Q1 2015 Earnings Call

Company Participants

- Bernhard Kaufmann, Chief Risk Officer
- Christian Becker-Hussong, Head-Investor & Rating Agency Relations
- Jörg Schneider, Chief Financial Officer & Member-Management Board
- Torsten Jeworrek, Chief Executive Officer, Reinsurance & Director

Other Participants

- Andrew J. Ritchie, Analyst
- Andy D. Broadfield, Analyst
- Frank Kopfinger, Analyst
- In-Yong Hwang, Analyst
- James A. Shuck, Analyst
- Kamran Hossain, Analyst
- Michael Haid, Analyst
- Michael I. Huttner, Analyst
- Thomas Fossard, Analyst
- William Hawkins, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day, and welcome to the Munich Re Quarterly Financial Statements Q1 2015 Conference Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Mr. Becker-Hussong. Please go ahead.

Christian Becker-Hussong {BIO 19080254 <GO>}

Good afternoon everyone. Welcome to our Q1 2015 conference call. Speakers today are Torsten Jeworrek and Jörg Schneider. I am sure most of you have listened to Jörg's audiocast this morning, so there should be no need for an additional statement from Jörg. However, Torsten will kick it off with a short statement on the April 1 renewal, and afterwards, we will go right into Q&A.

So with that, I hand it over to Torsten.

Torsten Jeworrek {BIO 5724439 <GO>}

Yeah. Thank you, Christian and good afternoon ladies and gentlemen. I would like to give a short summary as an introduction about our April 1 renewal. April 1 is for the Munich Re P&C portfolio, the smallest renew of the three renewal dates. The premium volume which was up for renewal was €1 billion, which is approximately 6% of our total P&C book. And very often this April 1 renewal is considered or described as a Japan renewal, which is right. But in our portfolio, the share of Japanese business is just 21% and 32% come from North America, further 30% from global business and the rest from Latin America and Europe.

And it is unchanged that in this renewal, we have the highest relative natural catastrophe share in our portfolio; that means the impact on competition and prices on this renewal is more important than in the other renewal dates.

And what happened in the markets? And I'll start with the primary insurance markets, which are very important for our pro rata business. Price environment very unchanged, both in – for personal lines and commercial lines in primary business, we see stable rate these days, particularly in the United States, the U.S. primary casualty business is still increasing. On the U.S. property side, we see a stable premium development. In the global primary business, that is particularly the large industrial business, there is an unchanged very fierce competition.

And what about reinsurance? Reinsurance, still abundant capacity available, strong competition in all of the mentioned – above mentioned markets, and particularly, the nat cat business is under pressure. On the proportional side, we see two different effects, one is we benefit from the good or positive development on the primary rates, but this positive trend is compensated by slight increases in commission. So altogether, there is a small, but very digestible profitability pressure on the proportional book.

And in the non-proportional nat cat business, the rate pressure is pretty much unchanged, above 10%, sometimes to minus 15% with very active portfolio management and discipline in the renewal, we achieved in our portfolio, a rate reduction of only 6%. So we came better out than the market here.

What about terms and conditions, particularly on the non-proportional side, although unchanged compared to January, there is some pressure particularly in the United States, but not material. And particularly under the U.S. windstorm programs, we see a further extension of the hours clause, which is now between 96 hours and 120 hours; remember, few years ago, that was 72 hours. And we see more and more the client request from the reinsurance market, an alignment and coverage with the underlying portfolio, that means they tried to negotiate exclusions which to some extent helped in the past to disconnect the non-proportional business from certain exposures in the underlying portfolio, particularly for terrorism.

And we don't see any very material trend here on the terms and conditions side, particularly we don't see a trend that we have to cover completely new perils like cyber or something like that; that is still in good shape.

And what about the Munich RE strategy? Our underwriting policy remains completely unchanged. We have a clear focus on profitability and our underwriters don't have explicit growth targets in their treaty business. And we try to be service-oriented and try to identify new business, which is not available for all markets and try to structure tailor-made solutions.

And it might appear surprising to you that we achieved a premium volume growth of 3.9% in this renewal and you might ask is that a certain contradiction to our cycle management policy. And we don't think so and we can explain that with good examples.

And in the underlying portfolio, we remained very disciplined, but we were very successful in this renewal to conclude a very few larger transactions, proportional transactions, which contributed to premium growth of eight percentage point of our €1 billion premium. And though that means, without these extraordinary new transactions, we would have seen a small reduction in premium volume, which reflect our cycle management policy, but we have new portfolio transactions here which help us to grow.

