

## **Audiocast for Q2 2016**

### ***Jörg Schneider, CFO of Munich Re (Group)***

Ladies and Gentlemen,

Welcome to the presentation of our Q2 results. My name is Jörg Schneider, and I am the CFO of Munich Re. As usual, I will provide you with the main messages, facts and figures. The conference call this afternoon – where I will be joined by our CEO, Nikolaus von Bomhard – will then mainly focus on Q&As.

In Q2, the insurance industry experienced a high level of major losses, combined with a very volatile capital market backdrop.

However, after a rather disappointing Q1, our net result of €974m in the second quarter was strong. To a large extent, this was driven by non-recurring effects that were – on balance – positive. A lower technical result and the restructuring charge for ERGO's Strategy Programme were more than compensated for by an increased investment result and FX gains.

There was some unavoidable earnings volatility in each of the two individual quarters – which was partially accounting-driven. But, despite this, the underlying financial development in the first six months was largely in line with our expectations. This proves that Munich Re is resilient in an unstable environment. The strength of our balance sheet continues to translate into additional earnings, offsetting some of the pressures imposed by low interest rates and soft reinsurance markets. With €1.4bn for the first half, we remain well on track to achieve our target of €2.3bn net earnings for the full year.

Let me start with the investment result.

Investment income for the Group was very high in Q2, with a return of 4.7%.

The running yield remained fairly resilient against low interest rates, reaching 3.1% in Q2. It included a seasonal dividend impact of 0.4 percentage points, and benefited from higher income from associated companies valued at equity. Our duration management and ongoing diversification efforts continue to prove beneficial. The average reinvestment yield fell to 1.6%. But in light of the enormous accumulation of political and economic risks around us, we are dealing with this ongoing decline of returns. So, we have no intention of altering the risk profile of our investment portfolio.

In Q2, all parts of the extraordinary investment result also improved substantially over Q1.

Disposal gains account for the largest share of the increase in investment income. This is mainly due to the sale of fixed-income securities, partially related to ZZR funding. Prior to the Brexit vote, we decided to reduce portfolio risk, and sold some of our equity holdings – which led to further disposal gains. At the same time, this resulted in lower impairments on equities compared to the first quarter. Furthermore, we benefited from write-ups on various bonds. As in Q1, we posted gains on ERGO's interest-rate hedging derivatives. The result from equity derivatives improved significantly in the second quarter, but lower inflation expectations led to losses for inflation derivatives.

Two major earnings drivers had an impact on the non-operating result.

Our asset-liability management refrains from taking large bets. Any economic mismatches are therefore quite small compared to the large amount of loss reserves and other technical liabilities on our balance sheet. We are long on the US dollar, and are short (only in accounting terms) on the currently weakening British pound. Furthermore, we have taken some smaller currency positions as a consequence of the diversification in our investment portfolio. Due to the strong market impact of the Brexit vote, we recorded a highly positive FX result.

This was offset by the restructuring charge for ERGO's Strategy Programme, with a gross effect of around €400m and a bottom-line impact of €160m.

The tax rate was more or less in line with expectations, at almost 25% for Q2, and for the first half-year.

The annualised return on risk-adjusted capital amounted to 11.9% from January to June, and the return on equity totalled 8.9%. Both figures are quite pleasing.

Let me now give you the highlights by business segment.

In P&C reinsurance, the combined ratio of the second quarter was 99.8%, after 88.4% in Q1. This was due to a significantly increased level of major losses – much higher nat cat claims, and man-made losses above expectations. We were able to release some of the reserves cautiously set aside for major losses experienced in prior years. So the major loss ratio of 12.3% in Q2 was in line with our average expectation of 12 percentage points of net earned premiums.

We continue to set provisions for newly-emerging claims at the top end of the estimation range, and expect corresponding profits from their run-off over time. For basic losses, notifications from prior years once more remained well below the expected level. In Q2, reserve releases amounted to around 5 percentage points, which is somewhat below our 6% guidance for the full year. This run-off result is within the normal fluctuation range in any single quarter.

