporting from clients which changes our numbers and have an impact on our numbers for quarter which is in the double digit range. And overall, I would say, they compensate each other and this was really a strong result. So in spite of being dominated by one-off, but one-off in both directions.

Going forward, I'm confident that this level is sustainable, but please do not rely on quarterly delivery of €100 million because sometimes we have chances, yeah, you have chances to enter into a new business which might be negative, short-term for our IFRS P&L, sometimes you can negotiate on recaptures with the client which is from an economic point of view attractive, from a P&L, IFRS point of view, perhaps a little bit burdening. So, therefore there will always be volatility but the level of profits going forward should be in the ballpark range where rate is now, or even a bit higher and we are very confident with regard to the value of new business going forward.

For 2017, let me first say and confirm what we already told some of you, that if we adjust for many things the 2016 results, for example for the ERGO restructuring with minus €250 million or the too low reinsurance investment result, on one hand. On the other hand, the lower major losses or the FX result, then we end up somewhere around €2.4 billion.

Going forward what do we know for – about 2017, that it's a further decline in the running yield, let's say, in the order of 50 basis points or so. Even a spike in interest rate wouldn't change it dramatically short term because it takes time with our mid-term to long duration before it really benefits the current interest earnings. Hence we have a further slight negative impact from 2016 and 2017 renewal.

So, therefore, on a like-for-like basis, it should be below €2.4 billion. And then we are sitting on a very strong balance sheet, which in the course of its run-off could have a positive impact. We will come up with a guidance for 2017 in the course of the Analyst Conference, but I assume that we will not surprise you.

## Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Thank you very much. Very helpful.

## A - Jörg Schneider

Thank you, Paris.

## Operator

We'll take our next question from Thomas Seidl from Bernstein.

## Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah. Thank you. Good afternoon. The first question is on the U.S. new government planning quite significant changes on borderline tax and intra-Group reinsurance deductibility, though my question is, if you could comment please on how serious those risks are? And what you could do to mitigate that?

And the second question is regarding China, it's a bit of a contradictory picture. On the one hand you basically say this is a big opportunity, on the other hand you're losing business (38:11) new Chinese local reinsurers being started up. So I wonder how you see the market share of Munich Re evolving in China? Thank you.

## A - Jörg Schneider

Yeah. Two most difficult questions. Let me start with the second one. China is a big opportunity because we have the phenomenon of underinsurance there, yeah. So enormous exposure to natural catastrophe and when we compare the insurance density with that in other mature market, then there is a lot of additional potential.

In addition to the economic potential obviously still a (38:50) strongly growing market, what we lost there, this is big quota of shares with high numbers, high top line numbers, but very low bottom-line. So therefore I wouldn't be so worried about the most recent development in the renewal 2017, but it is a very competitive market, that is for sure. Yeah. So we're fighting, we have a strong presence onsite, we have very good people there, we have the whole Munich Re knowhow and capacity, but we have nothing – we have no gifts to grant there, yeah, that means it will remain volatile from year-to-year, and very active underwriting policies of utmost importance that we do not only go for growth there and that will be the same in future.

With regard to the new U.S. government and the various plans, Munich Re has acquired good position there, because we have Munich Re America and we have a couple of primary insurance companies, which you all know, which give us a very strong foot on the ground, and also a lot of jobs on the ground, I would like to underline here.

Deductibility for outgoing intra-Group reinsurance is a matter we can observe, but we can channel that or we can react by increasing our local retention here. In principal, we believe in a worldwide diversification of risk, which is important and therefore we always protect our subsidiaries and even branch offices outside of our country by (40:44) agreements which more or less end up in Munich Re AG, Munich in the end. But we have some leeway to optimize it. And since we are a U.S. reinsurer with a domicile there, we are also protected against any negative impact there. When tax rates will be reduced we will benefit from this phenomenon.

Lastly, I have to clarify what I said before about Life, we have set the same level going forward, I wanted to refer, but I didn't explicitly to the €400 million guidance and not the €500 million, which we achieved in 2016. So the €400 million remains a good guidance going forward. Sorry, if I created here some irritation. Thomas, does it answer your question?

## Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah. Perfect, it's clear. Thank you very much.

## A - Jörg Schneider

Thank you.

## Operator

We'll take our next question from Anasuya Iyer from Jefferies.



## Q - Anasuya Iyer {BIO 18981555 <GO>}

Hi. Thanks for taking my question. My first question is just a follow-up on one of the other ones about ERGO. When you gave us the update last June, rates in Germany were almost negative, I think, and the 2016 guidance for profit was marginally net negative assuming no change in rates. Since then rates have worked in your favor, the net income has come in as per guidance. I'm just wondering, whether in the future this could change if rates do continue to spike up. I mean, I appreciate there is hedges and the duration is long, but any comments on this would be useful.

