Q3 2016 Earnings Call

Company Participants

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

Other Participants

- Andrew J. Ritchie, Analyst
- Frank Kopfinger, Analyst
- Guilhem Horvath, Analyst
- In-Yong Hwang, Analyst
- Kamran Hossain, Analyst
- Michael Haid, Analyst
- Michael Igor Huttner, Analyst
- Olivia Brindle, Analyst
- Sami Taipalus, Analyst
- Thomas Fossard, Analyst
- Thomas Seidl, Analyst
- Vinit Malhotra, Analyst
- William Hawkins, Analyst
- Xin Mei Wang, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day, and welcome to Munich Re Q3 Quarterly Statements. Today's conference is being recorded. At this time, I would like to turn the conference over to Christian. Please go ahead.

Christian Becker-Hussong {BIO 19080254 <GO>}

Yeah, thank you, Lisa. Good afternoon, everyone. Welcome to our third quarter 2016 earnings call. Today's speaker is Jörg Schneider, our CFO. There will be no further introduction on our end. So, we can go right into Q&A, and please limit the number of your questions to a maximum of two per person, as always, please. Please go ahead.

Q&A

Operator

Thank you. We'll now take our first question today from Thomas Seidl of Bernstein. Please go ahead. Your line is open.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah. Thank you, good afternoon. First question is regarding 2017 actually. I mean, we have a few weeks left in 2016. Normalized for one-offs, your current run rate is like €600 million net profit per quarter, so 2.4%, 2.5% for the year probably on an underlying basis and with investment income likely to come down and pricing still softening, should we expect a markedly lower guidance for 2017? This is my first question.

Second question is on ERGO. I wonder if you could give us, please, an update here. I mean, the two relevant news here in one sense is you're applying now translational rules for the Life businesses. And the second one is, in June you announced that you're going to publish ERGO International strategy, which seems not the case right now. So, I wonder whether this is an indication that things are getting a bit more difficult at the ERGO turnaround. So, if you could please give us an update there. Thank you

A - Jörg Schneider

Thank you, Thomas. First, yes, it could be something like €2.4 billion adjusted for good and bad luck here and there for 2016. And for 2017, there's clearly some items which directs downwards which is, first, the investment income and second, some spillover effects from the decline of reinsurance rates in 2016 into 2017. So, to quantify is difficult. We are thinking about investment income in the order between 20 basis points to rather 30 basis points, which would stand for something like €200 million negative deviation for the return in reinsurance coming from the technical result, let's call it something like €130 million to €150 million if we go for 1% deterioration in loss ratio, which is perhaps a little bit at the negative, at the pessimistic end.

So, overall, the direction is clear. The question is how far will it be compensated by the impact of Munich Re's strong balance sheet, which is a very strong level of claims reserves, a very strong level of other reserves, tax reserves, and a huge amount of unrealized gains, which is now in the order of €36 billion in total. Let's keep it with that because we will come up with our prognosis for 2017 only with the Analyst Conference in March. Second question is about the ERGO transitional rules, why now? The reason is that - I frankly admit after the Brexit, I lost hope that interest rates will come up very soon, and therefore, we say why shouldn't we immunize ERGO's regulatory capitalization against the impact of the capital market for the time being. It doesn't change anything in the economics, but it makes some things easier. Therefore, we applied for transitionals and got the approval from the German regulator for that. So, nothing spectacular behind it.

ERGO International, our colleagues are working pretty hard on the new strategy. In my view, no sensations to come up, but we will report in the course of the next couple of months on the development, I would say, at the latest also, in the Analyst Conference perhaps a little bit more, but this change will not be as drastic as for the domestic business. So, therefore, and your question, how difficult will it become to achieve the targets of the new strategy program in the difficult environment? We always said that this is an ambitious program, and that the circumstances are not easy ones especially with regard to interest rates. We are still confident that this is also realistic to achieve it and our first impression, ERGO is on the move and the projects are going into the right direction. And I can't add more at the moment.

Q - Thomas Seidl {BIO 17755912 <GO>}

All right. Very clear. Thank you very much.

A - Jörg Schneider

Thank you, Thomas.

Operator

Our next question comes from William Hawkins of KBW. Please go ahead.

