Q4 2015 Earnings Call

Company Participants

- Christian Becker-Hussong
- Jörg Schneider

Other Participants

- Andrew J. Ritchie
- Andy D. Broadfield
- Avinash Singh
- Frank Kopfinger
- In-Yong Hwang
- Michael Haid
- Michael I. Huttner
- Olivia Brindle
- Thomas Jacquet
- Vinit Malhotra
- William Hawkins
- Xinmei Wang

MANAGEMENT DISCUSSION SECTION

Christian Becker-Hussong {BIO 19080254 <GO>}

Thanks for joining us. Today's call is, as announced, on the Results of the 2016 1st of January Renewals and our Preliminary Figures for 2015. Set up is as follows. We will start with an introduction of our CFO, Jörg Schneider and then go right into Q&A.

And with that, I hand it over to Jörg.

Jörg Schneider

Thank you, Christian. Good morning, ladies and gentlemen. We met our guidance for 2015 in full and clearly beat our original target with a net profit of around €3.1 billion. This good result demonstrates our robust reinsurance earnings, supported by our strong balance sheet. It translates to an ROE of 10% and a RORAC of 11.5%. This is quite pleasing given the challenging reinsurance market conditions, low interest rates and capital market volatility.

In an increasingly uncertain economic environment, Munich Re continues to deliver financial stability and reliable earnings. The Q4 result of more than €700 million was quite decent, but requires further explanation as they were again counterbalancing one-off effects. As already indicated in early November and as a consequence of the prevailing low interest rates, we made a goodwill impairment in ERGO's life and health segment, with a negative impact of €429 million. On the other hand, Q4 earnings benefited from a positive FX result.

Our capitalization remains very strong according to all metrics and our healthy balance sheet continues to provide the basis for quite resilient returns and further high payouts.

Pending remaining methodology uncertainties, mainly in calculating owned funds, the economic solvency ratio, according to Solvency II standards, should have increased compared to the end of September and even versus yearend 2014.

In German GAAP accounting, the low yield effect is reflected in a book value write-down of €1.1 billion in the parent company's holding in ERGO. This impact on earnings under German GAAP is more than compensated by a strong underwriting results and positive tax effects.

Even after further strengthening of the equalization reserve, we achieved a German GAAP result of €2.6 billion. Since this is higher than dividends and share buybacks in 2015, we increased our distributable revenues over the course of the year.

Let me now give you the highlights by business segment. Please bear with me that I will have to stay on a rather general level. The numbers are preliminary and have not been fully audited yet. I do not expect any major changes but wish to respect the ordinary procedures.

Let us start with life reinsurance. The technical result of around €90 million in Q4 is more or less in line with the average quarterly run rate. As indicated earlier, the technical result for the full year fell short of our €400 million ambition due to two large single claims in the third quarter and the fourth quarter. These random effects do not concern us as they are part of normal earnings volatility. The underlying profitability of the business remains sound and all major markets performed in line with expectations.

I will now move on to P&C reinsurance. The combined ratio was a very good 78.6% for the fourth quarter. This was partly down to good luck due to low major loss activity and it was supported by reserves from prior years doing even better than expected with releases accounting to 16.5%, net of commissions, in Q4.

For the full year, basic loss reserve releases, adjusted for commissions again, were 7.2% of net earned premiums; once more above our 4% guidance. It is important to note that we did not sacrifice the reserve strengths on the P&C book and remain at the high end of the range of best estimates.

On a normalized basis, however, the combined ratio has continued to increase over the course of the year, amounting to slightly above 98.5%. Price reductions experienced in the renewals were mitigated by positive FX and business mix effects. In the current soft market, we have not given up on our underwriting discipline. Our initial estimates still seem to be quite conservative.

During the renewals of our reinsurance treaties at January 1, 2016, the market environment was almost unchanged compared with 2015. There was sufficient capacity in all classes of business. Prices remained under pressure, but to a lesser degree than in previous years. Terms and conditions were largely unchanged, as was the demand for reinsurance cover. We were able to limit the decrease in prices for our portfolio to just 1%.