And on the same topic, at the (42:41) is there a plan to give more details the targets on ERGO International, because I think that was the plan before?

And my second question is just more generally on capital repatriation. Obviously, your German GAAP position is quite strong, but at the same time you are saying that you could see a bottom-of-the-market in terms of pricing. How do you think about those two factors when you think about capital repatriation? Thank you.



## A - Jörg Schneider

Thank you, Anasuya. ERGO, last June when we disclosed our restructuring program, as far as I remember, it was based on interest rates which were higher than those in the fourth quarter and in the third quarter, so that it was – we didn't correct it immediately downwards, yeah, and now we are more or less back where we were – when the restructuring program was constructed and calculated. That means I wouldn't see a major positive between then and now from the increase in interest rates. But let me confirm on the other side that I feel a little bit relieved about this normalization of interest rates which we experienced recently, yeah, that this crazy development below the zero line came to an end and there is much more realism now in the numbers.

The targets for international expansion – let me predict, it will be a careful way, a careful way means first is consolidation, first is growth out of the existing and in some cases very strong entities abroad and then it will be about further expansion also by acquisitions by entering new markets. There could be an opportunity in the meantime which we would like to pick up, but it will not be a dramatic – a dramatic and totally different program for the next one or two years.

Then repatriation of capital, if markets would drastically improve and underwriting margins would go up, I think that wouldn't change so much in the short term, because we have a capitalization in the order of 260% economic Solvency ratio, compared to what we call optimal range between 175% to 220%. So, there is still some room to grow before we are in the optimal range. So we could increase our underwriting risks quite substantially, especially due to the fact that there's a very high diversification in place.

That means that typically underwriting risks, if they are not all focused to the peak natural catastrophe risk diversify pretty well in our portfolio. Therefore, there could be a lot of organic growth before we have to rethink our capital management policy.

## Q - Anasuya Iyer {BIO 18981555 <GO>}

All right, great. Thank you.

## A - Jörg Schneider

Thank you, Anasuya.

## Operator

We will take our next question from Vikram Gandhi from Societe Generale.

## Q - Vikram Gandhi {BIO 18019785 <GO>}

Hi, there. I've just got one question, which is why do you love (46:36) model for the negative interest rates, when yields seem to have at least stabilizing the positive territory.

## A - Jörg Schneider

Because we have to, yeah. It's a good question. We had to learn that negative interest rates are possible and we had to more precisely model the impact in our internal steering here and which is also the basis for the regulatory world here. And by the way also, the German BaFain, our lead regulator wouldn't have accepted that we ignore negative interest rates.

## Q - Vikram Gandhi {BIO 18019785 <GO>}

Okay.

## A - Jörg Schneider

If you look at the numbers right now, they might look unrealistic but we feel much better having modeled them appropriately.

## Q - Vikram Gandhi {BIO 18019785 <GO>}

Okay. That's clear. And just a follow-up if I can. Any release that you expect on the ZZR front?

## A - Jörg Schneider

Not really. Two extreme scenarios I have in mind. One is continuation of the very low interest rates, that could mean an enormous range from the ZZR, which we can fulfill by realizing our unrealized gains, especially on the fixed income side, in order to finance the ZZR requirements under local German GAAP. It could become very difficult for many companies to fulfill these requirements going forward and I don't know how the regulator and legislator will react to that.

Second scenario that is a very strong spike in interest rates, which would mean that the unrealized gains could immediately disappear. That means you wouldn't have any tool to finance the contribution to ZZR because ZZR would react very slowly because it is based on a 10-year average interest rate of first class bonds. In such situation, I would trust that legislation and regulation would find tools to change the formulas here. Overall, we see the ZZR with mixed feelings, on one side it's an enormous requirement, perhaps a bit exaggerated under the current circumstances, on the other hand it has a benefit that it supports discipline on the market with regard to profit sharing with policyholders, because if you have no profit then you can't share anything. Therefore, it's also in the interest of shareholders.

## Q - Vikram Gandhi {BIO 18019785 <GO>}

Okay.

## A - Jörg Schneider

Thank you.

## Q - Vikram Gandhi {BIO 18019785 <GO>}

Thanks a lot. Thank you.

## Operator

We'll take our next question from Frank Kopfinger from Deutsche Bank.

## Q - Frank Kopfinger {BIO 16342277 <GO>}

ERGO result...

## A - Jörg Schneider

Frank, are you are there?

## Q - Frank Kopfinger {BIO 16342277 <GO>}

Yeah.

## A - Jörg Schneider

Hello?

## Q - Frank Kopfinger {BIO 16342277 <GO>}

Can you hear me?

## A - Jörg Schneider

Yes, we can hear you well.