Q - William Hawkins {BIO 1822411 <GO>}

Hey, Jörg. Thank you very much. I'm picking up slightly on Thomas' two questions ready. In ERGO, can you explain very briefly the implications of the DAC charge that you've taken in the third quarter? Let's sort of focus on German Life. Have you adjusted DAC so your investment return assumptions are in line with yields at the end of September or whatever? Or is it somewhere just kind of higher than that? And this does DAC change effectively restore historical margins so the profit guidance you gave for ERGO six months ago stays intact? Or are you still left yourself with an under-run of the margins into the future? Very briefly, if you could just say, I know you've taken the DAC charge this quarter but what does it mean for perspective earnings in ERGO Life?

And then secondly, slightly more shorter term than Thomas as being on the combined ratio. The implication of your repeating the 95% guidance for this full year, if you're going to do 99% in the fourth quarter, which would be implying no unusual reserve development, which will be quite unusual in itself against what you've seen in the past few years. Normally there've been big releases in the 4Q. So, is your 95% deliberately a conservative figure because we should be knowing there's going to be good news out of the reserves? Or is that something that means that you are right to being conservative for the fourth quarter in your expectation? Thank you.

A - Jörg Schneider

Thank you, William. First, on DAC and loss adequacy test. We set up DAC where it's still available and we write it down where it's still available, where there are portfolio parts, where we do not have DAC at the moment. We have to increase the technical reserve but both together stands for the same phenomenon that its low interest rate and their impact on future profit schemes.

The rules are as such, we have to apply not the current reinvestment rate, which would be close to an economic calculation. But the investment – the running investment yield in our local GAAP returns, which means that the decline of the interest rate hasn't been fully digested yet. That means for the next couple of years, if all things in the environment remained unchanged, we would have further DAC write-downs and increases in technical reserve. That is different to the economic calculation for Solvency II purposes and in our internal model. So, this means additional expenses on that side in the years to come and they could be even higher than for 2016.

Second, your question on combined ratio, you are right that our assumption for 2016 for the fourth quarter in reinsurance property-casualty maybe somewhat pessimistic. On one hand, major losses, we do not yet exactly know what the impact of Matthew is. But as we see things now, it could be higher than the proportional share of our major loss budget in the first month of the quarter. And therefore, we were a little bit careful with regard to major losses because even Matthew can be relatively high.

Second, Reserve releases. We do not want to be forced to release as much as we did last year. Therefore, we wanted to stay with our prognosis a little bit on the careful side. From what I see at the moment in our internal analysis, the comparison between actually reported losses and expected losses, our confidence in the quality of our reserves is totally unchanged. That means, in the course of 2016, we didn't lift (10:20) from the past, we just released what came up in the normal calculation. Is that okay, William?

Q - William Hawkins {BIO 1822411 <GO>}

That's very helpful, Jörg. Thank you.

A - Jörg Schneider

Thank you.

Operator

Our next question comes from Kamran Hossain from RBC. Please go ahead.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi. Afternoon, everyone. I have two questions. First of all, coming back to, I guess the fourth quarter, just listening to your last comment, Jörg, is it (10:52) Matthew then on that basis is about 4% of net earned premium in the fourth quarter? So, just kind of some more detail around that. I appreciate you just said it's kind of one – a third of the quarter, so I was assuming – I just want to check that was right. And secondly, on inflation, you talked about the use of the strong balance sheet (11:13) to help out on the earnings side. Can you just talk a little bit about how well you are protected against inflation? And whether actually, on a normalized basis, whether a 4% reserve release expectation would still stand if the inflationary environment kind of picked up a notch (11:34)? Any color on that would be really helpful. Thank you.

A - Jörg Schneider

Okay. Kamran, first, the impact of Matthew is not that high. But when I compare one-third of our major loss budget with the figure – the first indication, internal indication, please, apologize that we do not disclose them yet because we burned our finger with Katrina a couple of years ago, 11 years ago already. It was more than a third of the quarterly budget but it was not that high, yeah. But let's wait a little bit and – but it has a substantial impact.

Q - Kamran Hossain {BIO 17666412 <GO>}

Okay.

Second, strong balance sheet inflation. First, our protection against inflation on the asset side was reduced. The reason was that we had overestimated our exposure against inflation in our internal AL (12:48) matching exercise, and because of the annual analysis, we took also on the asset side the protection against inflation a little bit down especially on the derivative side which, by the way, hurt us in the past couple of times when inflation was very low and when we had substantial exposure to derivatives here.