As we took advantage of attractive business opportunities resulting from our preferential client access and leading risk know-how, we even posted a slight increase in premium volume after adjustment for FX movements. The projected profitability of our portfolio is still comfortably above our cost of capital.

ERGO posted a disappointing net loss for the full-year 2015, mainly due to the goodwill write-down and the disposal loss for the Italian units. Positive earnings in German non-life business only partially offset losses in life and health and in international operations.

In Q4, the combined ratio of 103.9% in Germany was largely due to nat cat losses and a strengthening of the comfort level of claims reserves in liability business. Adjusted for above-average large claims and the reserving impact I mentioned, the full-year combined ratio comes a lot closer to our 93% guidance.

The Q4 combined ratio of our international non-life operations amounted to 115.3% and suffered from a deterioration in Poland, reserve increases in Turkey, and in UK legal protection business. The combined ratio for 2015 as a whole increased to almost 105%, clearly above our guidance at the beginning of the year. Furthermore, the sale of ERGO's Italian business contributed around minus €80 million to the segment's negative Q4 result.

The need for action is obvious. My colleague, Markus Rieß, ERGO's new CEO, is due to present his program for generating a sustainable earnings improvement during the second quarter.

Owing to a somewhat weaker performance in Q4, Munich Health slightly missed the upper-end of our full-year guidance of €50 million to €100 million. To a large extent, this is due to unfavorable claims experienced in U.S. health reinsurance business.

And now a few remarks on the investment result. In the last quarter, reduced impairments on equities resulted in lower net write-downs than in the third quarter. However, there were also reductions in net gains from disposals. Losses on derivatives were somewhat higher, mainly in primary life and health, where equity derivatives and interest rate hedges lost value.

In reinsurance, the result from commodity and inflation derivatives improved significantly against the substantial losses experienced in Q3. For the full-year 2015, we are quite pleased with an investment result of €7.5 billion, given the low interest rates. Our cautious investment policy, prudent duration management and high degree of diversification once more proved beneficial. The strong U.S. dollar compensated for the impact of low yields on regular income.

Although we almost refrained from active harvesting, we recorded slightly higher disposal gains. These mitigated net losses on derivatives that we are prepared to accept as they support economic stability. The decline in investment income compared to 2014 was mainly due to higher write-downs, which were a consequence of elevated capital market volatility. But you can rest assured that, going forward, we do not intend to change by taking on substantially higher investment risks.

We want our shareholders to benefit from the Group's good performance. The increase in the dividend to €8.25 per share is further confirmation of our attractive and reliable dividend policy and our trust in Munich Re's sustainable earnings power.

Thanks for listening. I am now happy to take your questions.

Christian Becker-Hussong {BIO 19080254 <GO>}

Thank you, Jörg. Now, quickly back to the operator. Just one remark, please, as always, my typical housekeeping; a maximum of two questions per person, please, in order to give everybody a fair chance to ask their questions.

Thank you. We can now start with the Q&A. Who is the first?

Q&A

Operator

Thank you. We will take our first question from Xinmei Wang from Morgan Stanley. Please go ahead.

Q - Xinmei Wang {BIO 17860767 <GO>}

Hi. Good morning, it's Xinmei Wang from Morgan Stanley. My first question was on reserving. I was wondering if you could give some more detail on the reserve increase in ERGO liability lines, what it relates to in particular, any underwriting years or lines. And maybe also on the reserve strengthening in Turkey and how that relates to the overall reserve buffer of the Group.

My second question is on energy. I appreciate you don't normally split this out, but given what's happened to the oil price, I was wondering if you could provide us your exposure to energy in your portfolio. Is there anything we should be factoring in here? Thank you.

A - Jörg Schneider

Hi, Xinmei. I'd start with reserving in ERGO. This is general liability business and refers to a couple of years. Nothing serious, I can say. Yeah, so it's just to increase the level of comfort and to bring it closer to the level in reinsurance. Different in Turkey; in Turkey, we've been suffering from a constant move upwards of the personal injury claims. And the last trigger here was a change in the minimum wage law, which just came up in the first days of this year, which has direct impact in the personal injury claims and the reserves. And we had to move upwards, and then we, within the reasonable range of best estimates, we went to the upper-half, I would say. But this is unfortunate. So, we are still suffering from old claims, whereas the current business is in good shape.

