Muenchener Rueckversicherungs Gesellschaft in Muenchen AG Strategic update on ERGO Corporate Call

Company Participants

- Christian Becker-Hussong, Head of Investor & Rating Agency Relations
- Christoph Jurecka, CFO, ERGO
- Jorg Schneider, CFO
- Markus Riess, CEO, ERGO, Chairman ERGO Versicherungsgruppe AG

Other Participants

- Anasuya Iyer, Analyst
- Andrew Ritchie, Analyst
- Frank Kopfinger, Analyst
- In-Yong Hwang, Analyst
- Jochen Schmitt, Analyst
- Kamran Hossain, Analyst
- Michael Huttner, Analyst
- Michael Hyde, Analyst
- Olivia Brindle, Analyst
- Sami Taipalus, Analyst
- Thomas Fossard, Analyst
- Thomas Seidl, Analyst
- Vikram Gandhi, Analyst
- Vinit Malhotra, Analyst
- William Hawkins, Analyst
- Xinmei Wang, Analyst

Presentation

Operator

Good day. Welcome to the Munich Re conference call update on ERGO strategy. Today's conference is being recorded.

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

Christian Becker-Hussong {BIO 19080254 <GO>}

Yes. Thank you. Good afternoon, to everyone. And a warm welcome to our call on ERGO's strategy program. Today's speakers are Markus Riess, CEO of ERGO; Christoph Jurecka, our CFO of ERGO; and Jorg Schneider, CFO of Munich Re. Markus will kick it off. And introduce to you the details of the program. Christoph will explain the most important financials, before Jorg will conclude with a few remarks from the Munich Re perspective.

After approximately, let's say around 40 minutes, we will start with the Q&A. And intend to close this call by approximately 5:00 PM at the latest. So Markus, please go ahead.

Markus Riess {BIO 1835270 <GO>}

Thank you very much. Good day. I will limit myself to 20 minutes. Because I understand that the financial impact of this program is of the utmost importance. And that's why I'd like to leave the floor to Herr Jurecka and Herr Schneider by this point in time.

Let me basically tell you where I believe ERGO is starting from. I think you are all very much aware of the industry changes that we have. And I don't want to allude to them. But based on these industry changes, I believe that ERGO has a good starting position. We have quite a significant position in Germany. We have market-leading position in health and in legal protection. We are well-positioned in P&C. We have challenges in life, because of the closure of the classical book. And I will refer to that in a minute.

In addition to the German footprint, which we are very well known for, we also have a significant international presence in over 30 countries, with top 10 positions in a couple of significant countries. And obviously being part of Munich Re gives us access to know-how, capital. And an innovative-oriented group.

Now one of the questions I often get is, what are my key findings. And you will find them on page number 4. I believe it's fair to say that ERGO has a track record of a disappointing development of top and bottom line, in this way lagging behind expectations. Their cost structures are clearly above the market. On the infrastructure and digitalization side, we have to see the effect in the eye that we need more reliable IT platforms to run the business efficiently. And also to accomplish the digital transformation, which will become increasingly more important in the way that the market is digitizing itself. And that's why currently I have to come to the assessment that the opportunities of digitalizations are not yet fully realized.

On the product side, it's very important to master this challenge, to have modular product concepts, which we currently have not yet fully integrated into our offering. And also on the life side, we need a convincing new strategy for new pension products with a basically stronger focus on financial products. And thus the realization of synergies with MEAG, our asset management company.

Lastly, I believe that given the fact that we have now embarked on a route to close the classical business more or less entirely, the organizational separation of the traditional life back book and new business is in order. Thus on page 5, the key aspects of our strategic measures are that we would like to achieve a situation in which we strengthen the role of being a leading primary insurer with a strong domestic market, by really creating a comprehensive offering of products, advice services across all distribution channels. And I cannot emphasize this enough that we really want the cost channel approach here. And we also are determined to transform our business model digitally.

We want to create promoters out of our customers, people who refer to us actively. We want to become a modern and attractive partner for our employees and sales partners. And we commit to maintain a sustainable contribution to Munich Re results of EUR500 million and more, starting 2021 at the latest.

We will need will EUR1 billion of investments. And the figures here are net figures that I refer to. We will invest this EUR1 billion until 2021. This will translate into EUR280 million of net cost savings. And given the fact that a lot of our competitors always use gross figures in this regard, we also translated them for you in EUR540 million gross figure. And again, this translates into the EUR500 million net profit as of 2021 onwards.

On page seven you see sort of the general architecture of the program. And it falls into three categories. We want to be fit. We want to be digital. And we want to be successful. And the general idea is on the fit category that we want to create a lean structure. And an effective (governance). On digital, we want to create the basis for the change of the business model transformation into a digital age. On the successful side, we want to have convincing solutions for all of our customer segments.

The EUR1 billion that we invest, a little shy of 40% go into the fit category, a little more than 40% go into the digital category. And 20% go into the successful category, which shows you that this program is quite balanced with regards to all of the pillars that it addresses.

I will now in the remaining 10 minutes very briefly touch on the most important of these 13 separately run initiatives, which however will all be tying into the picture that will ultimately create the new ERGO. One of the major changes that we undertake and with that I am on the following page, number 8. We will basically have to improve the effectiveness of our sales organization.

And with our previous strategies, we have almost semi-integrated the five sales distribution agency channels into one. But it's really only semi-integrated. So we put them into one legal entity framework. But process-wise, they still operate quite independently. With this move, we will now really conclude the creation of one ERGO. And transform those five agency channels into one ERGO agency channel.

In the same context, we will retain the regional presence and the customer proximity. But because of overlapping structures that gives us efficiency gains of 54 regional directions, which basically means we (restore) from 18 locations. And I could say in bracket, only. Because the rest is just a redundancy figure. And realistically this gives us a much more efficient structure than we currently have. In addition to that, in order to be more successful on the sales side, we would like to take the broker distribution out of the agency distribution management. And position that with what we call the product provider that is the risk takers of P&C and life.

On the administration side, on page number 9, we basically just have the goal of even further lean and efficient processes and structures. And given my assessment that I believe our costs are too high and I think that can be easily demonstrated when we do competitor comparisons, we believe we just have to become more efficient. I spare you the process on how we dealt with this. But after the end of the program, we are very well-positioned amongst our peer group of our competitors. And we will then basically have cost structures which we believe are medium-term sustainable in order to future grow.

Page number 10 refers to your third work stream, which is the international organization, in which we have basically only now decided two things. The first thing is that we changed the governance model. And basically moved the regional management out of Dusseldorf into the regions, which I believe is a more modern approach. And obviously we are then closer to our businesses. And we use this to establish an even more thorough governance of our Group CFO, who will comment on that when he has basically the floor in a couple of minutes.

In addition to this governance change, we come up with a cost savings program in the order of magnitude of EUR30 million, which basically gives us the confidence that we also become more financially efficient in the international organization.

Work stream number four is with German life and the separation of the traditional life business from the new life business. As you are very well aware, ERGO already announced the exit from traditional life business with regards to its new sales. Following this decision, organizational changes, namely the separation of the traditional back book and new business, will now be implemented.

We have the concentration of our future product strategy, which is a capital market related and biometric product range through our risk carrier, ERGO VORSORGE, which for those of you who know us on a detailed level, will have to be renamed into ERGO VORSORGE. Because currently it's just called VORSORGE.

We will then secondly establish an effective and separate organization and entities with optimized processes for the traditional life business, which basically means the legal entities ERGO Leben and Victoria Leben. And ERGO Pensionskasse will be closed for new business. New business will now be only generated from portfolio due to legal or contractual obligation. A new setup will basically retain or give us significant management advantages, including a higher financial transparency.

Page number 12 gives you a little more detail on this, where you basically see what I've just alluded to in graphics. I think this is something which I can jump over now.

Work stream number five and work stream number six deal with IT. And they both basically say in a nutshell that we are going to fundamentally renovate all of our IT. It's going to be a very big task, which we very diligently are going to manage. And it will basically start to come to bear fruit when we try to come up with more standardized software in our classical basis IT, with new testing methods, just basically to become more state-of-the-art in our basic foundational IT.

Based on these developments, which will take place in the next 18 to 24 months at least lying the groundwork for this, we will also in parallel grow a more digital and more agile IT structure. So for example on the digital IT, we will come up and build in cooperation with leading digital companies who will then come up with digital labs that we will jointly either own or operate, in order to retain a flexible IT digital infrastructure. And that should help us to have a much faster reaction time. And these will be the two key infrastructure ingredients in order to become very prepared for the business digital transformation.

And let me just basically point out that once this program is over, it is our ambition to have real state-of-the-art IT throughout the entire value chain. And it's very obvious to me that once this is completed, we will be able to achieve more growth opportunities. And to basically take new client groups in an order of magnitude that is not yet fully reflected in the plans that we currently have. But it's too early to say on a serious level what kind of direction this will take. Because we first have to do our homework before we contemplate that more seriously. And I would like to point out that we can transform the fact that we are now at a point in the investment cycle in which we now have to fundamentally invest into IT. We can transform that into an opportunity, which will be the basis for many more growth initiatives going forward.