And particularly in Japan, the renewal was much more satisfactory than one year ago. Our total non-proportional book in terms of profitability remained relatively stable this year and that has to do with the successful renewal of the few very large non-proportional programs, particularly earthquake programs, which were concluded on a multiyear basis and the few core relationships between Munich Re and the client.

And the windstorm – windstorm and other perils in Japan, there were some small pressure on the rates. In some cases, where we saw losses one year ago, remember the snowstorm one year ago, we saw even some smaller price increases.

Finally, we consider the pure price change in our portfolio of minus 2.6% as a reasonable or even very satisfactory outcome under the conditions which I described.

Here, I would like to finish, and I think I'll switch back to Christian.

Christian Becker-Hussong {BIO 19080254 <GO>}

Thank you, Torsten. We will now go right into Q&A. As always my usual request, please maximum of two questions per person. Thank you.

Q&A

Operator

Thank you. The first question comes from James Shuck from UBS. Please go ahead.

Q - James A. Shuck {BIO 3680082 <GO>}

Hi, it's James Shuck from UBS. I had two questions, please. Firstly, actually on primary life in Germany, I just want to – could you just give some big picture thoughts on what happens to German life companies if government bond yields are to stay below 1% over, say, the next five years? Obviously, they're going to have to increase funding towards ZZR, and at the moment they're funding that – most market participants are funding that through realizing gains. So I'd just like to get an understanding about what your view is on how the industry will play out if rates do stay low and how the cash flow funding for certain of your peers or the industry as a whole might play out? At what stage, do we start to have insolvencies? I guess, then in the interest of completeness, could you just sort of highlight what some of the risks are, if we hopefully do happen to get a rapid rise in German rates?

Secondly, just on the investment yield, you've got new money yields coming on the book at 2.0% on average in the third quarter. Could you just explain where that yield is coming from and what a spot rate new money yield is at the moment please?

A - Jörg Schneider

Hi, James. This is Jörg Schneider. Thank you for your questions. First on primary life, Germany, situation is difficult as you can imagine and as you described. Let me start with the IFRS position very briefly, because this is the least critical one. We reflect the difficult economic situation means the very low reinvestment rates we are faced with that at the moment, just by correcting the deferred acquisition costs and some other minor items on the P&L, that it means that for a while you do not see a lot under IFRS.

Second, regulatory situation, I don't have to talk about Solvency I, because this does not reflect the situation for the investments at all, and therefore, everybody is looking at solvency II. And as you know, and with the valuation of all liabilities applying the current swap rate, plus some minor corrections in the Solvency II rules, then liabilities are valued at very high amounts and that means that the economic situation is adequately reflected, if you consider the possibility that rates stay where they are at the given moment.

And since that isn't the case, most probably, we have the so called transition rules, which means that we have volatility adjuster that we have matching adjustment or that we have the 16-year transition periods from Solvency I to Solvency II. That means that for a while, there is not much of a problem from the regulatory side, except for the fact that together with the transition, with applying the transition rules, you have to deliver a plan how you want to go back to normal capitalization levels during that period.

What has to be seen is also the implication under local German GAAP and I assume under statutory accounting principles also in some other countries, and in Germany, we have the ZZR, we have something similar in Belgium for example, with the Knipperlichten reserves, and this has to build – to be built up on the liability side of the balance sheet to strengthen the reserve power in a way, according to a formula which is quite strict, which you know, and which will drive requirements for additional reserves quite rapidly, that means, that not in the first or second year that, but dependent on the situation of the companies, after a couple of years, it gets difficult. As long as interest rates remain so low as they are, it is for a while easy to finance the ZZR by realization of gains on fixed interest securities.

Your second question was, what happens if yields go up drastically, then this source is not available. But here I think, and that brings me to my last remark here is, that is then very easy to change rules here, because that would be a paradox situation. When the economic situation improves by an increase in interest rates and reinvestment opportunities, that exactly at that moment, companies would get in trouble with their local GAAP calculations and statutory calculations.

Therefore, I am not too concerned about such situation. What do I actually expect? Nothing spectacular for the moment. I assume that most companies in Europe will apply any kind – one of the various kinds of transition rules that we will have a smooth transition into the Solvency II world and that most of them will find ways to over time, finance the additional capital and liability requirements.

So I do not expect a shock situation during the next, say, three years or so. But you will – some of that – you will see some of that effect under local German GAAP and other statutory GAAP, and also you will see losses there, but still there is a capital. So, therefore, the industry will be able to manage it except for some very small players, I assume, who will not be able to raise the necessary level of reserve. So, to summarize, difficult economic situation, perhaps during the last couple of days, we see a little bit of light at the end of the tunnel with the increase in yields, but the circumstances and the regulatory environment is of a kind that allows for a smooth management of that situation.