And your third question, could you repeat it? I'm sorry. I was so busy in looking up the first one.

Q - Xinmei Wang {BIO 17860767 <GO>}

Okay. It was on energy, on your energy exposure, given what's happened on the oil price, could you give us an indication of your exposure there? Is there anything we should be factoring in?

A - Jörg Schneider

Yeah. So, are you referring to investments here?

Q - Xinmei Wang {BIO 17860767 <GO>}

Yeah.

A - Jörg Schneider

Yes. Okay. It's a substantial exposure. But overall, you must see our corporates only make up some 10% of our overall fixed income portfolio. And within that part of the portfolio, we more or less invest according to the big indices, where oil and gas plays a substantial role. The reason is that the oil and gas industry is a heavy lender - debtor, and therefore it's in line with the market. We observe it with some caution, but it does not develop into a major problem of us, due to the fact that our overall corporates exposure is relatively low in comparison to the market.

Q - Xinmei Wang {BIO 17860767 <GO>}

Okay. Great. Thank you.

A - Jörg Schneider

Thank you.

Operator

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

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

Hi. It's In-Yong from Goldman Sachs. Two questions from me. Firstly on the very significant reserve release that we saw in the fourth quarter, just a bit more detail on where it's coming from. And we're seeing obviously a run rate above the 4% normalized level for the full year. But when you kind of look at the reserving position, do you kind of see maybe not quite this level, but a level above the 4% being sustained for the foreseeable future? That's my first question.

And second question on your net income for 2016, I think I saw something in the media about Jörg, you're saying that the earnings going forward won't be below €2.5 billion. Just wanted to check whether that was correctly attributed to you. And just wondering on kind of the confidence behind that, given that it was kind of the low-end of your guidance for last year? And kind of – so the dynamics in the underlying reinsurance market seems to be telling you that things are probably going down rather than up. So yeah, just a bit on the guidance for next year. Thank you.

A - Jörg Schneider

Yeah. Thank you, In-Yong. I'll start with your first question on reserve releases. From a line of business perspective, the impact is driven by property lines and to a lesser extent by third-party liability, engineering and marine. And especially what I want to emphasize is we have not weakened our strong balance sheet. I don't know whether I can predict something for next year, because we do not willingly over-reserve here. But I do not have a reason to believe that the situation changes dramatically, as long as inflation stays so low. This is a caveat I have to make.

With regard to our guidance for 2016, if you look at the 2015 result, we had the factor of good luck with major losses, the A versus E, so the reserve release is clearly above 3%. We had, on the other hand, FX losses. And if you take all these one-offs, these and many others, and you could argue long time what has to be adjusted for and what not, but you end up somewhere between €2.5 billion and €2.7 billion or so. So this could be the baseline for next year.

Then we have ongoing pressure from the low yields. We have somewhat mitigated, but still ongoing pressure from the rates. So let's say that we can seriously earn €2.5 billion, and then we are sitting on a very strong balance sheet. And it's, according to my own experience, when this balance sheet runs itself off over time, it is only natural that you have additional gains. Therefore, it's too early now, we will do that in March to give a profit prognosis. But I do not have a reason to believe that we would go below €2.5 billion. And I would rather think that there is some space above. But I have to keep it so general at the moment.

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

Yeah. No, I completely appreciate that. Thank you.

A - Jörg Schneider

Thank you, In-Yong.

Operator

We will take our next question from Michael Huttner from JPMorgan.

Q - Michael I. Huttner {BIO 21417183 <GO>}

Fantastic. Thank you very much. And I had two questions. One is, in the past, you said that hedging, you would look at it, the hedging for commodities. And I just wondered whether that was already done when you'd spoken about that in Q3 or, in other words, taking off the energy part, which doesn't seem to correlate with much at the moment. And then – and maybe you can say how much of that is in the investment income. I guess it's all the derivative loss?

