Audiocast for Q3 2015

Jörg Schneider, CFO of Munich Re (Group)

Ladies and gentlemen,

Welcome to the presentation of our Q3 results. My name is Jörg Schneider and I'm the CFO of Munich Re. I now have the pleasure of providing you with the key figures and main messages. As usual, the conference call this afternoon will then focus on Q&As.

The third quarter has seen some mixed developments. There was a relatively benign level of major losses, combined with an adverse capital market backdrop, and we observed a reversal of important market parameters compared to the second quarter of the year.

In the third quarter, the performance of our technical business remained sound across most segments. The bottom-line result was affected by low investment returns in Life Re and both P&C segments. Despite an improved FX result and tax profits – with net earnings of €525m – Q3 was satisfactory, but not as strong as the first two quarters. With a net result of almost €2.4bn in the year-to-date, we are confident that we will achieve an annual profit of at least €3bn.

Let me start with the investment result. In Q3, it decreased by around €1bn over the previous quarter. At first glance, the ROI of 2.6% for the assets of the whole Group does not sound so bad. But in segments that do not include policyholder profit sharing, the investment results were very low, and had a correspondingly high bottom-line impact. If we leave aside the €134bn of investments in ERGO German Life and Health and ERGO International, all other segments – with total assets of €102bn – only achieved a yield of 0.9%. This was due to high write-downs on derivatives that we use for economic hedging purposes, write-downs on equities, and overall lower gains on disposals than in the previous two quarters.

Taking into account the Q2 regular income gained from dividends, the Q3 running yield of 2.9% remained fairly resilient against low interest rates. We continue to benefit from duration management and ongoing diversification efforts. The average reinvestment yield in the third quarter was 1.9%. As long as spreads do not adequately reflect risks, we must accept a decline in returns. But we do not intend to move significantly up the risk curve.

We posted substantial tax income in the third quarter, mainly referring to provisions for past years. The fourth quarter of 2015 might also benefit from tax effects, although probably not to the same extent as in Q3. They are a consequence of a conservative accounting approach. Over time, however, we are expecting the tax rate to normalise at around 20–25%.

When adjusting for non-recurring items, and allowing for a normalised tax rate, the underlying Q3 profitability of more than €700m meets our 2015 net earnings guidance on a pro rata basis.

Let me now give you the highlights by business segment.

The combined ratio in P&C reinsurance was a sound 94.5% in Q3. Due to low nat cat activity, major losses of 9.2% of net earned premiums once again remained below our average expectations of 12%. We recorded quite a number of sizeable man-made losses, with the explosion in Tianjin as the single largest loss at €175m.

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. Notifications from losses for prior years remained significantly below the expected level in Q3. Reserve releases amounted to 4.8 percentage points in the combined ratio, slightly above our guidance of 4%. After our comprehensive annual reserve review, I expect reserve releases above 4 percentage points for the full year.

The Q3 normalised combined ratio amounts to 98.1%, almost 2 percentage points less than in Q2. This number is subject to random fluctuation on a quarterly basis, but I find it quite gratifying.

In life reinsurance, we are satisfied with the technical result of €114m that we posted for the past quarter. The result reflects good claims experience in all major markets – particularly in Canada – but Asia, the UK and continental Europe also contributed solid results. Overall US mortality experience was in line with expectations, both during the quarter and in the year-to-date.

Given that business performance in the first half-year was generally below our expectations, we anticipate a technical result of €300–350m for the year as a whole. For 2016, a technical result of €400m remains a realistic figure.

So much for reinsurance. I now turn to the other parts of the business.

Overall, ERGO's Q3 earnings of €100m fall short of the extraordinarily strong Q2 result. German property-casualty business posted a negative investment result, which was compensated for by a large tax credit. At the same time, the underwriting result worsened due to an increase in major losses, contributing to a combined ratio of 96.1%.

In our Q2 earnings call, we had already highlighted the risk of DAC write-downs in ERGO's Life & Health segment in Q3. In fact, extraordinary P&L effects triggered by low interest rates had a negative net earnings impact on the life business of almost €50m. The investment income in Life and Health increased compared to the second quarter. The interest-hedging programme was the major driver, generating an improvement of €40m in the net result.

In international business, the Q3 combined ratio increased to a disappointing 104.1%. This is mainly due to accounting adjustments and reserve strengthening related to legal protection business in the UK. But even leaving aside these non-recurring effects, the entire international business has been running on an elevated combined ratio level in the first nine months. This is largely due to intensified competition in Polish motor and corporate business, and lower profitability in Turkey.

Net Q3 earnings of the Munich Health segment were markedly higher than in the second quarter, driven by a better technical result. This is largely due to a seasonal effect at DKV Seguros in Spain, which was only partly offset by a worsening claims experience in the US reinsurance business. For the year as a whole, we expect Munich Health to achieve its financial target from the beginning of the year. Yet the business segment will probably not match last year's net result, mainly because DKV Belgium shows an ongoing adverse claims trend that will still impact overall earnings.

In the annex of the slide deck, we provide the usual chart outlining the major components responsible for the differences between our stated Q3 result and the analysts' consensus. These largely stem from the investment result and taxes.

Unsurprisingly, the Group's capitalisation remains very sound according to all metrics. IFRS equity decreased by roughly 2% in the third quarter, reflecting a reduction in unrealised gains in our non-fixed-interest securities, a negative impact of exchange rates, and ongoing share buybacks. Unrealised gains on fixed-income investments hardly changed, as the impact of fallen interest rates was offset by widened credit spreads.

The economic solvency ratio dropped slightly compared to the end of 2014 and the second quarter of 2015. Available financial resources decreased as MCEV and IFRS capital declined. Risk capital requirements increased marginally. The main drivers were ERGO's Life and Health risks – as a consequence of lower interest rates – and an increase in the reinsurance market-risk capital. This was due to a somewhat higher equity exposure. Overall, our solvency ratio remains well within the comfort zone, and our healthy balance sheet continues to provide the basis for strong returns to shareholders.

Let me now turn to the outlook for the year as a whole. We estimate that the Group's gross premiums written will total around €50bn, supported by positive currency translation effects.

With some amendments in our forecast compared to our August estimates, we only take account of the actual experience versus the normal expectancy in the third quarter. These are:

- a return on investment for the year of around 3%,
- a combined ratio in P&C reinsurance of 95% (one percentage point improvement),
- P&C ERGO Germany at around 96% (one percentage point higher), and
- P&C ERGO International at around 101% (two percentage points higher).

As in previous years, a review of our loss reserves, tax provisions and intangible assets may result in substantial income or expenses in the fourth quarter. The overall trend is that there is more downside than upside for the primary insurance segments, and more upside potential for reinsurance. Subject to such result effects – and to random fluctuations in major losses or upheavals on the capital markets – we confirm the adjusted profit guidance of at least €3bn we gave in our half-year report. This means that 2015 will continue the long sequence of years where Munich Re has produced excellent results.

Thank you for listening.

I look forward to our discussion at 2.30 p.m. Munich time.