Q - James A. Shuck {BIO 3680082 <GO>}

Can I just very quick follow-up on that and that's very helpful. Thank you very much. I just wanted to be clear on one point though, and that is that, if the Solvency II calibration for companies shows a big deficit, then they can apply the transitional rules, where they basically over rule that. But is there signs of any tension between the regulator and what the transitional rules are actually saying? So, what I mean by that is, is there a point at which regulators look through the transitional rules, at what the true underlying position is, and then says, well, okay, we need you to close that gap now rather than allowing the 15-year transition to close it?

A - Jörg Schneider

I assume that there will be a very strict and strong observation of the most effective candidates by their regulator and a constant dialogue and a very disciplined plan and path from the current difficult situation to a better situation in future. But, on the other hand, in my view, the regulators are not allowed to undermine the rules which has been set by a contradictory behavior.

Q - James A. Shuck {BIO 3680082 <GO>}

Okay. That's very helpful on that question. Thank you very much.

A - Jörg Schneider

Then, on your other questions, where does the 2% yield, which we achieved in the first quarter come from, and it was a little bit less than 70% government bonds at an average reinvestment rate of 1.8% and then a good mixture of covered bonds, corporate bonds with the share – the latter with the share of 23%. And since we invest substantial part of our reinvestments in outside of the Eurozone, the situation doesn't look so dark at first glance.

Q - James A. Shuck {BIO 3680082 <GO>}

That's great. Thank you very much.

A - Jörg Schneider

Thank you.

Operator

The next question comes from Kamran Hossain from RBC.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi, all, afternoon. I've got three questions, first one is just following up on the James' question really, I assume from your comment, I mean you are planning to use transitional measures under Solvency II. I know you've got other benefits to come through into your 242% ratio that you kindly gave us at the year end. But what kind of quantum of – what would the 242% look like, if you weren't using transitional measure? So that's question one.

And the second question is just on one of the losses that you suffered during the quarter and that was Cyclone Pam. I saw the loss number was €30 million, which seems to me – I don't know whether I am missing something, but it seems kind of remarkably high given that the total economic loss according to Aon Benfield was only $100 million; so I don't know whether I am missing something there. And any kind of color on that would be really helpful. Thanks.

A - Jörg Schneider

Sorry, Kamran, we didn't quite understand, what kind of loss were you talking about in your second question please?

Q - Kamran Hossain {BIO 17666412 <GO>}

Cyclone Pam.

A - Jörg Schneider

Pam, okay. This was such a small country that we didn't even know it, okay, good. Thanks. Torsten will take that, but let me start with the first one. With our numbers for Q4, we did not apply transitional measures. So, we haven't made the decision right now, at the moment, and we are not forced to decide that in the course of the next couple of months. So it will be at the end of the year that we decide. There's nothing wrong in applying transitional measures, and because we have lot of tools to deal with the current situation and this is just one of them; but we do not want to exclude it, that is for sure. Torsten on that cyclone.

A - Torsten Jeworrek {BIO 5724439 <GO>}

Yeah, Cyclone Pam, it's true, I was not aware that this island does exist by the way before its happened.

Q - Kamran Hossain {BIO 17666412 <GO>}

My mother spent a year there, when she was 19, actually. I had never heard of it, apart from that.

A - Torsten Jeworrek {BIO 5724439 <GO>}

Should have asked you first. No, but – and you're right. I mean it's not for the insurance industry a big event, you are right. And we don't know where the final insurance loss will be at the end. However, whether it will be €100 million or let's say a few hundred millions or also, the explanation is the same. On this island, I even don't know the name now, to be honest – on this island, there is one Australian reinsurer worth an 85% to 90% market share in property business. So, this loss finally ends up with one primary insurer. And we have a strong reinsurance relationship with him. That explains it. So that this loss is not spread in the primary market.

Q - Kamran Hossain {BIO 17666412 <GO>}

Okay. That makes perfect sense then.

A - Torsten Jeworrek {BIO 5724439 <GO>}

Yeah.

Q - Kamran Hossain {BIO 17666412 <GO>}

Thanks very much.

Operator

The next question comes from William Hawkins from KBW.

Q - William Hawkins {BIO 1822411 <GO>}

Hi, there. Thanks very much. First of all, your economic solvency ratio, you acknowledge that it would have fallen in the first quarter. Could you try and help us just scale how much of it might have fallen by? And then specifically on that, you flagged that the strengthening dollar hurt you and I can see while the strengthening dollar would literally increase the required capital, but just thought on an all-in basis, if you're telling us you're along dollar, that would be more than offset by an increase in available capital. So, if the currency movements really have hurt your solvency ratio, could you help me understand why?