Talking as you did, the reserve side, claims reserves, we cannot simply extract how much inflation has been built in. But like for Swiss Re, also for Munich Re, the very low inflation has an impact on our view of the confidence in the reserve, the actual versus expected calculations which I mentioned before, that means when inflation goes up especially medical inflation then, our reserve buffer will reduce but what kind of numbers are we talking here? Yeah. So, we do not expect an enormous spike. The world economy is way too weak to trigger such a spike in inflation, and therefore, I personally assume that our reserve situation will remain as comfortable as at the moment. When inflation goes up dramatically, then we will still be well protected, I would say, but we would lose our buffer. I'm sorry for being so generous.

No. That's really helpful. Thank you so much.

A - Jörg Schneider

Thank you, Kamran.

Operator

We'll now take a question from Sami Taipalus calling from Berenberg. Please go ahead.

Q - Sami Taipalus {BIO 17452234 <GO>}

Hi. Good afternoon, everyone. First of all, I wanted to just ask if you could give a little bit more detail on the P&C Reinsurance top-line development in the quarter? Maybe break down the development a bit by large deal flow business and the non-traditional business? And you mentioned that you'd seen some attractive opportunities there, if you could expand a little bit on that, that would be great? Then, the second question I wanted to ask was on the Life Re result, which was pretty good, the technical result that is, and again, in the quarter. I just wanted to know if there was anything, any sort of positive volatile items in there, maybe the large loss budget was sort of materially below what you normally expect or similar. Thank you.

A - Jörg Schneider

I'll start with the second one, Sami, it's because it's easier. One impact there is from the deconsolidation of our Italian Primary Life subsidiary. That means that a contract, which had been consolidated for, that means ignored for the calculation of reinsurance life, now shows up including DAC and that means that it had a double-digit million positive impact. This is clearly a one-off due to accounting rules. Second is, there was actualization of data for North American books. There were some ups and downs in the technical reserves. Hence for Q3, on a standalone basis, we did not have any major losses. You correctly assumed that. I remember in Q1, we had two of them. Therefore, this Life Re result is on the positive end of a reasonable expectation and we are confident that we can achieve our annual target of €400 million or even perhaps go a little bit above that.

First (16:43), the distinction between special deals on property-casualty reinsurance and the normal what was called in a call of our competitor the flow business or so is difficult, yeah, because that's a grey line. There were a couple of major proportional treaties which served the purpose of capital optimization for the clients and we are confident that we will see more of that kind of tailor-made business. Typically, our colleagues work pretty hard on these kind of deals for months and either they come or they come not, yeah. Therefore, it is difficult to predict. I personally believe that they will have a growing impact and will be more or less reliable source for good earnings over the future.

Q - Sami Taipalus {BIO 17452234 <GO>}

Okay. Thank you very much.

A - Jörg Schneider

Thank you, Sami.

Operator

We'll take a question now from Frank Kopfinger from Deutsche Bank. Please go ahead.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Good afternoon, everybody. I have also two questions. My first question is also on your potential outlook for 2017. When we look at the reserve releases, should we still expect that you are going to come back to your previous 4% level? And also within the outlook 2017, when you presented the ERGO restructuring program, you pointed to a net profit for ERGO of €130 million within your program. Is this also given the (18:31) that we saw today? Is this still the right level that we should look at? And my second question is on your equity hedges. I was quite puzzled with the development, because when I look at the development in Q2, I would have said the overall equity markets was down by 5% and you had a positive impact of €19 million. However, in this quarter, I would have said the – it was just the opposite, markets were up by 5%, however, you had a significant higher negative effect of more than €400 million and can you shed some light on this development here?

A - Jörg Schneider

Thank you, Frank. First, the potential outlook for 2017 and reserve releases there. To the best of our knowledge, the conservatism in our ongoing reserve setting is in the order of 4%. It turns out to be somewhat higher here and there, but I wouldn't rely on it. So, I don't have better information for 2017. For the ERGO number for 2017, capital market development may impact the outlook but the DAC depreciation and loss adequacy test impact was included in the number, which we showed you in June also. So, nothing new here. And your third question is a difficult one and in my view, an absolutely reasonable one. It's a non-linear correlation here. It has to do with timing. It has to do also with other derivatives, it's not only put options which we buy here and therefore, one can see this kind of development.

Perhaps to describe it a little bit more precise in the – or just before the Brexit vote (20:34) of the British population, we were very skeptical and we decreased our exposure to equities substantially but by selling the securities itself so that the shares itself. And then we came back to the market as of July in a rather highly protected form, firstly, and therefore we now have substantial depreciations on the derivative. Overall, it's an economic AM matching (21:11). But for the equities, they typically don't match any liabilities. As you know, these are also kind of open bets always, yeah. But it's very difficult to draw conclusions how the underlying and the derivatives behave and the development of the underlying was clearly positive. But I assume, I admit that you can see this discrepancies here between the negatives in third quarter and the positives in the second. Thank you, Frank.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Thank you.