In Q2, the normalised combined ratio increased over the first quarter, and amounted to just above 100%. This is due to a higher basic loss ratio. Some of the carriers of our risk-solution business experienced an accumulation of major claims just below the €10m threshold, which separates attritional from major losses. Business-mix effects also played a role. For the full year 2016, we still anticipate a normalised combined ratio around the expected level of 99%.

Let me just say a few words on the renewal of our reinsurance treaties at 1 July, which involved a business-volume of €2.1bn. There was still some pressure on prices, terms and conditions – in particular for natural catastrophe covers, which accounted for about 21% of the renewals. However, we observed a further slowing of price erosion, which amounted to just 0.4%. Premium volume remained almost constant. We were able to take advantage of selective opportunities in individual markets, but withdrew from business in other areas. Thanks to our strict cycle management, our portfolio remains profitable even after the recent renewal rounds.

In the absence of single major claims, the technical result in life reinsurance improved compared with Q1, and at €103m met our expectations for a single quarter. The result includes a strong contribution from North America – particularly Canada – and also from Asia. The performance of the European markets was somewhat weaker than in Q1, but still within a normal range. For the full year, we are sticking to our guidance for the technical result of around €400m.

So much for reinsurance. I now turn to ERGO.

As in the first quarter, ERGO posted a Q2 loss, mainly due to adverse one-off effects. On a normalised basis, ERGO shows clearly positive results in both quarters. Negative earnings of –€34m in Q2 include the restructuring charges for the Strategy Programme, which will significantly increase its contribution to Munich Re's consolidated result.

On a segment basis, this translated into a positive net result for German Life and Health. Although the segment benefits from a high investment return, the result (especially the operating result) looks somewhat overstated. This is due to the policyholder participation in the non-operating restructuring charge. The two other segments once more recorded a negative result.

P&C business in Germany, however, showed a pleasing decrease of the combined ratio to 93.3% in Q2. Despite some nat cat activity, the amount of major losses remained well below the level of Q1. At the same time, the cost ratio improved.

After an exceptionally good first quarter, the combined ratio of our international primary business worsened to 103.6% in Q2. The combined ratios increased in most major markets, mainly due to less-favourable reserving developments compared to Q1. Despite quarter-on-quarter volatility, the combined ratio of 98.5% in the first half-year is a reasonable reflection of the current profitability of the international business. And it is quite close to our full-year expectations.

The technical result of Munich Health was adversely impacted by a large claim in reinsurance, and compensated for mainly by FX gains. With €16m in Q2, net earnings matched the result of the first quarter.

In the annex to the slide deck, we provide the usual chart outlining the major components responsible for the differences between our stated Q2 result and the analyst consensus. These largely stem from the investment result and FX effects.

Our capitalisation remains sound.

IFRS equity further increased by 0.7% in Q2. High net profits, currency impacts and increased unrealised gains were partially offset by ongoing share-buybacks and the dividend payment in April.

Yet, the impact of falling interest rates on IFRS equity only reflects the rise in market values of our assets. It does not show the corresponding negative effects on liabilities, which are recognised in our economic capitalisation. Together with some model changes, these caused our Solvency II ratio to decline to a level of 250–260% by the end of June.

German GAAP revenues of Munich Reinsurance Company, the parent of the Group, came in very strongly – supporting our flexibility in terms of distributions to our shareholders. In June, we started our new share-buyback round of another €1bn, which should be completed by the AGM in 2017.

Let me turn to the outlook for the full year.

In reinsurance, we still expect a combined ratio of 95%. For ERGO, we anticipate a combined ratio of 98% in Germany (which includes expenses for the Strategy Programme) and of 99% for the international business. As already announced, ERGO as a whole is expected to report negative earnings in 2016. This assumption includes an adjustment of the policyholder participation in the restructuring charge of €40m net, and expenses for investments for the Strategy Programme – partially offset by cost savings in the second half of the year.

For Munich Re (Group), we still forecast a return on investment of around 3%. Despite the high Q2 result, we are standing by our profit forecast of €2.3bn. Of course, the unexpected currency gains in Q2 benefit the full-year result. But in light of the upcoming hurricane season – and continuing high volatility on the capital markets and for currencies – significant unforeseen result fluctuations are possible in both directions.

Thank you very much for listening. Nikolaus von Bomhard and I look forward to our Q&A session at 2.30 p.m. Munich time.