We will work, on page number 15 and work stream number seven, in terms of automating and stabilizing our processes. That's something I'd like to flip over. Because it's really some sort of homework. So with that, I would like to move to the third pillar, which is being successful. And this itself falls into three categories.

Work stream eight is basically digitization of the product portfolio. We already have a very good basis for this product portfolio. Because we are quite successful in various areas of our business. We can, however, even accelerate this level of success if we truly digitized that. That means that we will develop products exclusively for the internet age. And for the digitized age, which will then-- and that is quite an often misunderstanding-- not only be available digitally. But these products are also able to be sold offline via sales agents, because the client behavior is changing. And they don't want these complicated products anymore. And we can also use this as an opportunity which will cross-fertilize into the classical offline sales, which is another growth opportunity.

Also-- and I would like to restress that, because it's such an important synergy-- we would like to embrace the opportunities that we have with MEAG. Because the asset management competence of our asset manager is not yet fully reflected in our product range, first and foremost on the old-age provisioning product offering. That's why I believe that it will be another very important way forwards.

Modularization and providing a (pricely) attractive basis product, which will then be augmented by various modules; that is another strategy which you are very well aware of from the market. And obviously we will adopt that as well.

We will then, once we have-- and we start now-- once we have a more modern, more digitalized product range, we will then go into client segments. The first client segment I believe it's the most important one, is the hybrid customer. Just for reference purposes, the hybrid customer and the way we look at it is the customer who seamlessly wants to be integrated between sales agents, internet approaches, call centers, et cetera.

That obviously requires significant investments, not only in the IT, which I've already alluded to in work stream number five and six, which again cross-fertilizes this opportunity. Because it gives an opportunity for us that once we are investing into these kind of new ITs, we can already have the product offering for the hybrid customer in mind. So these customers really do not fall into the category either sales agent or internet. They really do both.

And that is a very much growing segment. And we are very well-positioned. Because in order to succeed in that market, you need one, regional salesforces. Because these people do really want sometime a human interaction. And here we have a very large sales organization in the future even more efficiently run. And secondly, they need a convincing direct presence. And with ERGO Direkt, we have as you know, one of the most successful direct players in our group.

So a combination of the growing segment, the regional sales, ERGO Direkt in our group, plus the IT investments, I think, gives us sort of a pole position to take advantage of this market trend. And that's why I believe this will be a very important growth opportunity. And I would also like to say that this is something which also carries further beyond 2021. And will give us further growth opportunities over and above the current planning going forward.

In addition to those hybrid customers, there is a group of pure online customers. And the way I like to define that is that pure online customers differentiate themselves from hybrid customers that they are pure online only. This is a smaller segment. But it's something that we don't cover as ERGO. And in some areas, it has a significant market share, not that much. But still significant. So 5% to 10% of the new motor market, in my judgment, is easily be found in this category. And I would like to take advantage of that as well. That's why as of 2017, we plan to establish a pure direct player, no telephony, no sales agents, just internet approaches, very lean, very price competitive, very efficient processes; however, very customer-oriented for this target group.

We will do sort of a network approach. And try to collaborate with other providers that can be startups, that can be IT platforms, that can be other providers. We will try to partner with them, come up with an efficient platform. And use a new brand and put that in the marketplace first with a motor product in (2017). And we then plan to expand that both in terms of product range and diversify internationally as soon as 2018, if everything works out as we plan currently.

I will then very briefly only touch on work stream number 11, the industrial and commercial business. That's basically business as usual, just taking advantage of the competencies that we have on a more international area.

On number 12, ERGO Mobility Solutions, is something which we will use to increase our initiatives in the B2B2C segment. You are all very well aware that B2B2C is a growing segment. And we have been lucky enough to hire somebody who has a very good set of experience in the B2B2C automotive segment, is Karsten Crede. He will lead that. And I think, given his personal background plus the market (opportunity) plus the experiences that we already have in ERGO in this context, will give us a very strong position.

Like with the hybrid customer and the pure online customer, I believe there is growth opportunities in this area, which gives even more (fantasy) compared to what we have already put in the plan. But it's too early to tell. Because Herr Crede will only join us on the 1st of January. But again, in these plans we lay the foundation for further growth in this regard.

Last but not least before I hand over to Herr Jurecka, the international expansion will be revisiting in H2 2016. As you see, we have-- as you have seen, as we have just announced that we now a stake in the Thai operation. I would still like to say for the moment we focus on the operations that we have. And try to improve their profitability and the way going forward. We will obviously commit anyway to selectively grow our portfolio, especially in Eastern Europe and Southeast Asia, if and when opportunities arise. But our main focus for the moment is to invest and improve the current operations, which we already have, as I said, the significant franchise in.

And however, we have currently focused primarily on the domestic part of the business. And the international part of the business will then be revisited between now and November. So you can expect a new strategy statement in this regard by the end of 2016.

That was my brief 20-minute run through the strategic context. And I will now transfer to Christoph Jurecka, who will tell you something more about the financials. Thank you.

Christoph Jurecka {BIO 17223019 <GO>}

I'll take it from here. And give you a quick overview of the financial impact of our program. I'll start on page 24. And the headline of page 24 could be that our ambition is to grow above market starting from 2019.

When we start on the left-hand side of the page, this sounds rather surprising. Because in life, actually there is no growth at all. But this clearly has to do with our decision to go out of the traditional life business. And therefore clearly we can't expect any over-market growth at all in that segment.

But what we can expect is of course that in the sub-segment of capital-market-related product and biometric products that there we also aim at growth above market average. But this won't be enough in order to compensate for the reduction of our business in the traditional back book. And therefore there's overall a reduction of premium to be expected in the segment life.

In health, we have the expectation that we will have a growth of 2%. This is very much driven by the omni-channel approach Mr. Riess was just referring to. And this is something where, depending a little bit also on the price adjustments we are going to see in the market, this will be in line with market, maybe slightly above, or maybe slightly below market. But that's something where we will for sure be on the market level.

The focus of our growth also will be in the P&C and the direct segments. And those are the segments directly connected to what we call our strategy tackling the hybrid customer from a more digital and consistent approach.

And there you can see that in direct, we have plus 4% growth, especially from the hybrid customer segment. Then in P&C Germany over the full period from 2016 until 2020, 2%. But this growth is going to be increased until the end of the planning period. And therefore from 2019 onwards, we expect a growth above market. So you see that also in those figures there's a clear footprint of the growth initiatives Mr. Riess was just referring to.

On page 25 you'll see the investments we are going to invest until 2020, the overall amount of roughly EUR1 billion was already mentioned. Here you see the split over the years. And to start with in 2016, we are talking about roughly EUR300 million of investments. I would like to highlight that around EUR200 million of that are restructuring expenses, net, all net figures, which we are going to book in Q2. So those are included in those EUR300 million here.

Then you see a reduced amount of investments going down from year to year until 2020. And in 2020 still has a substantial amount being there. And you also can see that the major amounts in later years are in the digital segment, which shows that the IT investment is something which takes more time and Mr. Riess was referring to it that it's the basis IT and the digital IT. And both are included in those figures here. And digital in a certain sense builds on base. Though it's clear that it takes a little bit more time. Overall EUR1 billion net effect of investments. So I think a sizeable investment to strengthen our competitiveness in the market.

Page 26 you'll see the total cost savings. You'll see on across space in 2020 and onwards, we have roughly EUR540 million. So EUR536 million of cost savings. The net effect would be EUR279 million. And this has went up over the years from 2016 until 2020. So year by year, the cost savings increase.

On the right-hand side, in the upper corner, you see that the cost savings are primarily driven by the pillar fit, EUR340 million. And digital also contributes by EUR96 million. And successful of course doesn't, because it's mostly about growth initiatives. So I wouldn't expect something here. Then we have EUR100 million of an overall channel productivity enhancement also included in our figures, coming up with EUR536 million across overall. To achieve that we'll reduce our FTE number. So full-time equivalents, by roughly 1,900 by 2020. And the net effect, I mentioned that already of the cost savings, is EUR279 million.

On page 27, you'll see the overall net income impact of the strategy program. And you'll see that in 2020, the positive impact is EUR203 million. And what you also can see here is the major contribution is from fit. So basically the cost savings is basically mostly driven (by driving) the positive result impact. But also the growth initiatives. So the successful portion is already contributing substantially in 2020. And as Mr. Riess was pointing out, we expect the growth to further accelerate after 2020.

In the former years, you see that the profit impact is burdened by the investment, of course. And they are also very much driven by fit. But not only. And you see the split here over the year. Over all years, the sum is minus EUR49 million. So that's a positive impact in this five-years' period of the program is not fully. But nearly compensating, the impact on the results.