Operator

Our next question comes from Vinit Malhotra calling from Mediobanca. Please go ahead.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Thank you. So, the first question from me would be, Jörg – in the press release there is a lot of focus on, obviously, the innovations and the cyber risk product. And I can't help but notice that in the recent few weeks, there's been one of the largest ever sort of cyber denied of service or some kind of attack on the U.S. east coast. Could you just remind us how you manage the risk in an area where the other reinsurers are not that active? It looks like that you're leading this area. And could you just remind us how you're managing the risk in this kind of product? And second question is just more linked to the investment side. The reinvestment yield you mentioned of 1.8% it seems – I mean, it's quite a jump between the 1.5% that was mentioned in the second quarter call. Is it being attributed simply to duration, which probably went up by I think 5.7 to 6.1 (23:12), so, it feels like quite a bit of a jump, if you could please help understand the bridge? Thank you.

A - Jörg Schneider

Thank you, Vinit. First, innovation and here especially, cyber. Very complex area, and we have various initiatives, which are interlinked and which work together and exchange their experiences, but which are absolutely not similar. First is what we do with – from Hartford

Steam Boiler in the U.S. that is mostly small business coverage and here a mixture between financial protection and services. In the U.S. rules, I'm not an expert in that, but I'll try to do my best here, the companies are obliged in case of a data breach to inform their customers immediately and that is not only an expensive exercise but it also has to be done, yeah, and therefore we provide our insured with a very strong service here, yeah, that is – that we take care of part of this exercise and not only compensate for the financial loss.

Then, we have, for example, most recently we reported in the public that we provide major coverages up to €100 million together with the primary insurance partners to the higher end of the client spectrum. So, that means big capacities for major losses. But here, also, you must notice that it is limited, yeah. That means limitation of our exposure is always a must because we are still in a pioneering phase here. And then, we have initiatives at ERGO at the moment where we also develop cyber products and all is based on the same and coordinated knowledge space, but with very different offers according to the needs of the customers and always with limitations, which are very important for the enormous accumulation risk involved here (25:48).

So, I propose that we continue reporting to the market on this area, which is for us the area of growth in future or one of the areas of growth. Second, our reinvestment yield, indeed it rises with a longer duration and also we had here investments in emerging market, government bonds. And also, the respective share of the investments in U.S. dollars, British pound, Australian dollars, Canadian dollar, was relatively high in the third quarter in comparison to the second. That means, this does not stand for an increased level of risk but also has to do a lot with the currency composition of the investments.

Q - Vinit Malhotra {BIO 16184491 <GO>}

All right. Thank you very much.

A - Jörg Schneider

Thank you, Vinit.

Operator

We'll now take a question from In-Yong Hwang of Goldman Sachs. Please go ahead. Your line is open.

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

Hello. Good afternoon. Thank you for taking my question. I've got two. First on the German GAAP earnings, I think in your speech this morning, you said it came in strongly. Does it mean that we should be thinking about a net income on the German GAAP account that's higher than the €2.6 billion that we saw last year? And the second question is on the transitional measures, presumably, this now kind of confirms the fact that you don't need any capital injections from the group into ERGO for the structuring. But, I mean, how long with the low interest rate, kind of environment currently have to persist? Or how far would that have to drop for you to kind of start worrying about a potential capital injection that was at just not really in the realms of possibility at the moment? Thank you.

A - Jörg Schneider

Thank you, In-Yong. German GAAP earnings of the group, of the parent company, yes, they could be higher than for 2015, but dependent on the capital market developments and on the large losses in the last quarter, large losses don't play such a role because they would be absorbed by the equalization reserve. But we are exposed to potential depreciations in case of a very steep rise in interest rates or decline of equity markets, yeah. I would regard the probably of both as being somewhat limited, but there are still some volatility, but we are working here on a very high level. That means our distribution is really secured here including the ongoing share buyback.

Second on the transitional measures, on one hand, I can confirm that the capital injection into the two Life companies is not probable for regulatory reasons. But at the same time, these companies have to set up their local GAAP balance sheets and the pressure from the low interest rate is ongoing. And dependent on how low interest rates become, there could be, over time, during the next couple of years also a situation where they have problems to shut down the balance sheet, yeah.