And then, the other question is the solvency. So 260% was a figure we had in – or you said in November. And now, say, it's even above Q4 (20:51) last year, so above 277%, so let's round it to 280%. How do you jump 20 points in a quarter? It's fantastic, but if you can explain how that works, that'd be really lovely. Thank you.

A - Jörg Schneider

Yeah. Michael, good morning. First, commodities, yeah, we had somewhat reduced our exposure to these derivatives here, but it's still there, yeah. So, reduced, but not to zero. And the losses we had here is not only from the commodities and from the inflation linkers, but also from equity derivatives, yeah. So therefore it's a mixture. But it's fine, yeah. So I don't worry too much, I must admit. It looks so ugly, but it's part of an overall well-balanced investment policy.

And the ratio for – and our economic solvency ratio, we do not have a precise number yet. But in tendency, we should have benefited from a number of factors, be it interest rates, be it FX. And that means when we do very simple calculations here, which are to some extent reliable already, then we should end up slightly higher than at the end of 2014 and clearly higher than at the end of third quarter. This is the number we published in London when we explained all the methodology of our Solvency II economic solvency ratio here. So, I'm very confident that it will end up in this area.

Q - Michael I. Huttner {BIO 21417183 <GO>}

Brilliant. Lovely. Well done. Thank you.

A - Jörg Schneider

Thank you.

Operator

We will take our next question from William Hawkins from KBW. Please go ahead.

Q - William Hawkins {BIO 1822411 <GO>}

Hi. Thank you very much, Jörg. First of all, how would you help us characterize the awful numbers that ERGO has printed? Is there an element of kitchen sinking going on here so that Markus can be more optimistic from January 2016, or do you think there is still a sign that there are a number of underlying problems in ERGO, that means the outlook for 2016 and beyond should still be somewhat cautious?

And then secondly, can you give us an update on whether Munich's strategic thinking has developed in terms of the opportunities for M&A in the primary and reinsurance market versus your appetite for capital repatriation? Just sort of general strategic update there, please.

A - Jörg Schneider

Thank you, William. Good morning. Kitchen sinking, officially not. We do not give any order that they should present everything which could turn into a loss during the next couple of years. But I wouldn't be surprised if at one or the other location in the Group, one had the tendency to be a little bit more on the conservative side in such a phase of new start, so that you do not want to come up with surprises one or two years later. Therefore I think it will be something in the middle. On one hand, a quite cautious look at a number of existing problems, on the other hand, not very rigorous and extreme action of kitchen sinking. Second question.

Q - William Hawkins {BIO 1822411 <GO>}

Jörg, if I may just butt in. I'm sorry, just to come back on that. Again, just given what you said about the Group earnings, €2.5 billion or higher, directionally within that, are you assuming that ERGO is already able to achieve the 2015 target that it failed to reach or could ERGO still be underperforming against what you think is a normal target?

A - Jörg Schneider

That is, it could still underperform. So we got accustomed to our reinsurance operations producing much more than originally anticipated. We cannot build any prognosis on another year of good luck; that doesn't help. But the strong balance sheet could also produce additional earnings. So when we talk about IFRS results, then it's not our intention to give up our prudence with regard to reserving or with regard to tax reserves or things like that. But as I said before, and I would be surprised if all these sources of additional IFRS earnings would come to an end now, and that means there could be an additional room for compensation.

With regard to ERGO, it's premature now to say. There could be an impact from the change itself, yes, be it restructuring expenses, be it write-downs here or there, but I do not have any clear evidence for it at the moment, so it's a bit too early. And any positive impact from changes will only show up in the following years, and I'm sure that they will show up, but not in 2016.

So therefore let's say, if ERGO is still somewhat lagging behind its mid-term potential, that could be compensated by other sources here. But this is quite general and you can't do a lot with that. But when I look at the IFRS earnings of the last couple of years, they turned out to be extremely resilient.