With that, I'd like to go to page 28. And this is a very central page from my perspective, because it sums up the impact of our program from various perspectives. First of all, I'd like to mention that the assumption behind the planning we are showing here are the usual assumptions we take for planning. This is primarily that we take interest rates as they are of today. So no interest rate increases or any other positive capital market impact here. But really a stable market as a planning assumption behind all figures.

You'll see that after 2021, we expect-- or after 2020. So in 2021 we expect at least EUR500 million, based on that EUR450 million in 2020. So why do we expect that? Well in 2020 the figure still includes some investments. Then as mentioned before, growth initiatives should further accelerate until 2021. So be that it we clearly can expect a figure above EUR500 million in 2021.

You also see that in 2016 that's something we communicated already some weeks ago, we expect a slightly negative result, which is of course driven by the investments in 2016. And basically very much driven by the restructuring provisions we are going to book.

On the right-hand side, you see the split of the figures onto the different segments. Let me start with P&C Germany. P&C Germany continues to be the main earnings contributor for our group. So EUR250 million in 2020 is a very strong signal of an increased profitability by 2020. And we then have international at EUR110 million contributing. And with that, we are back to levels where we already were in the past. Then life and health Germany, here health and direct included here, are stable or let's say a positive earnings contributor, whereas life is putting this figure under pressure. And life in itself is a negative contribution, double-digit negative contribution on the result here. So this is clearly a burden for the overall earnings level of ERGO.

Having said that, I'd like come to the P&C Germany combined ratio. You see the development in the lower picture on the slide. We start with rather high values also compared to where we were in the past. But this is clearly driven by the investments. Because major parts of the investments are also to be booked in the technical results. So they will affect our combined ratio.

Then from 2018 onwards, the cost reductions and also then the reduced level of investments clearly will drive down-- the combined ratio down to 92% in 2020. And I'd like to emphasize that this improvement of the combined ratio is only driven by the cost improvements. So there's no impact of the technical-- on the technical side. So we continue to have a stable and very profitable book, like what we had in the past.

On the German GAAP level, the cost ratio will be 29.8%. So below 30%. And this brings us in the range where our competitors also are. So that's something-- a target level which is acceptable from that perspective in the market as well.

I'd like to conclude my section of the presentation with a remark that with that earnings level in 2020, we are going to earn our cost of capital. And from 2020 onwards, there's a fair chance that we exceed our cost of capital in earnings. And maybe coming back on my remark on life, if we take out the traditional life book from our earnings perspective even much earlier, our earnings would be clearly earning the cost of capital. But even above that. So all the segments except life are exceeding the earnings thresholds we are usually having within Munich Re group.

With that, I'm finished with my part of the presentation. I'd like to hand over to Jorg.

Jorg Schneider

Thank you, Christoph. What Christoph described is for us the clear answer to the question why Munich Re fully supports ERGO's strategy program. Because it pays off. We do significant investments in ERGO's infrastructure, product, employees. But we get decent return over time be it based on IFRS earnings or from an economic point of view.

And I can also anticipate the last statement on the slide 29, ERGO is for Munich Re more than just an earnings contributor. It provides the group with multiple options with synergy potential between ERGO and reinsurance, which has not been fully leveraged yet. And currently there are many business initiatives, common initiatives underway, especially in the most innovative areas like cyber insurance, data analytics, digital customer front end solutions, digital health, development of financial products; all that areas where a pure reinsurer in the traditional sense would not be able to compete with Munich Re in its combination with ERGO.

What I also want to emphasize is that the new management team of ERGO brings new ideas, best-in-class expertise. And a good blend with the experienced core team at ERGO. Whenever I had the chance to participate in the project work in the last couple of weeks on the strategy program, I was excited and encouraged to see the strong momentum and passion of the new teams of old and new colleagues here. On this great spirit we can build. And we are very confident about a good future of ERGO.

As Christoph said, the profitability will cover the cost of capital from 2020. And there are also upside chances which haven't been reflected yet in the, in my view, rather realistic business plans. From today's perspective, ERGO is able to finance the program by itself. And there is no need for downstreaming of capital as part of this strategy program. But this is based on the current shape of the capital markets. And there is a potential downside, especially from a further decline of interest rates, for example.

During the duration of the strategy program, it would be unrealistic to expect a dividend payment from ERGO to Munich Re. Short and medium term, this is a drain for Munich Re's local GAAP earnings. But according to our current estimate, we have sufficient distributable funds to continue with our strong capital repatriation policy, including share buybacks and the very high dividend, which we have paid during the last couple of years.

So on balance, ERGO's strategy program is a big plus for ERGO itself. And for the group as a whole. And with that, I hand back to Christian for the Q&A.

Christian Becker-Hussong {BIO 19080254 <GO>}

Thank you. Nothing to add from my side. Happy to take the first question. Now, just my usual housekeeping remark before we get started. Please limit the number of your questions to a maximum of two per person in order to give everybody a fair chance to raise questions. Thank you. And please go ahead.

Questions And Answers

Operator

(Operator Instructions) Sami Taipalus, Berenberg

Q - Sami Taipalus {BIO 17452234 <GO>}

Hi. Good afternoon, everyone. Thanks for taking my question. The first one-- I've got two of them, actually. The first one is on economic capital. I was a bit surprised to not see anything in the presentation or in the sort of broader discussion about what the impact of this program will be on the economic capital requirement and the sensitivity of the economic capital ratio of ERGO.

I mean I guess I'm thinking about this from the perspective that roughly one third of the group's economic capital requirement relates to ERGO. And that of, I guess, most of the interest rate sensitivity also relates to that. So some more sort of exploration on that would be very helpful.

Then my second question is on the efficiency improvements in the distribution. You mentioned about improving the organizational structures there. Is there also something that you can do on the commission side here? I mean it just seems to me that an awful lot of things have changed in the market. But that the commission structures haven't changed very much yet. Thank you.

A - Christoph Jurecka {BIO 17223019 <GO>}

It's Christoph. Yes. I'll take the first. Economic capital is-- yes, you're right. That's something we did not really cover in the presentation. Economic capital calculations are based on projections of future earnings. So Solvency II, for example, is based on that. Then as you see that long term, we benefit from cost savings. So long term, there will be a clear improvement of our economic position also by that program. We therefore expect also a positive impact on the economic capital. And this is true for all our companies. But also for the very often discussed life companies.

Q - Sami Taipalus {BIO 17452234 <GO>}

But just if I look at your plans there, you're doing a quite a lot to change your new business mix. And you're also talking about some work on the inforce business. And if I just looked at another company based in Munich, they've kind of linked those things to quite significant improvements in reductions in the interest sensitivity of their capital ratio. And also reductions in the required capital. Is that something that we can expect from you guys as well? Or am I missing some other impact here?

A - Christoph Jurecka {BIO 17223019 <GO>}

No-- I wouldn't-- I mean there will be-- as I said, there will be a positive impact from the program rather long-term improvement of economic earnings. And thereby improving the capital position of our companies. But the nature of the program we are proposing here is more a strategic one really to bring ERGO back into shape. And to improve the situation that we are really going forward are a very strong player back in the German and international market. It's more operational (inaudible).

Q - Sami Taipalus {BIO 17452234 <GO>}

Okay.

A - Markus Riess {BIO 1835270 <GO>}

Should I take the commission question? Yes. Markus Riess here. What you observe, Sami, is absolutely right. The environment for high commission has changed. We see both regulatory pressure as well as pressure from the customer protection groups on that scenario. And that's why I believe medium term provisions in commissions will have to be lower than today.

Now we are in a situation in which legally we have legal contracts with our existing agents. We are not in a position. And we don't have any legal basis for unilaterally adjusting these contracts to, let's say, the new economic reality. So we have to basically argue with the existing agents. And that's not an ERGO-specific issue. That's an industry-wide issue.

And we have, for example, just renegotiated with the agents a new package on the life insurance commissions, based on the LVRG, which is the Lebensversicherungsreformgesetz in Germany. And which we basically transform upfront commissions into a longer-term retrocession kind of commission, which then obviously retains different responsibilities for the agents to retain the business for a longer side, which in turn translates into a lower commission ratio de facto.

However. And that is a very important however, for new agents we are at liberty to change something. And one of the nice effects that we are going to have one homogeneous ERGO agency distribution going forward. That gives us the opportunity to contract new agents on one homogeneous new level. And that new level for the first cohort of sales agents that will come to us as of 2017 will clearly see a lower commission structure.

However. And I have to repeat that for legal reasons, we have to take the time to let this new commission structure grow into our base of agents. But medium term, there will be a lower average commission than there is now. But it will just take time. However, all of the necessary preparations will be in place by the beginning of 2017.

Q - Sami Taipalus {BIO 17452234 <GO>}

Okay. Thank you.

Operator

Vinit Malhotra, Mediobanca

Q - Vinit Malhotra {BIO 16184491 <GO>}

Oh, hi. Thank you very much. Just if I can ask on slide 27 please, if I just back out these restructuring or net profit impact of strategy, the underlying net income seems to not be moving much. For 2017, for example, your EUR130 million, you add back EUR110 million to EUR240 million. At EUR203 million, you add back-- it's whatever you subtract, it's (EUR250 million) or something like that. So the underlying trend in earnings is not really changing. So if you could just remind us what is driving the sort of stable outcome, excluding the strategy program, what are you doing as well?