So therefore, here, I cannot fully exclude that the capital injection would be possible. The reason is the German Zinszusatzreserve ZZR, additional interest reserve where we have to fill the gap between a reference rate, which is the 10-year average of AAA government bonds and the technical interest rate. And this has already a volume of €1 billion for 2016 and it's going up until 2018 from year-to-year according to their current metrics, and that means this is a huge requirement for the German GAAP calculation. And from that end, we are not 100% sure. But the probability of the capital injection in 2017 is pretty low, close to zero.

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

(30:36).

A - Jörg Schneider

Thank you, In-Yong.

Operator

Our next question today comes from Xin Mei Wang calling from Morgan Stanley. Please go ahead.

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

Hi. I have two questions, please. The first is just a follow-up on the ZZR. I was wondering if you could comment on your discussions, if any, with regulator with regards to the reference rate or the rules there. I think we saw some relaxation of the rules late last year with respect to the results that could be used to fund the ZZR requirements. I was wondering if there were any more ongoing discussions around that, particularly as interest rates have remained low and how that's developing for the German Life side of things?

My second question is on focusing on severity trends. Could you please comment on those trends and how you see them developing versus your initial expectations, particularly in your motor books given comments by some – one of your large peers and some of the U.S. primary insurers cannibalization (31:44) seems to be picking up. And I was wondering how you'd factor this into your initial loss picks (31:50) and how that was developing? Thank you.

A - Jörg Schneider

Xin Mei, hello. The second question is about U.S. moto?

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

Yes.

A - Jörg Schneider

Yeah. Good. (32:01-32:25) Sorry. I was just – my colleague told me that I forgot to switch on the mic, sorry. So, ZZR, there are discussions ongoing on the adequacy of the rules and I frankly admit that they are a little bit overdone with regards to the requirements. On the other hand, Munich Re does not participate too actively in this discussion because the ZZR is a good tool to ensure market discipline with regards to profit sharing with the clients, yeah. It's better to build up ZZR than to compete with policyholder crediting rates. The rules have just been changed. You can now include less expectations, which stands – I read it, I'm not sure. I never calculated myself for something like 10% to 15% decline in requirements, which is mild, which is perhaps below what should be economically accepted here. There's also an ongoing discussion on the reference rate.

There could be some changes, but according to my understanding, the German regulator is currently reluctant to intervene as long as the companies can afford to build up the equalization reserve – the ZZR, sorry. This will change when interest rates go up dramatically, yeah. Because then the companies wouldn't have any unrealized gains, which they can realize to fund ZZR and then we need a change, yeah. But then, also the reason for the ZZR would go away to some extent, yeah. Therefore, let's wait before that situation comes and up to now, we can well finance our ZZR requirements and are happy that we are not the only ones in the market who have to finance them. Second, trends in U.S. motor. We can confirm that we also see some developments here, but, fortunately, our exposure to that line of business is pretty low with some €600 million, if I'm well-informed here, of overall premium income, and, therefore for us, it is a minor issue.

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

Okay. Brilliant. Thanks very much.

A - Jörg Schneider

Thank you, Xin Mei.

Operator

Our next question today will come from Michael Haid calling from Commerzbank. Please go ahead.

Q - Michael Haid {BIO 1971310 <GO>}

Thank you very much. Good afternoon. Two questions; on your DAC write-downs and your Life operations. Can you give us first the figures pre (35:32) policyholder participation? And then you mentioned that the DAC write-down and the additional reserving requirements in local GAAP are based on the running yields in local GAAP. Can you give us this figure? And is it the year end – so, the yearly figure for 2015 and could you tell us also if that is look through running yield or if it is just the published running yield in local GAAP?

A - Jörg Schneider

Now, it's a difficult one, Michael. Let me try. The number before policyholder participation and before taxes is €450 million for the third quarter of standalone. But this is also the bulk for the year because we do this calculation in the third quarter. And your question about the yield, as far as I know, it is the 2016 running yield in local GAAP balance sheet. And we would not quantify that but take as a rule of thumb that this number, the gross number could go up quite substantially, yeah. So, something like 50% in the next couple of years or even if it's higher, because the DAC amortization is a very long dated one with a very long duration and when interest rates stay where they are and when our investment income goes down like we must anticipate if we do not go for substantially higher risks, then the impact will be higher in the future.

Q - Michael Haid {BIO 1971310 <GO>}

But if the – is this requirement – the DAC write-down, is it based on the look through running yield or is it based on the published running yields, i.e., is it distorted by special funds distributions?