On your second question, no major change about our view about M&A. We have been and are interested in making fantastic acquisitions at good prices. Unfortunately they are not easily at hand here and I do not see a change here, because so many companies are currently desperately looking for growth and investing in enterprise acquisitions, that we still see a level of prices which does not adequately reflect the challenges from the business. Therefore, I personally regard it as highly improbable that we do very big acquisitions. You might see mid-sized ones like you did in the past. But I hope that you can rely on us being on the rather conservative side when it comes to valuations here.

Q - William Hawkins {BIO 1822411 <GO>}

Lovely, Jörg. Thank you.

A - Jörg Schneider

Thank you, Will.

Operator

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

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

Hi there. Thanks. Just a quick question on the German GAAP earnings, which you said, I think, were €2.6 billion or €2.5 billion after the goodwill write-down, implying a very high level of underlying German GAAP earnings. I'm just trying to relate that to what a sustainable level of German GAAP earnings is going forward. I appreciate there's yet another benefit from a reduction or even a reversal of equalization reserves to occur beyond this year. But were there some gains or other positive one-offs inflating that number? Or is the underlying €3.5 billion (28:32) of German GAAP, is that sort of the ongoing run rate? I'm just trying to – just some guidance there would be useful.

And very quick second question. What was the net benefit to the combined ratio – the normalized combined ratio for the full-year from FX? Thanks.

A - Jörg Schneider

Easy one is your second question, roughly 0.5%, yeah, so positive impact from FX. That means our U.S. business is more profitable than the average and therefore we have a positive impact here.

Your first question, extremely strong German GAAP result in spite of the write-down of the ERGO shares, it's partially sustainable, partially also driven by positive effects. Let's take – we have, for example, a write-up also not to the same magnitude as to write-down. With regard to our U.S. American operation, we had again very low taxation under local German GAAP, and we had an excellent underwriting result driven by low major losses and the reserve releases. And in spite of the contribution to the equalization reserve, we had a positive net underwriting result, which was fantastic. So very good circumstances, I would say.

Going forward, for 2016, we do not expect further need to contribute to the equalization reserve, which is beneficial, and for 2017, even a major reduction in the equalization reserve. Both should support our distribution capacity. Therefore, I'm today very confident that the current level of distributions can be sustainable for a long while.

Yeah, so I was always concerned. I never wanted to propose to my colleagues and to the Supervisory Board distributions, where we can already see that our revenue reserves would expire over a reasonable mid-term period. But this is not the case. So I'm very confident that the very high distributions of Munich Re can go on.

On the other hand, I do not want to create too much fantasy that we have a huge one-off step or so. So please take our boring attitude, our reliability also as a plus from a capital market perspective. Thank you, Andrew.

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

Okay, great. Thank you. Thanks.

Operator

We'll now move to our next question from Olivia Brindle from Bank of America. Please go ahead.

Q - Olivia Brindle {BIO 17273762 <GO>}

Hi there. So two questions from me. Firstly on the renewals. Just around your volumes, I was wondering if you could explain the differential versus last year. I mean the pricing trend wasn't that different. And last year you sort of went through explaining that half of that was from big transactions, half of that was from various other things. So could you just talk through what the volume trends were this time around? That would be helpful.

And then the second question, you say that overall you are comfortably above your cost of capital at this point, which makes sense. I was just wondering whether that (32:18) are parts of your portfolio where that is no longer true, sort of pockets within that. That would be helpful to hear. So thank you.

A - Jörg Schneider

Good morning, Olivia. Thank you. First, a lot came from major transactions and also very pleased that we see some business from – which is Solvency II-driven, which we had always hoped for but never showed up. But now that it becomes reality, we also see business coming here.

There's also the FX effect. We were quite strong in casualty proportional business because we saw there a quite good stabilization. So overall it is a well balanced picture at the moment.

Cost of capital, there were buckets where we do not - do no longer earn our cost of capital. In most cases, we withdrew from the coverage here. In other cases, we stayed within the contracts because we could either subsidize it from other sources or in very specific cases, where we see a strong chance that this client we develop so favorably that we will make a lot of money with him over time. But it's a mixed picture meanwhile. For example, in marine offshore business, that is an example which I can give you, there we would say that we are already below our cost of capital.