Next question is just a clarification on slide 28. The combined ratio comment that the improvement on this chart is coming more from the claims-- sorry-- improvement is coming more from the expense ratio. Now that seems to be quite a lot. Because on the one hand you mentioned a 3-point sort of improvement between 2015 and 2020. But the improvement in the reported combined ratio is much larger. So if you could just comment on both these.

If you would you like me to repeat question one on slide 27, I'm happy to repeat. Because I think the line was breaking a bit.

A - Christoph Jurecka {BIO 17223019 <GO>}

Okay. I'll start with the first one. Yes. You're right. If you deduct the impact of the investments, the impact of the strategy, you come up with a rather stable earnings development. That's correct. First of all, I'll have to remind you that the interest rate assumption we are taking here is a stable one. So stable also means that for new investments we invest at this very low rate every year. So the average return on our book already reduces year by year. And therefore, let's say the natural development you would have been expecting without any measures would even be a negative one, not even a stable one.

Then I have also to say that in this base case here, which you are here having as a comparison to the case including the strategy, there are also investments required which we need for regulatory purposes or regulatory reasons. And then also for life cycle reasons. That's also something which is included here. And those two reasons are enough in order to even if you have some improvements which are also included in the basis, you still do not really move ahead and stay at this stable level for (EUR250 million).

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes, sorry. Can I just follow up? So the whole purpose of so much digital investing should have been to increase that, isn't it? Because it's a long term. And there's so much investing going on.

A - Christoph Jurecka {BIO 17223019 <GO>}

Yes. But I mean I think we mentioned it. First of all, the digital investment is part of the strategy. So it contributes to the EUR203 million. But having said that, I mean what you were saying is right. I mean the digital development is something which has also a more long-term character than, let's say, the more short-term initiatives like cost reductions. And therefore we expect an additional benefit from the digitalization far beyond the year 2020. And this is clearly not presented yet in our figures. Because we just had to stop the planning period at some point in time.

Then the other question was on the improvement in expenses in our combined ratios. And yes, I mean you're right. The driver for the improvement of the combined ratio is really more or less only the expense ratio. It's roughly 4% improvement compared to where we stand today. So if you compare it with combined ratios we are currently achieving or we are currently at. And then deduct 4%, I think you end up with the level which is fairly in line with what we are showing here. And on page 28.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay. Can I just follow up? The 2015 combined ratio is 98%. It goes to 92% in 2020.

A - Christoph Jurecka {BIO 17223019 <GO>}

Yes. But in 2015, we had a year which was also very much burdened by one-offs. So the, let's say the more average level, average claims and not cut, it would be more around 96% today. And therefore the 92% is something where we could at with the cost measures.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay. Thank you.

Operator

Michael Huttner, JPMorgan

Q - Michael Huttner {BIO 1556863 <GO>}

Fantastic, thank you. Just on the-- you spoke about capital-- both CFOs spoke about capital. But you didn't give us any figure. And there was a question. And you didn't answer it. And I just wondered why. Could you give us the figure please? What is the capital allocated to ERGO at the moment. So we can judge the numbers you said about clearing costs of capital and everything. Even if we have to-- you have to provide a trajectory for the capital. That would be really, really helpful. To me, I agree with my predecessors that's missing from the presentation.

The other point. And it's related exactly to the same issue. Because to me, Munich has a huge pile of cash. And I do wonder about all this investment. But what is the risk, Mr. Schneider, of a capital addition? You mentioned low interest rates. I mean what are the assumptions you're making at the moment that there is no risk for capital addition? And at what level would you say, no, actually now we do-- we are in the territory where we have to consider it? Thank you.

A - Jorg Schneider

Herr Michael, thank you. With regard to capital, you could use the IFRS capital, which is in the order of EUR5.4 billion of ERGO. Or you could use the economic risk capital, the Solvency capital requirement. And here it's a bit difficult to allocate the diversification effect. But it's somewhere a little bit below EUR5 billion. So it's a big number. And it's driven by the market risk. And the life risks from the German life business, as you know.

So this is something where you can-- you can't do a lot about it. And therefore, I can only fully underline Christoph's answer before when he was asked, what do you do about economic capital. This program is not about dealing with the low interest rate and its consequences. Here we just capsulate the back book, which is an important step. And a very beneficial step. But everything else one can do here has not been implemented in this program, which is rather about operational efficiency and about growth potential

And what you could also hear is that we do no longer sell the traditional classic life products. This is also an enormously beneficial contribution going forward.

Risk, risk for capital or for the self-financing of ERGO here, as things stand today and taking into account current investment markets, including the current very low interest rates, we can finance-- or ERGO can finance a program by itself. But it's at the edge here, as you can imagine. Because there are capital requirements in the life companies. We have been dealing with that, with a bunch of measures. But we are not on the safe side with regard to future interest rates. They can go further down, even more. And that is the biggest question mark on it all at the moment. So we must be realistic about it.

Q - Michael Huttner {BIO 1556863 <GO>}

Could you-- is there any way of giving a figure around this?

A - Jorg Schneider

It doesn't make a lot of sense. Because there are so many parts of the equation which are uncertain. So for example, at the moment we very moderately invest in credit risk. And we have some assumptions with regards to default, for example. So as long as capital markets remain as benign as they are at the moment with regard to the credit risk, it's fine. When we see drastic adverse movement here, then this would hit us to some extent. Therefore it's difficult to quantify here.

But as things stand at the moment, we are confident that we do not need any capital injection.

Q - Michael Huttner {BIO 1556863 <GO>}

(inaudible). Thank you very much.

A - Jorg Schneider

Thank you.

Operator

William Hawkins, KBW

Q - William Hawkins {BIO 1822411 <GO>}

Hello. Thank you very much. First of all, I think this risks echoing Vinit's question. But with regards to your 2020 earnings guidance, I'm trying to make sure I understand the numbers correctly on slides 25 to 27. Because if I take the middle of your original guidance for this year, which is EUR300 million. And then subtract the EUR99 million of investments still going on in 2020. And add the EUR279 million and EUR203 million of cost savings and strategy benefit, I get closer to a figure of EUR680 million, which is more than EUR200 million higher than your actual guidance. So I just wanted to be clear. Am I misusing one of those numbers in a certain way? And if not, is the drag the issue of low yields and that kind of thing that you were talking about to Vinit, or is it something else?

Then secondly, Jorg, what's the near-term risk to Munich Re's earnings, not the dividend, when we think about 2017 and 2018? On a normal basis, this year you were going to be at EUR2.3 billion to EUR2.8 billion. Other things equal, the ERGO guidance is now something like EUR100 million to EUR200 million lower than we were kind of thinking about previously. So that's about 10% of what your 2016 guidance would have been. Are you kind of thinking that nevertheless this all gets lost in the rounding? So the overall Munich Re group can continue to maintain the 2016 level in the near term? Or is this actually incrementally hurting 2017 and 2018 earnings for Munich? Thank you.

A - Jorg Schneider

Let's start with the second question. William, yes. It may sound arrogant. But it is true what you said. So it's in the rounding. It doesn't make our task easier to fulfill our EUR2.3 billion target. But we are confident that we can make it, especially based on the strong balance sheet.

Q - William Hawkins {BIO 1822411 <GO>}

And to the extent my question was about 2017, you're also-- this is not going to disrupt 2017 or 2018 (visibility)?

A - Jorg Schneider

Yes. And even in 2017, we would be negatively affected. Because we are still working with a very low number coming from ERGO. Nevertheless, we are confident that we can deal with it. And that you wouldn't see a lot of an impact in the IFRS result. On a like-for-like basis, each euro which is missing from ERGO is negative, which is (inaudible)? Christoph?

A - Christoph Jurecka {BIO 17223019 <GO>}

Yes. I'll take your first question. I'm not sure if I fully understood what kind of calculation you just did. But let me maybe explain page 27 what really is shown there. What you see there is the overall net profit impact of our program. And this includes investments. This includes cost savings. But not only. It additionally includes also net profit impact from growth strategies from other cost factors and various other topics, which are not disclosed in the presentation here. So you won't be able to calculate the net profit impact of the overall program, given by other information you find in the presentation here. That's not possible.

To explain the figures, you see in 2020 the EUR203 million. And we discussed it before. If I take those out of the EUR450 million we're showing on page 28, then the baseline would be around EUR250 million. So somewhat below the midpoint of the range you were just referring to. And this is correct. Because until 2020, as I just said before, interest rates stay low in the projection here. And also we have to assume some investments in regulatory projects and also in life cycle topics, which we just have to do. And they are also part of let's say the base case underlying the page 27.

Q - William Hawkins {BIO 1822411 <GO>}

Thank you. So I think I was misunderstanding. So just to be clear, the EUR279 million cost savings for 2020 is part of the EUR203 million benefit from synergies.