A - Jörg Schneider

I assume that it is the latter, that it is the official one. But I'm sorry Michael. I will ask my colleagues whether they can look it up. I don't know that out of the top of my head.

Q - Michael Haid {BIO 1971310 <GO>}

No problem. Thank you very much.

A - Jörg Schneider

That, I'll come back later. Yeah. Thank you.

Operator

Your next question today comes from Andrew Ritchie from Autonomous. Please go ahead. Your line is open.

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

So, hi, there. Just a little clarification again on ERGO. You're running at a €111 million net loss to the nine months. I think the original expectation was a smaller loss than that for the full year. But just to clarify that after €160 million of restructuring, is that €160 million comparable to the expected €302 million that you talk about in June as the total investment in the new program this year? In other words there's another €140 million to take. I'm a bit confused between restructuring, especially restructuring cost and what you're sort of putting within the combined ratio.

The indication being though that even you say you're on track with ERGO, the underlying profit does appear to be running at a weaker level. And I'm guessing it's just the Life issues but maybe clarify what's left and really is the underlying really in line? The second question, a very simple one. I'm assuming there is no impact for the group Solvency II internal model coverage from adopting transitionals at the subsidiaries, I think that's the case, but just clarify? Thanks.

A - Jörg Schneider

Yes, Andrew. That is true the latter. But let's start with the first one, €160 million is a net effect of the explicit restructuring cost but all-in other numbers are unchanged with regard to the ERGO strategy program. That means, apart from the restructuring cost, there are also other investments, investments which are not, how we call it, capitalized but – which are directly taken into the P&L. For example, for the German property-casualty combined ratio for the third quarter, they make up for a full combined expense ratio point, yeah. So therefore, there's still an impact. The underlying performance is not good. I can confirm that. But the major drivers of the bad Q3 result had been included in our prognosis for 2016 in total and for 2017 too. That means for the fourth quarter, we expect a gain for ERGO, profit for ERGO, to bring it back to the lower negative number which you mentioned before.

Second, Solvency II, economic solvency ratio, what we had disclosed at the beginning of the year, and also for the half year and also now does not include the impact from transitionals. This impact is substantial in the order of 50 points. But sorry, we don't take it serious, and therefore we will have to show the number including the impact from transitional measures, but also adjusted for transitional measures. And the latter will be our – the currency for our annual reporting for our economic – capitalization. That means take the 250 (41:15) where we are at the moment as the right number and ignore the second one.

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

So the €160 million you've taken, so how much is the total investment and the initiative and year-to-date? It's not a €160 million, it's a figure higher than that. Did you know – because the €302 million that you talked about in June included the non-explicit investments. Did you know where you are relative to that €302 million?

A - Jörg Schneider

Yeah. So, there is another €40 million to come in the fourth quarter, as a correction of the policyholder participation in the restructuring charges, a negative €302 million, that's our best guess at the moment. I think, we also announced that already, yeah, in Q2, and in the course of the disclosure of the ERGO program. In addition, there are investments in the order of €50 million, mostly the ballpark number, mostly IT investments. And it's also difficult to distinguish between what is devoted to the ERGO strategy program and what is normal expenses, yeah.

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

Okay.

A - Jörg Schneider

Right now, we are according – we are in-line with the batches here, yeah, so there are no...

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

It sounds like it's around €210 million or something that you've actually taken.

A - Jörg Schneider

Yeah. Yes, if I remember well, something like that.

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

Okay, still implies a very low underlying but fair enough. Okay. Okay, thank you.

A - Jörg Schneider

Yeah, that is true. Yeah, thank you Andrew.

Operator

We'll take our next question today from Thomas Fossard from HSBC. Please go ahead.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yeah. Good afternoon, Jörg. Two questions on my side. The first one would be to push you a bit more on the reserve release side. Two small question in that. First of all, what is the Munich Re management willingness to offset a creep up in the reported combined ratio approaching the 100%. And second point, is there any, I will say, now reserve buffer over best estimates, which would, I will say, trigger a kind of ceiling in what will be accepted by your auditors or, I will say, well, anyway, third party people looking at your account?

Second question would be on the Life Re technical profit. I think that this is probably the first year since quite a long time you're going to potentially match your €400 million technical result guidance. Does that create, I would say more stable base or create more optimism to revise (44:21) this guidance going forward? Thank you.