Q - Olivia Brindle {BIO 17273762 <GO>}

Okay. That's very helpful. Thank you. And then maybe just could you make a quick comment on cat in that context? Is cat still above cost of capital, would you say?

A - Jörg Schneider

U.S. cats, yes, that is okay. In other areas it's mixed, yeah. So for example, Europe was worse than U.S. U.S. proved to be more stable here.

Q - Olivia Brindle {BIO 17273762 <GO>}

Okay. Thanks very much.

A - Jörg Schneider

Thanks.

Operator

We will take our next question from Frank Kopfinger from Deutsche Bank. Please go ahead.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Yes. Good morning. I have two questions. My first question will be also again on your economic solvency position. Are you somehow worried on the high volatility that we see in this number? Is this the new normal that we should expect or are there also some instruments, I would say, to mitigate this volatility?

And my second question is on tax provisions. I believe that you did not use additional tax provision releases in Q4. But could you confirm this and also provide an outlook on what we should expect in terms of tax provision releases going forward and how they contribute to the 2016 guidance?

A - Jörg Schneider

Frank, good morning. Your question on high volatility, our economic solvency ratio is volatile, but we are not concerned because we are on such a high level and it doesn't make a lot of a difference whether you are 260% or 290% or so.

And the other reason is that, unlike others, we do not use some tools to stabilize it artificially, if I may say so. Yeah. So for example, no dynamic volatility adjuster, things like that. That means that we show our exposure to capital market movements because we can afford it, yeah. And because this gives us internally better information and gives us the necessary stimulus to reduce volatility where we regard this as being appropriate. That is the huge advantage for us of running an internal model which is fully in line with our internal steering and which is very close to economic realities that helps us enormously. But that explains partially the high volatility of the numbers you see from the outside.

Second, tax provisions, difficult to answer. I can confirm that there were no major movements in the fourth quarter. What will happen in 2016, I don't know. So when we see an open tax question, then we typically tend to set up the reserve. And in the past, in some cases, it turns out – it turned out to be more benign than originally anticipated.

To predict that for the future is difficult because governance need money, and especially the German government will need money, if I may say so. And therefore, in tenancy, there are some new tax rules which could slightly increase our tax rate going forward. But we still stick to the range between 20% and 25% for the Group, perhaps more on the upper than on the lower end.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Okay. Thanks.

A - Jörg Schneider

Thank you.

Operator

We will take our next question from Avinash Singh from Nomura. Please go ahead.

Q - Avinash Singh {BIO 17348287 <GO>}

Yeah. Hi. Avinash Singh from Nomura. A first question on your ERGO International business, given that – I mean, the conditions in Poland and Turkey remains challenging, what's your guidance or view on the combined ratio for 2016?

And secondly, maybe a repeat, but for your 2016 profit guidance, in 2015 operating numbers you almost had sort of €1.5 billion favorable, sort of €700 million, I can say, ever normal (38:29) reserve releases of the similar number in terms of a low nat cat losses, and also higher regular investment income because of a strong dollar. So I mean – and also the tax rate was lower. So how confident are you with the €2.5 billion floor for 2016 profits? That's my two questions.

A - Jörg Schneider

Thank you, Avinash. First, ERGO International for 2016, yeah, I'm personally very optimistic with regard to Poland. Poland is by far our most important market here and we have a very strong company on side (39:10). And I trust that their market position is so strong that they will reverse the negative trend of the last couple of years. Short-term, it could still be suffering from the market developments, yeah. So for 2016, it is difficult to predict a reversal. But going forward, I'm very confident with regard to their strengths and to their profitability.

Other markets may be more difficult. In Turkey, these are legacy problems. So the current portfolio is small, but in good shape. But the impact from Turkey from legal expenses U.K. and so on is nothing in (40:03-40:09). Oh, sorry. I was just told that the microphone was out there, so I have to repeat. I'm confident with regard to Poland mid-term; short-term, 2016, can still be difficult because the pressure on – in the markets, the competitive pressure is still strong.