A - Christoph Jurecka {BIO 17223019 <GO>}

That's right.

Q - William Hawkins {BIO 1822411 <GO>}

And the reason it's high, is because you've got to deduct the restructuring costs into other stuff, yes?

A - Christoph Jurecka {BIO 17223019 <GO>}

That's right.

Q - William Hawkins {BIO 1822411 <GO>}

Thank you for that. Thanks.

Operator

Kamran Hossain, RBC

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi. Good afternoon, everyone. Can I just firstly come out with a very high-level question? Why was now the right time to-- I guess-- to get (investable) in ERGO? Was this simply just kind of recognition of, I guess, the organization that Mr. Riess previously came from was running very, very differently to the way that ERGO is now. So I guess that's question one.

And the second question, just on the German life separation of the two books. Is this preparation for a sale or anything else? Or am I just reading too much into that? Thank you.

A - Jorg Schneider

Jorg here. Let me take both questions. Right time to invest in ERGO, I would say absolutely yes. We decided to really make a new huge step in the right direction by hiring top-class people. And by managing it with a totally new approach, an approach which is oriented to best-in-class practices. And that needs investments. And I'm sure that these investments will pay off. That is the very simple answer.

Second, German life, to capsulate it is important for running the business efficiently, for using opportunities we have to make it, let's say, less of a burden to some extent. We have further options. But they are not on the agenda at the moment.

Does it answer your question, Kamran?

Q - Kamran Hossain {BIO 17666412 <GO>}

That's perfect. Thanks very much (inaudible).

A - Jorg Schneider

Thank you.

Operator

Olivia Brindle, Bank of America

Q - Olivia Brindle {BIO 17273762 <GO>}

Oh, hi there. Two questions. First one just in terms of your thinking on the timeline. One of your slides says EUR500 million from 2021 at the latest. What is your confidence level of maybe being able to achieve that a bit faster? I'm just thinking that it's quite a long, drawn-out process to get to that level. So how are you thinking about the confidence on that?

Then secondly on the international side of things, obviously the market conditions there remain pretty difficult, pretty challenging. How does that factor into the targets that you've given today? And how conditional are your numbers on things at least not getting worse in those underlying markets? Thank you.

A - Jorg Schneider

Olivia, Jorg again. This is in my view a very realistic plan. That means it is neither based on an unrealistic ambition, on a lot of optimism, nor on worst-case scenarios. We-- as Markus described before, we are aware of the challenges we are faced to. Also not only in our own book. But also from market forces. He mentioned regulatory pressure. He mentioned consumer protection pressure. We tackle them. And we are confident that we can give good answers to it. Therefore, I would regard the plan as being absolutely achievable. But it's ambitious. It's not unrealistic. But it's ambitious.

Okay, Olivia?

Q - Olivia Brindle {BIO 17273762 <GO>}

Yes. Thank you. I'm sorry on the international?

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

Olivia, would you please repeat your question on the international business?

Q - Olivia Brindle {BIO 17273762 <GO>}

Yes, sorry. So my question was just around the fact that market conditions are still pretty difficult in some of those markets. So wondering how you thought about that within your plan. And how conditional some of these numbers are on those underlying market conditions at least not getting worse.

A - Christoph Jurecka {BIO 17223019 <GO>}

I mean of course we have planning assumptions behind the whole plan. And I think I mentioned before already that we have some kind of a naive prognosis. So (inaudible), it's a best estimate. Take market conditions as they are. We do not factor in any situations. But neither improvements also in the respective markets. So from that perspective, it's just what Jorg was referring to. It's realistic in a sense, with ups and downsides. But we wouldn't bet on any improvement in any of our international markets.

And maybe on top of that, anyhow, Mr. Riess was pointing out already that the growth strategy will be reviewed in the second half of the year. So there's also the chance to look into the things again for us.

Q - Olivia Brindle {BIO 17273762 <GO>}

Okay. Thank you.

Operator

Thomas Seidl, Bernstein

Q - Thomas Seidl {BIO 17755912 <GO>}

Yes. Thank you. Good afternoon. First question on life. Clearly you are not alone with the issue of running off German life businesses. So my question is, is in that chance an idea that you combine forces and run it off together more efficiently, like we have seen in other countries. Is that the best way forward, rather than each company dealing on its own? I wonder what your thoughts are on this.

And secondly, again on life, can you give us the breakdown or the impact on the cost side for the life business. And a comment maybe how beneficial that is for the life capital situation?

A - Jorg Schneider

I'll take the first one, Thomas. We are open to any idea at the moment. But that sounds interesting. But I haven't seen any concrete plans on that. So I can't say more at the moment. Christoph?

A - Christoph Jurecka {BIO 17223019 <GO>}

The question was the split on life. And then how beneficial it could be for life companies from a capital perspective. Yes. You're right. I mean cost improvements and in general the improved result situation of our life carriers clearly helps also from a capital perspective. In Solvency II we look at projections of the earnings into the future so that's exactly the right way to look on it. We think it will help us. But it's not the main driver for the topic. So it will help. Actually I can't give you the split of the cost savings on life. But it will be a substantial amount which will hit life. So it will help. But it won't be-- it's not the main driver.

Q - Thomas Seidl {BIO 17755912 <GO>}

It's not the main driver. But what would be the main driver then?

A - Christoph Jurecka {BIO 17223019 <GO>}

The main driver for life separation was what Jorg was just referring to it. It was that it's much better from a management attention perspective. Prioritization is much easier. We can concentrate of running off the book, versus new business in a separate entity. So management can concentrate on the respective topic. That's the main reason why we're doing it.

Q - Thomas Seidl {BIO 17755912 <GO>}

Sorry. I'm not talking about the capsulation. I was talking about the cost cuts you're planning; are any of those cost cuts accruing to the life back book? Or is it basically P&C and the life new business benefitting from that?

A - Christoph Jurecka {BIO 17223019 <GO>}

No. They accrue also to the life back book. That's what I meant before. So the capital will benefit from it. But as I said, this benefit is the main driver. We do it for operational reasons. But of course, it's a benefit also for the life companies, both on capital as well as on earnings.

Q - Thomas Seidl {BIO 17755912 <GO>}

Okay. Thanks.

Operator

Xinmei Wang, Morgan Stanley

Q - Xinmei Wang {BIO 17860767 <GO>}

Hi. Good afternoon. My first question is on the net profit in 2020 by segments on slide 28. Could you talk about the shape of that from 2015 to 2020? I know-- so in 2020 the majority is coming from P&C Germany. Is that (going to be the case) throughout the years? That's my first question.

My second is just a follow-up a previous question. I'm not sure if you answered the one about potential sale or considering a potential sale of your life back book. Is that something you've discussed as part of the strategy program? Thank you.

A - Christoph Jurecka {BIO 17223019 <GO>}

For the first one, that's something which actually does not make too much sense to talk about. Because the main flavor it, for the split over the years will just be how quickly will we be investing. And the quicker we invest, the more burden we will have earlier years. And the less in later years.

So from that perspective, we decided just to say 2017 EUR130 million, we are back to positive levels. I think it's an important message. And then 2020-2021, at the target level. But in between, it's still very uncertain, given the fact that we will have to decide when to invest, how much. And therefore it just doesn't make too much sense to talk about it.

A - Jorg Schneider

Yes, Xinmei. And it's also difficult because the cost allocation is to some extent arbitrary. So there is some estimation (around) here. On your second question about a potential sale, it is not in the agenda.

Q - Xinmei Wang {BIO 17860767 <GO>}

Okay. Thank you.

Operator

Andrew Ritchie, Autonomous

A - Jorg Schneider

Andrew?

Q - Andrew Ritchie {BIO 18731996 <GO>}

Hello. Are you there?

A - Markus Riess {BIO 1835270 <GO>}

We hear you, Andrew. Andrew? We are courageous about your question--curious.

Operator

Andrew appears to have stepped away from the phone. We now have Thomas Fossard from HSBC.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes. Good afternoon. One remaining question on my side for Markus. And that would be related to the product side of the program today and on the life business. Regarding potentially the need to-- will they be able to manufacture, I would say, attractive asset management product, something like that. And I think that in your presentation you alluded to working more closely with MEAG. Do you believe that currently MEAG has, I would say, enough strength on third-party asset management if and if potentially you're contemplating an acquisition in that field in order to strengthen the value proposition of your life product and to support your ambitions? Thank you.

A - Markus Riess {BIO 1835270 <GO>}

Thank you very much for that question. I believe that for the purpose of this strategy, we do not need to consider an acquisition. Because realistically, MEAG is a very good asset management company. And one of the key success factors in coming up with this strategy that incorporates asset management products and know-how into old-age provisioning products.

It is really key that these products have a good quality, low cost. And a low complexity. We have to be very careful with over-complex products in this regard. And I believe that MEAG is actually in its current state perfectly prepared for being a very important product provider and success contributor in that issue.

So I believe cooperating with MEAG is very beneficial. As it is, a further acquisition would not add any value in this context.