## Q - Frank Kopfinger {BIO 16342277 <GO>}

Okay. So my first question is on the ERGO result. Can you provide some more color on these standalone Q4 effects in respect to impact from disposal gains, tax effects, and also if occurred, whether they were some movements on the reserve side, i.e., some runoffs in P&C.

And my second question is on the restructuring in Belgium. On the €300 million capital injection, could you comment on whether this had been done by equity injection or via hybrid capital? And also, whether there is a risk that you have to inject more in the future?

## A - Jörg Schneider

Thank you, Frank. First ERGO Q4 result was plus €70 million, roughly. In Life and Health, it was even €95 million, so very high. It was based on a very high technical result, that has to do with an increase of the shareholder quota in the shareholder-policyholder split for technical reasons. Because the contribution to the policyholder funds to the RfB (51:12) are kept with regard their tax deductibility, and therefore we had to optimize it from a tax position, a very technically effect.

Second, we had very high gains from disposal in the investment result and we had special effects from the distribution of income and expenses over the quarter. So Q4 is dominated by one-off effect, also tax effects from tax audits. Therefore that – unfortunately, will not to be – cannot be extrapolated in future.

In property-casualty Germany, we had a lower level of large losses than in the last year. Also in the fourth quarter it was pretty mild, and we had a contribution to loss reserves for liability – industrial liability insurance. This contribution was rather strengthening, a real strengthening of the reserves instead of filling a hole.

So the confidence level in Primary insurance is narrowing to that of reinsurance, let me put it like this. In ERGO International, we had losses in Belgium, substantial expenses for restructuring and debt impairments, which were to a large extent compensated by a very high investment result from disposal gains. We also had some reserve increases in Turkey, but on a much lower level than last year.

And your second question on the restructuring in Belgium, the split between capital increase and subordinated loan, it was a capital increase in the order of €280 million plus and €80 million subordinated loan, overall €360 million. Big amount and we expect it to be enough to finance what is necessary onsite and this is on one hand also a reserve which is similar to the German ZZR (53:42) and on the other hand these were investments, which have to do to the run-off status of the business.

We are now confident that the company will show profits in the years to come, instead of losses. Is that okay, Frank?

## Q - Frank Kopfinger {BIO 16342277 <GO>}

Yeah. Thank you very much.

## A - Jörg Schneider

Thank you.

## Operator

We'll take our next question from In-Yong Hwang, Goldman Sachs. Please go ahead.

## Q - In-Yong Hwang {BIO 18784369 <GO>}

Hello. Thank you for taking my question. I have got two. Firstly, on the renewals, a lots of your competitors have seen quite extraordinary levels of growth in what they call loss transactions (54:20), structured reinsurance and so on. Is that part of the renewals disclosure, that you made today. And it looks like you're kind of not as enthusiastic about those kind of transactions as your peers, is there any kind of reason behind that. This is my first question.

Secondly, on the life reinsurance side, I think the 4Q result have a kind of one-off reserve release from the U.S., does that signal confidence in your reserves for some of the old-age kind of U.S. mortality business that have been initiated for the last few years? Thank you.

## A - Jörg Schneider

I start with the first question on the renewal and yeah especially the structured reinsurance. And we do not have a separate disclosure unlike our peer, and the reason is that it's not too easy to separate that from the other part of the business, as you can imagine, because more or less, or let's say a large portion of our reinsurance business is dominated by optimization requirements, means tax, accounting, regulatory stuff, and our tailor-made business, for example, is in the order of one-third of the overall business.

We do not split it up in a way. The reason is because we offer it typically as part of an overall coverage for a client combined with traditional reinsurance elements. We are active here in all territories, in all geographies, especially in Europe, Caribbean, Australia, China, to a lower extent in the U.S. And it's typically high-premium low-margin business, and as I said an integrated part of broader coverage program.

On your second question about reserve release is in the U.S., it was about life insurance, wasn't it?

## Q - In-Yong Hwang {BIO 18784369 <GO>}

Exactly, yeah.

## A - Jörg Schneider

Yeah, okay. That was a release of claims reserve from other refinements in the area of inflation riders for disability and long-term care, very specific line of business, and it was something which was overdue, I would say. And this had a major impact. Very technical, and not to be extrapolated in future.

## Q - In-Yong Hwang {BIO 18784369 <GO>}

Okay, understood.

## A - Jörg Schneider

Thank you, In-Yong.

## Operator

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

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

Thank you very much. Good afternoon. Just two questions. First on the reserve buffer and the prudency margin. I would like to better understand the drivers behind them. You mentioned that the reserve buffer has been – has stayed fairly stable, you took out €1.1 billion reserve releases. So does this mean that the initial reserving is also with basically putting in €1.1 billion on new business or are there any other parts which I'm presumably missing?