With regards to the 2016 result for the Group, yes, it's a challenging time. We have pressure from investment income, from – still from reinsurance rates. We have the various one-offs in both directions. Mid-term to long-term, I'm sure that we will succeed in mobilizing much more profit potential from expanding the barriers of insurance. Short-term, there are dampening effects, but these dampening effects should be somewhat mitigated, if not overcompensated by the effects of the strong balance sheet. Therefore, I'm still confident with regard to our IFRS result for 2015 – for 2016. Thank you, Avinash.

Q - Avinash Singh {BIO 17348287 <GO>}

Okay. Thank you.

Operator

We will take our next question from Michael Haid from MainFirst Bank. Please go ahead.

Q - Michael Haid {BIO 1971310 <GO>}

Thank you very much. Good morning. Two questions. The goodwill impairment in life and health, €429 million, why did you write-down the goodwill of health insurance? I thought that was a business which is quite resilient.

And the second question, the book-will (41:55) write-down of ERGO, the €1.1 billion, what exactly did you write-down? I mean the book value, you must have written down something on the asset side, I guess.

A - Jörg Schneider

Yeah. Michael, good morning. Health is very resilient. Good profits and also from an economic point of view in good shape, but it's part of the same segment, yeah. So we were forced to compare the value we see in this segment with the book values. And since life is under pressure and since we had to reduce our reinvestment assumptions, we had to write down the whole goodwill. And let me frankly say, we did not make any efforts to aggressively defend it, which would perhaps been possible within reasonable estimation ranges.

Second, the goodwill write-down, this is the – the write-down in local GAAP. This is the write-down of Munich Re on its ERGO's share. That means the same phenomenon, low interest rates, lower profit expectations here for the whole ERGO translated into a revaluation and to a loss from impairment. That's an asset impairment here.

Q - Michael Haid {BIO 1971310 <GO>}

Okay. May I ask also about – have you made a decision regarding applying the transitional for your German life business?

A - Jörg Schneider

Yes, we did. We will not apply transitionals for the time being.

Q - Michael Haid {BIO 1971310 <GO>}

Thank you very much.

A - Jörg Schneider

Thank you, Michael. Bye.

Operator

We will take our next question from Andy Broadfield from Barclays. Please go ahead.

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

Hi, Jörg. Two questions, please. On the proportional side of the renewals, I think you'd make (43:57) assumptions around the underlying primary trends in order to reach your overall 1% price decline. I was just wondering whether you could give us some color on the main components of that. Your peer avoids that discussion yesterday and typically does, but you try to do this, take some view on that, so I'd appreciate that color.

And secondly, in your very good disclosure, you gave last year on Solvency II. I was just wondering around the economic earnings whether – two things, whether the things like the reserve releases and these balance sheet strength, they largely – in my assumptions, they largely come through the economic earnings as well.

And secondly, whether the level of economic earnings, it was coincidentally, in 2014, very similar to the IFRS number, but clearly they move very differently. Just whether you feel that the direction of that is broadly consistent with the messages you've been giving about renewals, et cetera.

A - Jörg Schneider

Your second question – Andy, good morning. Yes. So we do not have better indications at the moment. So the reserve releases and the good luck with major losses translate itself into economic earnings one by one. Then we have the impact from the changes in the capital market, but these were minor, the economic earnings here, because we see – in spite of the huge volatility in the course of the year, we'll see a surprising level of, how should I say, of stability when I just compare end 2014 with end 2015.

With regard to proportional business, I also listened into Hannover Re's conference yesterday and I found it also interesting that in accordance with their earlier practice, that they do not give pricing guidance for the proportional business. We try to include that into our number on the basis of original rates here which we expect to be rather stable.

In the U.S., there could be increasing pressure, which – and we assume a development which is flat to up to minus 2%, 3% or so. But overall, our assumption is stable rates in primary insurance. And this is what we build into our calculation for the overall price change. And we feel quite comfortable in the last couple of years that worked pretty well. Thank you, Andy.