Q - Thomas Fossard {BIO 1941215 <GO>}

Thanks for this very clear statement.

Operator

Michael Hyde, Commerzbank

Q - Michael Hyde {BIO 2054985 <GO>}

Thank you very much. Good afternoon, Michael at Commerzbank. Two questions, first on-- I'm sorry again-- term and life. The organization or separation of the new business and the back book seems to me that you create kind of a bad anchor, kind of a bad life insurer. What measures do you want to take to improve the profitability of the life back book? Is it only cost savings? And I assume you have a negative expense result in the local GAAP accounts. And so here you have significant leverage when you improve costs. Because you can give it fully to the shareholder.

Second question, the net profit impact of your strategic program. To what extent have you factored in the competition in your targets? Other insurers have similar initiatives regarding IT and digitalization. And I think it would be kind of naive to assume that in this process of industrialization, prices remain unaffected. So it would be more reasonable to assume that some efficiency gains are competed away. And what are your assumptions regarding this?

A - Christoph Jurecka {BIO 17223019 <GO>}

I'll take the first one on life. Basically there are a couple of positives we see. First of all, of course, what you were also mentioning, cost is very important. So the idea is to really concentrate the back book management. And by doing so to implement a more-- let's say a leaner administration and more efficient administration of the back book. That's the first thing.

The second thing is that we think that we could organization our IT more efficiently. Then we will also continue to invest in the IT there to have a platform which allows us to really efficiently serve the contracts we are still having in that back book. And they will be lasting for a very long time. This back book is clearly running off very slowly.

Then, of course, it's also management attention and the dedication of the people working in that particular area. Because we're currently in the situation where you still have to serve the requirements of new business as well as the back book. You're always somehow in between two things. And you neither concentrate only on the one or the other. And we think that it's also beneficial to have people really concentrating on the back book management. And specializing in that. And then building up expertise in that. I think that is really something which will benefit a lot also going forward.

Q - Michael Hyde {BIO 2054985 <GO>}

Maybe an additional question on the back book. You mentioned new IT for the back book. I mean you are basically winding down this back book. And you have the IT in place to do that. Is it not more efficient to just leave the IT for the back book as it is. And wind it down?

A - Christoph Jurecka {BIO 17223019 <GO>}

No. It's really a question on efficiency. But also I mean the systems, they have a life cycle anyhow. Then if you look at the back book, I mean, duration of a back book. We're talking about decades. And if you look, for example, decades back from today, you would never have the idea that it would have been a smart choice 40 years ago to just maintain on the systems you were having in those days. So the need to upgrade systems and to renew them over time will remain also for work for an organization which is focusing on back book management. Because we are just living in the world where life cycles tend to be quicker and quicker and shorter and shorter.

And so we see the need to invest. And we will invest. And of course the target will be a more efficient administration and a leaner management of the back book overall. But this will involve IT investments.

Q - Michael Hyde {BIO 2054985 <GO>}

Okay. Thank you.

A - Markus Riess {BIO 1835270 <GO>}

On your question with regards to the competitive landscape, I think your observation is fully right. A lot of other competitors are targeting the same groups as we are. And I would like to say the devil is in the detail. I mean just having the ambition of addressing those targets (inaudible) is not necessarily already a convincing success factor.

I believe that ERGO brings a couple of important elements to the strategy which makes its success in this regard more successful-- more likely. First of all, we have ERGO Direkt. ERGO Direkt is currently the direct insurer with the highest number of clients.

Secondly, we are in an investment cycle. And I alluded to that when I talked about the IT investments, in which we have the obligation to really thoroughly investigate and renovate as well our foundational IT, as well as the digital IT. That gives us an opportunity not to work with systems going forward that are 5 or 10 years old. But really very modern systems coming up. And they're already engineered towards digital clients. Now I am fully aware that this is strategy going forward. But I'm very confident also from my market expertise that this will create a competitive edge.

Thirdly, in the plan we accounted for that factor. Because on page 26 you have a category called productivity enhancement, which is exactly addressing the point that you are making. And fourthly, if it wasn't for that strong competitive environment we would have been more ambitious in our plans. So realistically we believe that this already takes the competitive landscape into account.

Q - Michael Hyde {BIO 2054985 <GO>}

Perfect. Thank you very much.

Operator

Andrew Ritchie, Autonomous

Q - Andrew Ritchie {BIO 18731996 <GO>}

Oh, hi there. Can you hear me this time?

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

Yes. We can here you.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Great. Thanks for that. Sorry about that. Two questions; one is you described the restructuring costs, or you described it as restructuring costs and investments or investments overall. I guess my concern is that particularly for digital, these aren't really one-off investments. And how much confidence have you that that digital investment really winds down? Isn't that just becoming part of ongoing running costs? Is there really enough visibility to say beyond 2020? I think you've still got EUR60 million or thereabouts that we should just assume that isn't recurring. That's my main-- my first question.

The second question for Christoph, I think you said that the discrete life business was double-digit loss-making in the projection, where you give the profit by segments for 2020. I guess I just want to understand what's driving that. Obviously it's a low-rate environment. But is this reflecting-- there's a complex interaction between local GAAP and IFRS on the ZZR edition. Is that impacting IFRS profit more by that point? Or what's the main driver of the double-digit negative? Thanks.

A - Christoph Jurecka {BIO 17223019 <GO>}

Okay, first of all, I'm happy to take both questions. Christoph here. The restructuring costs and investment, yes, you are right. I mean building up the digital IT will lead to the fact that of course we have to pay for the digital IT as long as you have it. Although there will-- some costs remain with us. But on the other hand, we'll renew our platform overall. And we expect cost savings beyond that also going forward. So there might be a compensating element on that.

The second question, double-digit loss, I would even say high double-digit loss. Then what you said was just right. I mean we are talking about mismatches here between local GAAP and IFRS. Then Solvency II is different again. So it's really a nightmare in explaining those figures. Let me try at least.

In local GAAP we think over the next four or five years, we'll get through without a major loss, maybe a minor one. But without a major one. In local GAAP, you know we have the

ZZR which is a burden on our liability side. On the asset side, we compensate that by realizing unrealized gains.

And we do so in two ways. One way is doing-- just selling bonds to the market, which is just what we would expect. But we have a different-- a second way how we can do it, which is more efficient. And this is we sell bonds from one company within our group to the other. And clearly has the advantage that we get the midpoints, we don't (bid-outs) for it. So it's much cheaper. We don't have to pay any fees. And so it's efficient to do it that way.

And so being the CFO, I love the way. But the huge disadvantage is in IFRS you don't see. Because you just consolidate them out. So there's no benefit from realizing those gains in IFRS. We have the benefit in local GAAP. So it fits toward the need for the liability. But you don't have the benefit in IFRS. And that's why IFRS looks worse than local GAAP regularly.

But the good news with that is that is-- I mean realizing gains always means that the future return of your bonds is lower. And this affect is also something which is not there in IFRS. So earning in IFRS should be more stable going forward compared to local GAAP. That's the flip side of the coin. So that's one reason.

And the second reason is that we have the ZZR in local GAAP. And we have a related animal in IFRS which is called liability adequacy test and (DAC depreciations). And those are, let's say, at heart they are similar. The idea behind them is similar. But the detailed calculation is differing a lot. So that from one year to the other you couldn't say if the ZZR is higher or the DAC on the liability adequacy test are higher. And this gives you an additional mismatch between local GAAP and IFRS.

And therefore we primarily (inaudible) local GAAP with the effect that we do the realizations of bond unrealized gains to the level we have-- that's another requirement. But in IFRS we have two reasons why this deviates and can deviate drastically. And one, just as I said, is the difference between ZZR and DAC and liability adequacy test. And the second one is that we usually do not have the realized gains in the IFRS result for a major part of the realizations, because we just sell them once from one company to the other.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Okay. That's complex. But clear. I think the bottom line is that there's a bit less scope to keep the IFRS profit as resilient as it has been, I think. Is that a fair very quick summary?

A - Christoph Jurecka {BIO 17223019 <GO>}

I mean in the end, the life insurance business, I could comment that in the end it's all about distributing earnings over time. And you as a management team have a lot of freedom how to do it. I could realize easily enough unrealized gains in order to compensate for it. It just wouldn't be reasonable from an economic perspective. Because it costs money. And going forward it reduces the earning base for the future. So it's all about timing in the end.

And as there is so much freedom in there, also for the planning assumption here, we've been just conservative for the planning assumption. (With the) local GAAP and ZZR, there will be no major loss in local GAAP. And IFRS is just resulting. And those two mismatches we're having lead to the effect that the IFRS result is (burdened). But that's nothing to be worried about. Because it is just accounting gimmicks, I would call it.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Great. Okay. That's very helpful. Thanks very much.

Operator

In-Yong Hwang, Goldman Sachs

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

Thank you very much for taking my question, just two from me as well. Firstly, I think Jorg, you mentioned on the Munich Re German GAAP result, it will be a drain as well. But would the investment cost of EUR1 billion, would that be a one-on-one effect? I feel like maybe it would be slightly less than that on the German GAAP accounts.