A - Jörg Schneider

Thank you, Thomas. Interesting one, whether we shy away from crossing the 100% line, yeah. In theory, we would do anything with the reserve to avoid showing 100%, but perhaps in practice, yeah. So, I can't give you a reliable answer but more seriously with regards to our rules here for the reserve adequacy. We reserve for best estimate, which is not a single number but a reasonable range of numbers. There's a broad range within which we can move, which the auditor would accept, and we are somewhat at the upper end of this range of possible best estimates. So, there is not an official buffer in it, but in practice, it's the same somewhat.

On Life Re technical profits, yes, we could hit the €400 million. But my new boss, Joachim Wenning has threatened me not to create any optimism beyond that number for 2016 or for the future. The reason is the following: IFRS is not an economic reflection. That means, the economic view of the contract is different. It's based on embedded value techniques. That means that there are buckets where we would like to have the client recapture the risks and where we are in negotiations here.

And we do that on the basis of our economic view of the business where we have an interest and where the client and us see a win-win situation which could, in one or the other cases, have a negative impact on our IFRS numbers, which are based on totally different rules and where it plays a role whether it belongs – this specific contract belongs to the one or the other portfolios. Therefore, we are very grateful for this good run in the third quarter, but we do not want to create too much fantasy to the upside. I assume personally that we could (47:04) above €400 million, but you can't rely on it. Is it okay, Thomas?

Q - Thomas Fossard {BIO 1941215 <GO>}

Thanks. Just on the reserves. So – I mean, you are approaching the very high level of confidence level of your best estimate. Does that mean that in fact, you're reaching a level, which will prevent you to add or to be in a situation to add significantly more than you have, and potentially give a bit more flex to your 4 points or 5 points of combined ratio going forward?

A - Jörg Schneider

We have some flexibility, but we did not increase our confidence in 2016, yeah.

Q - Thomas Fossard {BIO 1941215 <GO>}

Okay. Okay.

A - Jörg Schneider

So we left it on the same level, but we were not taking something out of the drawer (47:56).

Q - Thomas Fossard {BIO 1941215 <GO>}

Okay. Thank you.

A - Jörg Schneider

Thank you.

Operator

Our next question comes from Guilhem Horvath, calling from Exane. Please go ahead. Your line is open.

Q - Guilhem Horvath {BIO 18460437 <GO>}

Yes. Thank you. So two questions on my side. The first one is on investments outlook, and the 20 points to 30 points of erosion you mentioned earlier. Would you be, in a way, okay to increase the investment risk to offset part of this? This is my first question. And second one is on gain contingency reported by Travelers a couple of days ago, an asbestos case with American Re. Can you give us a little bit of background on this case, and maybe your thoughts on this? Thanks.

A - Jörg Schneider

Yeah. I just had to get the order from Christian on the question on Travelers. So, there were some reports, yes, but we are not allowed to talk about these topics of our clients here. First one, on the investment risk, investment prognosis, investment return. So, do we want to increase risk? Generally not. But it could be that we would like to take technical chances here and there. But overall especially in reinsurance, it's a sideward movement of our risk appetite. In primary insurance, here and there we slightly increase the investment risk, but only for smaller companies, not for the portfolio in total. So, no news from that side. Munich Re is not prepared to increase its risk profile at times where we regard that risks are not adequately compensated for.

And I can add to what Michael Haid asked before. The calculation of the DAC write-down and of the new calculation of the technical reserve is oriented on the regular yields on book values under local GAAP. Only the conventional investment portfolio assumption is a side movement of capital markets. That means, at the moment, it's without special funds, it's just bread and butter fixed interest portfolio, yeah. So, it's higher than our own reinvestment yield. And second, on the settlement with Travelers, we are fully reserved for this, yeah. But apart from that, I cannot add something. There will be no IFRS earnings impact on 2016.

Q - Guilhem Horvath {BIO 18460437 <GO>}

That's perfect.

A - Jörg Schneider

Is that okay? Good. Thank you, Guilhem.

Operator

Our next question today comes from Michael Huttner of JPMorgan. Please go ahead.

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

Fantastic. Thank you. I came late to the call, so if they have been asked, I'm really sorry. I have three questions. On German Life, what's the total level of buffers you currently have, the RfB and the ZZR? How many years of interest can you - your guaranteed rates are about 2.7 (51:35) or something, could you pay? On Solvency II and you probably answered that, what could be the figure today? And in the ERGO-combined ratio, what is the - how much in that number and also in your forecast for the year is kind of one-off investments and costs and stuff like that? What's the underlying figure at the moment? And then the last point, which really interest me - well, anyway, Motor Insurance in Germany, what's happening now? Is it still profitable? Because one of your competitors (52:09) it's not really bad. Sorry about many questions.