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

Thanks, Jörg. Can I just say very quickly, last year 2014 – or the 2014 disclosure, economic effects was quite a big positive and I know there are some other negatives, particularly around ERGO and the operating earnings. I was just wondering whether we should be looking at that operating earnings adjusted for the ERGO – the big ERGO negative last year as a sort of base line. We should assume some positive economic effect as a matter of course.

A - Jörg Schneider

The economic effect just compare the end of 2014 to 2015, yeah. So this is – we'd not have the same impact as we had in the course of 2014, because in 2014 the interest rates went drastically down, whereas in 2015 they were between start and end, more or less similar. Therefore, I do not expect many – or a lot of negative effects here from – yeah?

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

Okay. Thank you.

A - Jörg Schneider

Thank you, Andy. Bye.

Operator

We will take our next question from Thomas Jacquet from Exane. Please go ahead.

Q - Thomas Jacquet {BIO 4110153 <GO>}

Hi. Good morning, gentlemen. I have a follow-up question on the cost of capital. What are you currently putting in your assumptions for the underwriters? Is it based on RORAC? Is it already based on Solvency II capital?

And my second question is on the renewals. From a technical standpoint, if you sign a deal with a public scheme, let's say a Flood Re, would we see that in the numbers of these renewals or is it something that is segregated? Thank you.

A - Jörg Schneider

Good morning, Thomas (48:25). Cost of capital in the order of 8%, but this is highly subjective, but it's not very aggressive, in my view. Then any business with public schemes which comes up at 1st January as part of our renewals disclosure here. And in tenancy, it should have a growing importance over time coming from small origin at the moment. Thank you.

Q - Thomas Jacquet {BIO 4110153 <GO>}

Thank you.

Operator

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

Q - Vinit Malhotra {BIO 16184491 <GO>}

Good morning, Jörg. Just one thing I wanted to highlight is that in the manmade claims, we seem to be frequently above the budget over last three years, four years now. Is there an internal discussion to review this? And why I ask is because obviously it's important for normalizing the numbers. That's the first question.

On Solvency II, I just wanted a quick clarification. I missed it, I think. I think you mention a number of almost 280% or something for the full year, if I'm not mistaken. But does that include the dividend – oh sorry, does it already count the deduction for dividend or not? So that's something that I'm a bit confused about. If you could clarify, that would be very good. Thank you.

A - Jörg Schneider

Hello, Vinit. First, manmade claims, whether there is a discussion to review our prognosis of 3.5 percentage points, yes, there is. Yeah, so we still see the manmade losses of 2015 as being partially random, but nevertheless, there is an ongoing discussion. And there could be a change, but I do not expect ending up in a totally different range here, perhaps a slight increase.

Second, I did not dare to give a number for the economic solvency ratio because this is just not possible. It's so complicated with adding up all the solvency capital requirement and the eligible own funds. And with the eligible own funds, we also have some open points which are in the final clarification with the auditor and with the regulator. So there could also be movements by 10% up or down or so, fortunately on a very comfortable basis that one, so we are not worried at all. But this is the reason why I would never dare to give a clear prognosis.

What we do is we only deduct, and that is on your question, dividends which have been publicly announced at the date of the calculation or to which the calculation refers. This is different from some competitors, not from all competitors. It is in line with the regulation. That means only at the end of the first quarter we would deduct the dividend because at that time the proposal which was made by the board of management to the supervisory board, which we present today to the capital market, this is for us, the triggering event for deducting the dividend. So in our calculation for end 2015, the dividend will still be in. But we will inform the market about that quite clearly and it's an easy calculation.

Q - Vinit Malhotra {BIO 16184491 <GO>}

All right.

A - Jörg Schneider

Thank you, Vinit.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Thank you. Thank you.

A - Jörg Schneider

Bye.

Operator

That concludes the question-and-answer session today. At this time, Mr. Becker-Hussong, I would like to turn the conference back over to you for any additional or closing remarks.

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

Yeah. Thank you and thanks to all of you for joining us this morning. We are very much looking forward to our analyst conference and hope to see many of you here in Munich. And if you have further questions, you know where to find us and we are happy to help you with any questions. Thanks a lot and see you soon. Bye-bye.