And then secondly, congratulations on the Markus Riess hire, that's quite exciting. But normally when there is a new CEO coming into a business that people know has issues, there is the concern of kitchen sinking or other immediate remedial measures that maybe required to get that new person at his desk. I'm just wondering what your feeling is on that, because obviously you and Nikolaus have already done a very conservative job managing ERGO, on top of them – you have Torsten. So, yeah, any risk of kitchen sinking as Markus Riess arrives? And any specific mandate that he has got that we should know about? Any particular issues that you want him to be addressing in short order? Thanks.

A - Jörg Schneider

Okay. Thank you, William. Economic solvency ratio would have fallen by double-digit percentage amount. We do not quantify it, because in the course of the year, we do not precisely calculate our market consistent embedded value. So, we just do it using our broad thumb and therefore we do not want to give quarterly reports on that. This will change with Solvency II where we have quarterly information to the regulator and to the public.

Q - William Hawkins {BIO 1822411 <GO>}

I'm sorry, may I just butt in, when you say double-digits, is that with reference to your 138 or with reference to your solvency 2? To the 138.

A - Jörg Schneider

Yes. 138, very small double-digit amount. And meanwhile, totally reverse when I look at the market. And this is perhaps also a reason why it's better not to go out and panic. Perhaps what is a good message for me or good experience I should rather say is, even under these extremely adverse conditions not with regard to FX, I'll come to that later, but with regard to the interest rate, we were in good shape. We were far away from becoming deficient, because as you know, the 138 of the turn of the year refers to economic risk capital, which is 1.75 times the regulatory minimum, which means that even after falling, until end of March, we were still higher than double the required minimum, and therefore, we're sitting here quite relaxed.

Your remark about the dollar is absolutely correct, the impact was close to zero, because our available financial resources went up in parallel to the economic risk capital. And so therefore, net – on our economic solvency ratio, a strong net impact of interest rates, of interest rate volatilities, but not of currency.

About Markus Riess, we are glad to get him on board and it is obvious that with such a high caliber new CEO for our important business field ERGO, and there will be strategic changes, but not in the form of a kitchen sinking, because very good things are underway and we must now be consistent in following the initiatives which are already in place, and therefore, I do not expect any, how should I say, any strategic moves of a kind, which would result in a disaster or so - or not - specially not in - as a disaster for our numbers, yeah, if you have that in mind, yeah.

So, as you know, we're always trying to reflect bad news as early as we could under current accounting rules. So, we look forward to getting him on board, but we do not expect to see drastic changes with regard to this strategy very soon.

Q - William Hawkins {BIO 1822411 <GO>}

Lovely. Thank you very much.

A - Jörg Schneider

Thank you, William.

Operator

The next question comes from Andrew Ritchie from Autonomous. Please go ahead.

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

Hi, there. Quick one first of all for Torsten, the underlying combined ratio in Q1 was 98%, although I think that included about a point benefit from currency. So, the underlying maybe is 99%. So I assume that there is just some quarterly noise in that number and it's not the case that, you know, I remember last year, when the underlying started evolving fairly quickly, a lot worse than you had expected, because you had underestimated the price and margin effect; so maybe just give us some reassurance on that.

Secondly, is the case, I guess, the price declines in excess of loss business, the rate of price decline is easing a bit, as we progress through various renewals, but did you see a risk though that we're going to see an increase in the rate of decline on proportional business, which so far, I think you said as being more or less flat, taking into account the underlying rate against the higher ceding commission. Do you think we're going to get in a situation this year where overall rate all-in price on proportional business is going to start falling? Thanks.

A - Torsten Jeworrek {BIO 5724439 <GO>}

Yeah. First, to your combined ratio question, that is true. We have certain positive contribution from the stronger dollar from the foreign currencies to our combined ratio, which helped us a bit. On the other hand, as far as normal price changes are concerned, which we did plan and which realize so far when I compare these two, we are pretty much in line what we had in mind at the beginning of the year. The April revenue came - here, we came off a bit better than we originally thought.

So when I take everything into account and consider that there is for a quarter always considerable noise, when I consider that the reserve releases which stand at 4% now for the first quarter are more on the low side than we could afford if we wanted. I think the 98% normalized is very reasonable. And the projection for the full year, which takes account the random fluctuation of the large losses in the first quarter and we lowered that to 97% now and I think that is very realizable. So I'm confident that this is a good and the best figure we can show now. I don't expect for this year, further deterioration on a normalized basis.