Second, you just mentioned large quota-share business, which comes at a high-volume, low-margin, low-profit, and how much of this high-volume, low-margin business is included in the renewals in the January 1 renewals. Is it fair to assume that on a per unit of risk basis you actually have grown?

## A - Jörg Schneider

No, I can't confirm that we grew there, Michael, and thank you for the question. We cannot precisely say that on the unit of risk that would be – yeah, that would be, how should I say, artificial precision. Roughly perhaps about 30%, 20% – 20% of the risks perhaps, something in that area.

With regard to the reserve buffer, yeah, I've been in my current position now for 16 years, and it started in a pretty ugly situation with regard to the reserve and then it got better, perhaps we overdid the prudency somewhat coming from the very bad experiences early on. And now we would very much like to keep the level of confidence where it has been during the last couple of years.

The reason is that when it's bad, then it's extremely bad, that had been the experience of the past, because the market in total sometimes underestimates the deterioration in the early phase of the worsening market. And we want to be somewhat resilient against that phenomenon and therefore we insist on keeping the current level of confidence and of – one can also say necessary buffers.

And it is, as you describe it, it goes in and out, yeah. So we try to reserve new losses with some conservatism in the calculation. And in the course of the run off of the business part of that gets released over time. And that it is – how it is ongoing and we do not see a major difference between 2015 and 2016 with regard to our experience, so no deterioration. But we are not immune against underreporting from our clients. If that happens, then we have additional buffers which we set up ourselves. So therefore, we should be fine for a long while.

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

And did you change any expectations regarding inflation or can you give us a sensitivity of how inflation would change the buffer? Obviously, it would go down by how much?

## A - Jörg Schneider

No. I would – I'm pretty sure that the low inflation was one of the drivers of the very comfortable industry position with regard to reserve, that means if the direction changes then it will also have an impact on reserves. Reserves are not dominated by an impact of consumer price index, but rather of wage inflation, wage is important and also medical inflation because we are mainly talking about personal injury claims, and here the expenses for care are very important and also the longevity expectation of the respective victims.

These are the main drivers and we have them under very tight control, but we do not sort out an inflation factor, which we can give as a sensitivity for the whole portfolio, but we are on very safe ground.

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

Okay. Perfect. Thank you.

## A - Jörg Schneider

Thank you, Michael.

## Operator

We'll now take our final question from Mr. William Hawkins from KBW.

## Q - William Hawkins {BIO 1822411 <GO>}

Hi. Thanks for letting me sneak in. You told Michael Huttner that the HGB result was €3.4 billion. Can you just help me understand that because that's up significantly from €2.6 in the previous year, I think? And you mentioned that the claims equalization reserve this year hasn't changed very much, and I know it's not the same but the IFRS results was actually down quite a lot. So €3.4 billion seems like a huge result and I don't quite understand how you've got that?

And then related to that, if the HGB result is strong presumably you'll distribute some reserves would have taken a big increase as well. Does that have any impact on capital management when we think about buybacks for the future and the rest of it or is this just one of those nice cushions that you're going to enjoy getting bigger? Thank you.



## A - Jörg Schneider

Yeah. It's rather the later. Let me start with a reason for the increase. Last year, we had to write-down over $1 billion on our ERGO's share. And that was the main driver of the difference. And the lower level of contribution to the equalization reserve, again, a very high investment result. And here within the investment result, there is also two major gains from intra-Group transactions. In one case, we shifted a diversified portfolio of bonds and shares from one location to the other for technical reasons. And in the second phase, we wanted to realize a gain actively in order to be prepared for any tax changes which did not appear later on. And so, both had an enormous impact on the result, and therefore this is not a sustainable HGB result. And that is also the reason why we see with pleasure that our distributable earnings are now on a very high level.

And if I see the prognosis also for 2017, we again expect a high HGB result based on the fact that there will be a lower, if no requirement for the equalization reserve that means also for the total of 2017, which remains the same. But I would not recommend to drastically change our distribution policy, because the impact of the low interest environment and of the lower rates on the reinsurance side find their way also in the HGB results.

And on the other hand, ERGO will at a later stage deliver dividends, but there is still some years to go, therefore, I rather take it as a very nice block of distributable earnings in order to even more confirm our distribution policy, which we have followed during the last couple of years, but not to make a major step upwards.



## Q - William Hawkins {BIO 1822411 <GO>}

That's very clear. Thank you.

## A - Jörg Schneider

Thank you, William.

## Operator

That concludes today's question-and-answer session. Mr. Becker-Hussong, I'd like to turn the conference back to you for any additional or closing remarks.

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

Yeah. Nothing to add from my side. Thanks to all of you for joining and please don't hesitate to call us with further questions. Looking forward to seeing you soon. Thank you. Bye-bye.

## Operator

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