And my second question is on the-- again on slide 28, when you have the 2020 net income forecast by segment. I think Markus, you mentioned for the international business there's-- I think early in the presentation-- EUR30 million cost cutting assumption. Does the EUR110 million net income assumption for the international business, does that include that EUR30 million in there as well? Thank you.

A - Jorg Schneider

In-Yong, thank you. With regard to German GAAP situation, it's a loss of the ERGO dividend, which (inaudible). And how one could quantify that that is somewhat arbitrary at the moment what would we expect from ERGO. From ERGO in the final stage of the program, I would say something like EUR400 million or so per year. At the ERGO before the strategy program, with a lot of problems, perhaps EUR200 million. And therefore for us, we can't quantify it precisely. But it's a sacrifice by Munich Re. But a sacrifice which is a very good investment too.

A - Christoph Jurecka {BIO 17223019 <GO>}

And the answer to the second question is very easy. Yes. It's included. So the EUR110 million include the cost savings as well.

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

Great. Thanks very much.

Operator

Vikram Gandhi, Societe Generale

Q - Vikram Gandhi {BIO 18019785 <GO>}

Hello. Good afternoon. Can you hear me?

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

Yes. We hear you well.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Yes. Okay. I've got two questions. The first one is now that the traditional life book is closed to new business, can you please share how much of the existing technical results would have run off by 2020? Let's say taking the end of 2015 number as a starting point, which is about EUR1 billion.

And the second question is, does this program on ERGO restructuring change your thoughts about applying the transitional rules under Solvency II? Thank you.

A - Jorg Schneider

If I understood your question well, Vikram, only a small part of the business runs off by 2020. Because we haven't grown so much in traditional product during the last couple of years. So in other words, there was very little new business on that. Christoph, do you want to add something here?

A - Christoph Jurecka {BIO 17223019 <GO>}

Yes. Maybe it's important to mention that I mean closing it for new business and sales does not mean there's no new business at all. Because we have legal obligations in our book to take new business in our books for existing policies. And so there will be still some new business. Because we just can't avoid it. We are legally obliged to take it. And this, of course, lengthens the duration of the portfolio. And so as I said before, it will take decades until this portfolio will be decreased substantially-- it will have decreased substantially.

A - Jorg Schneider

On your second question, we haven't used a transition as yet. And it's open whether we could use them in future. It's an option. But it hasn't been decided to go that route. At the moment, we do not need them.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Okay. Thank you.

Operator

Anasuya Iyer, Jefferies

Q - Anasuya Iyer {BIO 18981555 <GO>}

Hi. Thanks for taking my question. My first question is on international, just a clarification really. With the second half of 2016 when you revisit it, can we expect any more cost there, or is any cost related to that revisit already in the plan?

And the second question, I guess, is broader and it might be at the risk of repeating some of the earlier questions. But in sort of 2015, early on the guidance for ERGO was about EUR500 million. Now we have EUR1 billion of investments, a full program (inaudible) strategy just to get back to that EUR500 million in five years. And I guess I'm just trying to understand in the plan now, what downside risk you're allowing for. And I guess another way to phrase it is do you think the risk is-- you will hit less than EUR500 million. Or is the risk that it will take up until 2023 or something? Thank you.

A - Jorg Schneider

I start with the second question. Yes. It's disappointing. I agree. But with Markus Riess entering the boat, he made a very clear analysis of where we stand. And especially also of market challenges. And circumstances have not improved since, because interest rates went down even further than they were before. And therefore it's now a mixture of realism on one hand. And of ambition on the other hand. And ambition comes along with the investment. So in my view, this prognosis now, this ambition of EUR500 million in 2020 is much better founded than the EUR500 million which ERGO should have achieved in 2015 before. And so I feel much more confident that we can reach it.

Is it still at risk? Yes. It is, like always. Like every entrepreneurial activity, it is at risk. But I think it's well founded. And there is upside and downside in a very balanced way at the moment.

A - Christoph Jurecka {BIO 17223019 <GO>}

On international, I mean as we mentioned before, we did not really look into it. So this is something we will do in the second half of the year, except one thing. And this is expenses. And so expense reduction is already part of that program. And of course, I mean some of our investments of course you're seeing in this overall program are related to costs. So at least for that part, it should already be in our figures. But for other topics, I can't really (inaudible). I just don't know. So it's a little bit too early. We'll look into it. But I wouldn't expect large figures here.

Q - Anasuya Iyer {BIO 18981555 <GO>}

Okay. Thank you very much.

Operator

Jochen Schmitt, Metzler

Q - Jochen Schmitt {BIO 4227302 <GO>}

Thank you very much. Good evening. Why are you creating an additional online carrier by 2017 rather than optimizing your existing carriers to boost online distribution? I'm aware that different levels of services might require different pricing. But to me, this seems to me not streamline the ERGO group structure, nor does it give a clearer picture about your key target products or key target clients in my opinion. That's my question. Thank you.

A - Markus Riess {BIO 1835270 <GO>}

Thank you very much for that question. It gives me the opportunity to basically pronounce a contradicting view to what you have just said. Because I believe it is of utmost importance that we differentiate the pure digital part of our offering from the integrated digital part of the offering. And maybe you allow me to talk a little bit about my previous experiences here. The way I have come to see the insurance marketplace is that the traditional marketplace, traditional customer behavior is very, very vastly evolving into this hybrid customer segment.

And that means people who are part of the agent salesforce only 10 years ago, they are now part of this integrated community who researches everything online, who buys online and offline at their leisure. And they don't do that consistently. They might buy a motor product online. Because it's so easy to compare it. And they might buy an old-age provision offline. Because they believe that there is no alternative to physical advice.

Now having said that, the proposition of this offering needs to be absolutely distinct from the proposition of a pure digital player. Because the pure digital player has totally different key buying factors that's basically convenience in the (inaudible). And there is ultimately a price proposition.

Now the price proposition, you can realistically not achieve by leveraging the existing business model. Because it comes with still the telephony. It comes with more or less mandatory services. And if you were to basically use a marginal cost model and put it on the same platform, you always run the risk that people buy your cheap digital products and still call your agent. And basically arbitrage their product offering against us. So to speak.

And I'm telling you this from experience. So the organizational separation is very important in order to coherently address the pure digital segment, as opposed to the integrated segment. And that does not only hold true for the product proposition. It holds true for brand. It holds true for the entire services that you adjust for that. And you can do it as effectively as possible by really separating it as much as possible. And there is, I think from my market intelligence, very clear indication that these two groups don't mingle. Those people who really buy online but want some sort of agent or telephony services, they go online. But they do it under the ERGO brand in the ERGO system. And that is totally assured.

Now you could you argue that this might hold true in the front end. But not in the back end. And there's a grain of truth to that. But for that, you would need a very modular absolutely state-of-the-art mass retail platform. Because on those pure digital players, you have between September and October, have to calculate hundreds of thousands of prices per day. And we have to be very honest that our platform is currently not equipped of doing that. So we need to find a way to leverage existing platforms. That's why we adopt partnerships.

I am totally with you that if we were to build this platform on our own, the synergies that you imply, these synergies that you imply in your questions would materialize. That's why we intentionally set up sort of a partnering network, where we basically license other people's platforms who have some sort of this business model in other countries. And then basically have a mass retail platform at marginal cost in a partnership structure, put a new retail brand on it. And really put it visibly and organizationally away from our overall business.

And let me finalize by saying we are talking about 5 to 10percentage points of new business in only limited areas of product offerings. However, in those areas it's very important. We all don't know if it's growing. It's possible. Because it creates a different price position. But we need to be in that market alone for a strategic hedge. I also believe it's a growth opportunity. But even if that wasn't the case, we need to strategically hedge our position. And this can only be done convincingly from my experience if it's done in a way that we suggest. And not in the primarily, I think, more intriguing way of saying just leverage your existing platform, because of the reasons I just stated.

I hope that convinces you at least to certain degree.

Q - Jochen Schmitt {BIO 4227302 <GO>}

Well I still have to think about it. But thanks for the answer.

Operator

Frank Kopfinger, Deutsche Bank

Q - Frank Kopfinger {BIO 16342277 <GO>}

Yes. Thank you. Good afternoon, everybody. I have two questions. My first question is on your local GAAP accounts. Do you see any risk of a potential write-down of the ERGO book value, as obviously once you created ERGO-- this restructuring program had not been within the plans.

And my second question is on the sensitivity on your overall group targets on your P&C combined ratio target in Germany for 2020. The 92% seems very low. How confident are you in reaching this as the sensitivity is very high. If you don't reach it and you, let's say, have only a 95%, which would be still good in historical context, you have 40% of your P&C Germany net profit target to be shed off. And 20% of your group profit target.