Second question, right – the price changes on the excess side are still high. But it might be that we seem – let's say a slower trend, a slower price decline in the coming renewals, because we have achieved a low level of profitability under certain cat businesses in the various regions. That is, let's say positive on the low level if you want.

And what happens with pro rata business, for the coming year, I would not expect your scenario that we see more significant profitability pressure on that business. Primary rates are reasonable and it seems that the capacity is not so, let's say, replaceable on the proportion side compared with the cat business. So, here the relationship is of higher importance and our strong leading share in this relationship gives us a very good position for renewal of our negotiation.

However, your concern in principle is right, that one cannot completely exclude even not this year, but maybe, let's say, in the mid-term future, that profitability could come under pressure. But I see here more scenario, if it should happen, that we see gradual commission increases now, which are absolutely justifiable from the profitability perspective when you take into account in your calculation, the rising primary rates and both together holds the profitability at decent levels now. The question is, however, could we imagine a scenario that we now go to higher commission levels. And then, let's say, in two years or three years now the primary rate begin to decline, what happens then?

So that is my concern, if you want. I'm not so concerned about pressure on commissions or that is manageable, but I wonder, or we ask ourselves, is it thinkable that this price competition spreads into the very regional primary markets. And that cannot completely be excluded.

However, I would always expect that this, let's say, the competition in primary business is always, let's say, stronger and heavier in the very global primary markets, their capacity is very flexible and goes for the larger volumes at the end of the day. Very often the regional markets, be it the UK motor business, be it the admitted business in the United States, admitted primary business, it's, let's say, not so flexible in terms of rate changes and term changes. So that I would – I do not expect radical changes in that business. But it cannot completely be excluded that such a pressure comes into the business even not – even if I don't think it's this year.

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

Okay. Thank you very much.

Operator

The next question comes from In-Yong Hwang from Goldman Sachs. Please go ahead.

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

Good afternoon. This is In-Yong from Goldman Sachs. So one question on P&C Germany where you kept the 93% combined ratio target despite the high cat losses this quarter. What gives you the confidence to think you can achieve that target? I think you need something below 92% combined ratio for the next three quarters to get to 93% for the full year?

And the second question is just on the effect of the recent sharp price and interest rates on your capitalization. The higher rates logically should help the capitalization for solvency ratio. But you mentioned interest rate volatility as a reason why it declined in the first quarter this year. So could it have a offsetting detrimental effect? Thank you.

A - Jörg Schneider

Hi, In-Yong. This is Jörg. P-C Germany, we see some random movement from quarter-to-quarter. A quarter is not a lot. You must imagine the net earned premium in that line of business is €700 million for the quarter. That means €7 million stands for 1 percentage loss – a 1% loss ratio point. And that means, for example, for the storm Niklas with a burden of some €70 million as an initial calculation, this is already more than 2 percentage points. And we had another big industrial loss – two large losses for industrial fire business and they contribute more or less the same. And that means, that you end up with an unexpectedly high number, which we do not see as a general tendency in our portfolio. Also there could be some positive movements in the reserves by the end of the year. Therefore, we are relaxed and think that the target of 93% is still within reach.

Your second question about the rise in interest rates. Yes, indeed, the volatility is high at the moment. We are now roughly at a situation where we are close to where we were at the end of last year with the interest rate level. But what is – that means the absolute level of risk-free rate is much more important for the calculation than the volatility element. Therefore, it could be slightly lower at the moment, the capitalization, but not at all that we feel here a general negative tendency.

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

Great. Thank you very much.

Operator

The next question comes from Michael Haid from MainFirst Bank.

Q - Michael Haid {BIO 1971310 <GO>}

Thank you very much. Good afternoon. Just one question on solvency, Jörg. You mentioned that 138% would have fallen by a low double-digit percentage amount. One insurance company not too far away from you, said it took measures, managerial actions to improve the solvency situation. The low interest rate environment definitely put some pressure also on your German life operations and the solvency there. So my question is, did you take some measures during the course of the first quarter to improve your solvency situation? Or did you just accept the situation as it was?

A - Jörg Schneider

It was the latter, Michael. We accepted it because we have the tool at hand and we don't have to apply them. So we could use Group internal reinsurance, we could use as part of the LTG measures the transition rules at the end of the year.

And if we do not change the economic situation, then in our view, you only have to look at whether you have formal instruments to deal with it. But what I would like to emphasize is our product policy. So we quite radically changed our product profile to more solvency benign product and we very much hope, and this is something which I forgot to mention when James asked at the beginning that, it's a market discipline, yeah.

So we very much hope. And I must say, I'm also convinced that Solvency II will bring discipline into the primary life insurance market in a way that guarantees for lifetime at very high levels plus bonus policies which are extremely generous will be something of the past. This is my hope.