A - Jörg Schneider

Michael, thank you. Your second question, was it about Solvency II? I...

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

Yes, please. Solvency II today, if you have it, but only if (52:23).

A - Jörg Schneider

Economic Solvency ratio today, what do you mean?

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

Yes, please.

A - Jörg Schneider

I don't have a daily number on that, but it should be similar to what we had a couple of weeks ago. Something like 250 (52:37) or so, excluding transitionals. Then, German Life, the buffers, for a couple of years, we are well off, yeah. And it doesn't cause sleepless nights to me. So, we are well-reserved, especially with regards to the enormous amount of unrealized gains we still have on the books, yeah.

So, we had a long duration in our - not in comparison to the liabilities, but in comparison to some other very long asset portfolio. So therefore, I'm confident that we can sustain the situation for a while. Then, the combined ratio, ERGO one-offs, something like 1 percentage point in the third quarter. So adjusted for it, we would rather be in the area of 95 (53:36) where we always wanted it to be. Last question, German motor. Very competitive still. No clear tendencies at the moment, yeah. So, we see it as stagnating where it is. Hence, we hope for the better for us. The relative importance of German motor in our portfolio is below the average of the market. Is it okay, Michael?

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

Yeah. It's just that I think (54:14) were talking about claims inflation, I think between 4% and 6% seemed high. Have you seen anything like that?

A - Jörg Schneider

I can't say more about it at the moment. I don't have a number for claims inflation. Like everywhere, with the personal injury claims, the inflation is higher than the consumer price inflation here. That is what is worrying the insurers all over the world in a way. But it hasn't deteriorated recently.

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

Okay. (54:50). Okay. Thank you so much.

A - Jörg Schneider

Thanks.

Operator

We'll now take our final question for today from Olivia Brindle from Bank of America. Please go ahead.

Q - Olivia Brindle {BIO 17273762 <GO>}

Hi there. I have two questions on the P&C combined ratio. The first one is just around seasonality actually. So, unlike some of your peers, you don't officially seasonalize your large loss budget. But I'm not sure how you really think about that when you adjust the combined ratio, because in the first quarter you told us, nominally if you do an adjustment, it's a 100%. But actually, if you were to seasonalize the budget, we're really in line with our guidance of 99%. Now, that makes sense to me. But if you apply the same logic to the third quarter, then you'd be sort of visibly above 100% taking into account the fact that third quarter budget should really be above average for the year.

So, I'm just wondering if you could clarify exactly how we think about that seasonality? So should we be adjusting for that when we look at your adjusted combined or should we not? That's the first point. And then, the second one, Jörg, you mentioned that maybe 1 percentage point of deterioration in the loss ratio next year is a bit harsh. Could you give us a sense of the split you're thinking of between business mix (56:09) of pricing from this year?

A - Jörg Schneider

Olivia, thank you for the questions. First, seasonality, yes, there is seasonality also in our budget. It's the same as that of our friendly (56:28) competitor. But I listened to their conference call, and I heard how difficult it is to be explained and track that, and therefore, I frankly admit that, that we decided for the sake of simplicity to leave it with a 12% all over the year.

Second reason is that there is an enormous random fluctuation around that number, yeah? So, the hurricane season overall was mild except for Matthew. Then, we have the earthquakes, which do not know anything about seasons. And therefore, we left it in the simple form. But I admit what you say. It's true that if we adjust for a typical Q3 budget, then the adjustment would be higher than that what we – that we disclosed. So, when you look at the annual adjustment, then you are somewhat below or very – little bit below 100%, and that is close to the truth.

With regards to the spillover effect, one-third of the business spills over into next year. And when we talk about an average decline of rates of 1% in 2016, then it would be two-thirds – then it would be – one-third of that would show in the next year. Nobody knows how the incoming – January 1 renewal will work, but there are clearly stabilizing factors at the moment to be observed. So, I'm personally mildly optimistic that we could see re-stabilization here, because companies have to make money. And in the low yield environment, there is a very clear pressure from investors into the right direction.

So, we have our ways to avoid the, let's say, blunt impact from competition that is a tailor-made business, that is the innovation initiatives all growing slowly but, in my view, very promising development. And at the same time, we believe that our bread and butter markets of the past will stabilize. Therefore, it's not an endless downturn, which we see here. Thank you, Olivia, and thank you to all of you. And I hand back to Christian.

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

Nothing to add from my side. Thanks for joining us and please feel free to call us with further questions. Thanks again, and see you soon. Bye-bye.

Operator

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