A - Jorg Schneider

Thank you, Frank. First on potential depreciation in local GAAP on ERGO book value in Munich Re's account, the value of the share for the purpose of German GAAP accounting is subject to impairment testing, which is based on what we call a flow-to-equity approach, which discounts expected future cash flow. And this program improves ERGO's position. And it also improves in this calculation the benefit for Munich Re. Therefore it is in tendency positive, in spite of the high investment.

That means it improves our situation also with regards to the book value. I cannot exclude further depreciation, subject to a deterioration of the market. And a deterioration of ERGO's performance. But (isolately) seen, this program is beneficial. Christoph?

A - Christoph Jurecka {BIO 17223019 <GO>}

Yes. Sensitivity on P&C, yes, you're right. I mean that's a very relevant question. And yes, of course, there's no plan without risk. But we are confident. And let me explain why. The reduction of the combined ratio is primarily cost driven, or only cost driven I might say. And the cost development is something you have much better under control than compared to your claims development. And therefore we are rather confident to achieve that.

The portfolio in itself will stay stable. And the balanced portfolio is something we will maintain. But as I said, the cost will improve. And therefore we are very positive that we can achieve that 92%.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Okay. Thanks.

Operator

William Hawkins, KBW

Q - William Hawkins {BIO 1822411 <GO>}

Hi. thanks very much. I'm very sorry to drag the call out. So hopefully these are quick. Markus, this is a Herculean task you've got. Could you talk a bit about how you're going to be rewarded for succeeding? I appreciate it's a grubby subject. But is your performance going to be measured annually? Or have you got a three or five-year assessment period? And what exactly, from what you've presented today, is the key deliverable? I mean is it hit the profit. And everything else is detail? Or will you get rewarded if you've achieved on the investment side, even if the profit turns out to be poor?

Then secondly, can you just confirm what you think about the key risks here? Presumably you've had the green light from the trade unions and sales networks by now. But I just wanted to confirm that. And where else do you see the risks? Because I've got to say, without knowing anything about this, I've been told by other people that a company that tries to completely rebuild its IT infrastructure is normally going to end up in quite a challenged place. So I would assume that's a pretty material execution risk. Thank you.

A - Markus Riess {BIO 1835270 <GO>}

Yes. I'm very grateful for the question on the rewards. I have the same question myself I think. No, no, just kidding. Well actually, I have been currently working without asking my colleagues from Munich Re and Nikolaus von Bombard and Jorg Schneider in particular, about a detailed question-- about a detailed answer to this questions in terms of what the KPIs ultimately will be. You are very well aware of my compensation system. Because it's published in the Munich Re (inaudible) annual report. And basically it's made up of a yearly component. And a multiyear components, three-year component that is-- a certain proportion of this compensation then ultimately goes into Munich Re shares, which have minimum holding periods. But that's the basics. So to speak.

In terms of the KPIs, I think we will have to negotiate that by the end of this year. If you ask me. And that's really something prior to any discussion, my primary goal would be the EUR500 million net income. Because I believe that ultimately is the one figure that sums it up. I would also like to volunteer that below 30% cost ratio on P&C. Because I just happen to believe that if you get this right-- and we had the issue about sensitivity-- the likelihood of achieving that is higher.

And thirdly, I think that also gives us the opportunity of being in the market on a long-term sustainably competitive basis, which also is then the future basis of further growth. So realistically, I believe that will be along those lines. And obviously when we meet next, I will know more about it. And Herr Schneider will be jumping in here.

A - Jorg Schneider

Yes. Just quickly to interrupt Markus on that, there will be an element of economic earnings too. And this is our basic elements everywhere be it for the annual compensation, be it for midterm. But when we talk about major acquisitions, for example. And even more when we talk about such a complex program that wouldn't cover the realities. And therefore, I assume without being actively involved too much, it's a matter of the supervisory board in the end that it's along the KPIs of this program and the achievements, especially as Markus Riess said, with regard to the cost also of this program.

But you can rely on us that we are very consistent with that. And it's always midterm oriented. And not based on short-term success. May I hand it back to you, with regard to the challenges of the program?

A - Markus Riess {BIO 1835270 <GO>}

Yes. Thank you. Then again, you can rest assured that I'm self-motivated enough to make this happen. So that's another comment in this regard.

Now the risk. And I appreciate you saying it's a Herculean task. I believe that is very well said. I still think it's worthwhile doing it. I also believe that the management team and the employees at ERGO, they are capable, willing. And motivated of undertaking this Herculean task. Because it's by no means my task. It's our task. And we really have to stand together those next five years in order to accomplish that. But I think it will assure the future-- profitable future of ERGO. And that's why it's a fight worthwhile fighting. And actually that's why I came here. Because I wanted that kind of fight. So realistically, I'm all for it.

Now with regard to the risks, I think there are various risks. First of all let me clarify. I'm not sure whether I understood you correctly. But clearly there is no green light from the trade unions at this point in time. Because we are obviously, as of today. And that's the way the German systems work, as of today my colleagues responsible for HR has been starting in negotiations with the unions and workers representatives in order to achieve a consensus. And I'm very happy that we have this kind of culture. Because ultimately it's in our self-interest to achieve consensus from the workers representatives on this context.

And this usually takes between three to six months plus. So today is not the right time to give any indication on that. I would, however, not consider this as a risk to the program. Because I believe that our program is convincing. The more important risks are basically twofold.

One risk is all around the sales organization. Because I have just been very frank about telling you that we do the-- that we integrate the five semi-integrated agency sales organizations into one. This will create a certain disruption. And this might lead to a lower productivity in those transitional periods. That's something that a lot of companies see if they undertake an effort like this. It's usually temporary. So it's also not something that in my judgment jeopardizes the overall potential of the program. But it has to be taken into account. And we are very well advised to mitigate that accordingly. And you can rest assured that we have already in preparation, a lot of mitigating measures in order for this to be avoided.

The second big category of risk is all around information technology. Your judgement is right. We'll be investing over-proportionally in the IT in the foundational IT. And in the digital IT. And that is both a big opportunity, like I have been stressing. But it's also a potential risk. Because we don't want to underestimate the complexities and the challenges in this context.

However, we have to take this risk anyway. I mean there's no way around for us investing into information technology. So it really is, in terms of marginal risk, really something more in terms of do we envisage having too much too soon. And that's something that I have personally very much on the radar screen, as you are maybe aware. I have hired a new Chief Technology Officer who has transformation experience. And that's why I believe we are very prepared. But I will obviously have to make this one of my priorities to observe that this information technology improvement is really done fast enough. But also careful enough. Because we don't want to jeopardize the existing quality of the technology.

These, I think, are the two major risks that we see. Then obviously there's the capital market risk that Jorg Schneider has already alluded to. There are various other risks in terms of losing know-how area. So you could basically, if I was a risk officer, I would use an hour to discuss potential risks in this regard. But I believe these are the major managerial risks. They do exist. I feel confident that we can mitigate them. But we have to be very observant not to be too self-assured. But really have to question ourselves all the time again, are we doing everything to mitigate these risks? And since I have already had the opportunity of completing transformational programs like these, I hope that given this experience, I can calibrate this mindset in an appropriate fashion.

Q - William Hawkins {BIO 1822411 <GO>}

Thank you. Best of luck.

Operator

Michael Huttner, JPMorgan

Q - Michael Huttner {BIO 1556863 <GO>}

Thanks very much for giving me the opportunity. Two questions, one, why today? Because it was weird that you kept saying beginning of June. But never gave a date. Then suddenly on Monday-- oh, actually it is the 1st of June. What happened that today was okay. I thought it was the unions, clearly not.

The other-- I'm still a little bit unsure. So for me the elephant in the room is the interest rates. And we've kind of said, oh, actually the program doesn't address the interest rates, or it's not designed to address it. It's designed to address other stuff. And I mean, what is the risk that-- I don't know-- interest rates go negative? Then we have to have-- we are given the opportunity to revisit the program maybe in six months' time and have-- because negative interest rates would change things quite materially. Thank you.

A - Jorg Schneider

I start with the second, or perhaps I try to cover both. And Christoph and Markus will correct me. 1st of June, we tried to do it as thorough but also as quick as possible. And this was now the time to inform the staff there are no holidays here. So people are present. And the team have done tremendous work in the last couple of months. And this was in a way, the earlier possible moment. And from now on, there's a very, very long and intensive work phase. But it's important now that we could inform the staff. And that we could inform the public and the investors.

Second, with regard to interest rates, there is some protection in place that is that we can offer long-term guaranty measures that we can go for transitional-- for valuing according to the transitional rules. We did not draw that option. And we are hopeful and confident that we do not have to. But we could. Therefore, short and midterm, there is no major challenge from that side.

Q - Michael Huttner {BIO 1556863 <GO>}

Fair enough. That's very kind. Thank you.

Operator

As there are no further questions in the queue at this time, we will now hand back to our speakers for any additional or closing remarks.

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

Thank you. Not that much left for me to say. Thanks for your participation and for joining us this afternoon. And for further questions, please don't hesitate to get in touch. Thank you very much. And hope to see all of you very soon. Bye-bye.

Operator

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