Q - Michael Haid {BIO 1971310 <GO>}

But the fact that you changed the product does not affect your solvency immediately, right? It's just a more long-term change of the situation.

A - Jörg Schneider

That is true. But we also gradually changed the investment policy and increased the duration in the last two years. Yeah, that is also beneficial here to at least mitigate the effect.

Q - Michael Haid {BIO 1971310 <GO>}

Perfect. Thank you very much.

A - Jörg Schneider

Thank you, Michael.

Operator

The next question comes from Frank Kopfinger from Commerzbank.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Hi. Good afternoon, everybody. I have two questions. My first question is on your U.S. dollar impact. Could you help us better to understand the impact of a stronger U.S. dollar on your P&L. I understand that you have a positive 1% impact on the combined ratio in P&C Re, but there must be certainly also some impact on the technical margin in Life Re as it was significant part of the U.S. And – but also you have a significant share of your bonds invested there, especially in the reinsurance business in U.S. and Canadian bonds. So this would be my first question.

And secondly, I realized on the admin expenses, especially in the reinsurance segments that they were significantly up by €56 million or 15% for both reinsurance segments in Q1 versus the previous year quarter. Could you elaborate what the troubles have been there?

A - Jörg Schneider

I start with the first one. Perhaps, I have then to interrupt briefly to look up the reasons for the second one. With the first one, the impact in – for the technical property-casualty reinsurance business is obvious, like Torsten mentioned it before, we are over-proportionally profitable in the U.S., relatively low combined ratios. And fortunately, these profits translate now into higher euro profits. The same applies marginally, but you don't see it from quarter-to-quarter with the Life business. We also have an impact from the investments because our – the non-euro returns on investment come in at higher euro rates, that is in the region – it depends on how markets move, but mid-double digits million amount. Then, for the other non-operating result, we were long U.S. dollar, and that means that we have a positive FX result. This also comes not only from derivates and from this long position, but also from the fact that we translate the value of the shareholders' equity of our non-euro subsidiaries into euro quarter-by-quarter and that has a positive impact. So overall, some minor impacts here. The biggest one is that from the technical reinsurance segment.

Your second, I would like to answer after the – it's commissions, yeah. Torsten, would you take it?

A - Torsten Jeworrek {BIO 5724439 <GO>}

Sure. The change in admin expenses or in expenses is purely from higher commission and profit commission. That's the full effect. It has nothing to do with admin expenses. We have, because of good profitability, higher profit commissions. And we have higher flat commissions because of some softening in the business.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Okay. Thanks.

Operator

The next question comes from Michael Huttner from JPMorgan.

Q - Michael I. Huttner {BIO 1556863 <GO>}

Thanks a lot. My first question is, you had the €700 million derivative loss, which we find the €700 million, I guess, in the balance sheet on the other side. And I'm just wondering, how to understand this? I'm so confused. Because on the one hand, nothing has actually happened. So you could almost say, well, we don't have the derivative loss and we'll correct the movement through the balance sheet; or you could say, well, actually, our return on investments is exactly as we forecasted. Here I'm just wondering how to think about it? It's really – maybe you can help me? Maybe you can explain how you see it? Because I'm confused to see that. I would have been temped, because I was always a bit optimistic to say, well, the reported results was €790 million, but if I correct for the derivatives, which is not - does not impact the economics, the real result would have been X millions higher.

The second question is, just going back - you kind of answered, but maybe if you can give me the answer I'd like to hear. The solvency ratio, where you've said, well, 97% is now achievable for the year instead of 98% before. The impression I have is that you haven't actually changed the usage to - or the expected usage from excess reserves. So, to the extent, I would think that insurers and reinsurers are a bit conservative, there must be something you're seeing, which gives you the confidence of moving a number which you only set three months ago. Is there something here or am I missing the point? Thank you.

A - Jörg Schneider

Michael, on your second question first, there's nothing spectacular. It's the same phenomenon, as during the last many years I must say. The difference between the actually reported losses and the expected losses is substantial. That gives us the confidence that in the course of the year there will be further reserve releases.

On an ongoing basis, we think there's conservatism in the reserve setting for the current year in the order of 4 percentage points, and there should be corresponding reserve releases later on. What Torsten said, and what we are all convinced about it, that the releases could be higher from this phase of the constantly decreasing inflation rates, yeah, where we really, yeah - surprised is perhaps the wrong word at the moment, we got accustomed to it, yeah, but we must realize that our reserves are very comfortably set. That is what we notice at the moment.

On your first question on the derivatives; it's difficult, and it's a stress, and it's a constant discussion also inside the company, How far do we accept accounting distortions by our economic asset/liability management. And we came to the conclusion that it's much better to be well matched even with using derivatives, and by that, accepting some distortions, because the accounting rules require that the moments in derivatives go directly into P&L where the underlying doesn't. In some cases, the underlying even doesn't go into the balance sheet. That means we must live with some distortions. But using derivatives for the ALM is, in our view, without alternatives because it allows us to move our exposure to the portfolio - of the whole portfolio in a cost-efficient and quick way. And therefore, we use derivatives besides the underlying. In this case, in the first quarter, it's an easy one. It's all coming from equities more or less. That means we have this very strong rally of European equities.

And since we protect these equities partially by put options, mostly by forward, we had very substantial losses on these equities in the order of €760 million. So this is a quite big number. But on the other hand, it's very typical in such a situation that we have high gains from disposal and that happens. And we do not really adjust for these derivative losses, we take them as coming in and we explain them and we make them transparent.

And when you would set up the same kind of P&L, the moment you would have the reversal effect. Because these derivatives, this protection of the value of equities has proved to be beneficial in April and in early May.

So therefore, I hope that you can live with it; it makes the prognosis of our quarterly results very difficult also for us, I admit. But we believe that a good economic balance between asset and liabilities is a must, because you can deal with accounting mismatches, but you can't deal with very severe ALM mismatches.

By the way, talking about accounting, I erroneously said a couple of minutes ago that the translation of our shareholders' equity of the non-euro subsidiaries into euro goes through to the P&L. This is not true. This is a balance sheet effect only. So this is not part of the movement here. Sorry for that.

Q - Michael I. Huttner {BIO 1556863 <GO>}

Can I just have a very quick follow-up. The €760 million, how much was the net effect?

A - Jörg Schneider

Net after tax or what do you mean by that?

Q - Michael I. Huttner {BIO 1556863 <GO>}

Yeah. After tax and policyholders.

A - Jörg Schneider

Well, you can deduct some 25% perhaps.

Q - Michael I. Huttner {BIO 1556863 <GO>}

Okay. Thanks.

A - Jörg Schneider

Thank you, Michael.

Q - Michael I. Huttner {BIO 1556863 <GO>}

Thank you very much.

Operator

The next question comes from Thomas Fossard from HSBC.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes, good afternoon. Two question on my side. First question will be on the life primary business in Germany. I'm sorry about that, I should know about it. But I've read some press article about the Protektor scheme, which potentially could make a – basically Munich Re and ERGO liable for the potential financial trouble of some of your peers. Is that the way this is working? I mean, can you explain us how the scheme is working and potentially what could be the financials at stake here? And the second question will be for Torsten, the Pemex energy loss, is this a concern for your combined ratio Q2? Thank you.

A - Jörg Schneider

Hi Thomas. I'll start with your question on Protektor and I can add that Protektor has meanwhile been replaced by something called Sicherungsfonds which is economically the same. But it's a follow-up legal structure – Protektor was an entity, which was arranged by the industry itself, and later on it was replaced by a legal requirement. So for life insurers, this protection fund, Sicherungsfonds, can levy special contributions of 1 to – of up to 1 per mill of total net technical provisions in addition to a regular contribution of 0.2% – what is it, 0.02% of total net technical provisions.

For health insurer, we have the same. And this could give rise to potential payments, which would be indeed triple digit for the Group. So therefore, we very much hope that the industry in total will be able to resolve the issues and we are confident that this will be able also with the support of the LTG measures, because this is – this would really be a burden also for our Group like for our competitors here.

A - Torsten Jeworrek {BIO 5724439 <GO>}

So I come back to your question of Pemex loss. Pemex loss is an explosion on an oil drilling platform in the Gulf of Mexico on the Mexican side. The loss is new. It only occurred on April 1 this year. Of course, considering the late date of the loss, it's pretty uncertain at this stage. We checked our treaty participation or direct participation. And at this stage, it seems a very digestible loss, we think low double-digit euro amount for our portfolio. So it's something you would expect in one or the other way. You have always these kinds of single man-made losses every quarter. So nothing large for our portfolio.

Q - Thomas Fossard {BIO 1941215 <GO>}

Okay. And just to come back on this former Protektor scheme, any sense, any fear that this funding of the scheme could be approaching soon, or obviously that you're pretty relaxed on this point in the short-term? Thank you.

A - Jörg Schneider

I don't know. It's difficult. I can't give a reasonable and reliable statement on that, because I'm not aware of the situation of the market in total and even less about the situation of very small individual players.

Q - Thomas Fossard {BIO 1941215 <GO>}

Okay. Thank you.

Operator

We'll take the next question from Andy Broadfield from Barclays. Please go ahead.

Q - Andy D. Broadfield {BIO 7273415 <GO>}

Hi, good afternoon. Two questions please. The first on your investment approach. You say that you are investing outside of the Eurozone a reasonable amount. I was just wondering whether you can articulate how you're managing the FX exposure so that if indeed there is any meaningful FX exposure. And if you are using hedging, what the cost of that hedging is? So and ideally a sort of net yield number, you talked about 2% being new money. Is that 2% before or after hedging?

The second question is around the solvency. You alluded to the possibility you might use grandfathering and other things. I think one of the concerns I hear and I certainly feel myself is the degree to which Solvency II has been discredited because of the very significant changes to the ratio, because of the change in methodology. What are you thinking about the importance of stability to your stakeholders from a robust and reliable solvency measure versus the practical and programmatic issues of avoiding a shortfall or a difficult conversation just because you're being conservative?

A - Jörg Schneider

That's an interesting question. Perhaps I ask Bernhard Kaufmann, our CRO, who is also here later to answer that questions. Because we are in the final phase of the finalization of our internal model and the application with the German supervisor for using it for Group capital requirements and we regard this model as being a really good solution for our business, which is used in practice.

But on your first question with the FX exposure. There is very little FX mismatch involved, because as you know, we have liabilities which are, to a large extent, outside of the Eurozone. And therefore, as long as assets and liabilities match each other, there is no reason for hedging. To some extent, we take small bets in addition, but these are willing bets. And we hedge only with ERGO who has very little foreign liabilities, especially almost no U.S. liabilities. Here, we do investments in U.S. dollars at the moment, also not to a large extent, but some, which are partially hedged. And the cost of hedges are pretty low at the moment, yeah. So you can more or less forget about it as long – in spite of the high volatility, I must say, but the markets are extremely liquid. So that works pretty well. Bernhard?

A - Bernhard Kaufmann {BIO 18347993 <GO>}

Yeah. Hi, Andy. This is Bernhard Kaufmann. First of all, like Jörg already mentioned, all long-term guarantee measures that are applied in the industry will be transparent from their effect. So there will be full transparency on what they do to the economic solvency ratio and the owned funds.

And we are also in the process of considering what are solutions beside long-term guarantee. So that, what Jörg also mentioned, as a discussion that is going on, so how we will also position ourselves. If we really would go for long-term guarantee measures, then we would only use those who are very easy to handle in the way of – they are very transparent also in our economic steering framework. And there are some transitional measures, or one way of also applying transitional measures where it's very transparent and also very easy as they can be applied just as a measure more or less in the end of all calculations where you just have one additional step, that is then something which you can also again take out if you apply this for internal steering purposes or if you are also then going to the public and show these numbers. And so that is also something which is very near to our heart, that we have full transparency, if we would apply this on our numbers and not framework, but also how we internally then can use the numbers as – and not watered down by these measures.

Q - Andy D. Broadfield {BIO 7273415 <GO>}

Okay. Can I just come back on one other sort of related point is, I think we're seeing sort of steady pressure building from other stakeholders. It was interesting in the IMF's Financial Stability Report and subsequent comment just yesterday or day before about highlighting Germany – not Munich Re but Germany as an area where there needs to be action taken sooner rather than later. And the whole point of the transition measures is, it can happen later rather than sooner.

So I was just wondering whether you see that – those sorts of pressures coming in more and more into the industry and into some of the Solvency II discussions with the regulator or whether for the time being that's irrelevant?

A - Jörg Schneider

We see a lot of stability at the moment in the requirements. So EIOPA is still working on some technical standards. The local regulators will apply them according to the complied or explained rules. But the industry now has acquired good basis for the necessary calculations. Bernhard, do you want to add anything?

A - Bernhard Kaufmann {BIO 18347993 <GO>}

Perhaps one additional point. I think the pressure is already high with respect to the life insurance industry as the problems are transparent. The Solvency II framework with the long-term guarantee measures gives some time for smooth transition, but behind the scenes, of course, the regulators are also in talks with the industry and with the companies who are then also perhaps more affected than others. So I think that is also part of the way of making this really a smooth transition and not some sort of accident happens on the way.

Q - Andy D. Broadfield {BIO 7273415 <GO>}

Okay. Thanks very much.

Operator

That will conclude today's question-and-answer session. I would now like to hand the call back over to your host for any additional or closing remarks.

A - Jörg Schneider

Yeah, nothing to add from our side. Thanks for joining us this afternoon. We're looking forward to seeing you soon. And further questions, please don't hesitate to give my team a call. Thank you. Bye-bye.

Operator

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