Analyst Meeting - Ergo Strategic Update

Company Participants

- Christian Becker-Hussong, Head-Investor and Rating Agency Relations
- Christoph Jurecka, Chief Financial Officer
- Jorg Schneider, Chief Financial Officer
- Markus Rie, Chief Executive Officer

Other Participants

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

Presentation

Operator

Good day and 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 Rie, CEO of ERGO, Christoph Jurecka, 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 Rie {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 at most importance and that's why I'd like to leave the floor to Jurecka and Jorg 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 a 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 [ph] 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 in innovation -- innovative oriented.

Now one of the questions I often get is what are my key findings and you will find them on page number four, 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 utilization 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 a digital transformation, which will become increasingly more important in the way that the market is digitizing itself and that's way 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 mark that 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 to convince a 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, in a word 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 five, 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 are also 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 result of EUR500 million and more starting 2021 at the latest.

We will need 1 billion of investments and the figures here are net figures that I refer to, we will invest this billion until 2021. This will translate into 280 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 540 million gross figures and again this translates into the 500 million net profit as of 2021 onwards.

On page seven, you will 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 wants to create a lean structure and an effective covenant, on digital we want to create the basis for the change of the business model transformation into digital age. And then successful side, we want to have convincing solutions for all of our customer segments.

The 1 billion that we invest, the 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 quiet balanced with regards to all of the pillars that it addressed. 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 change that we undertake and with that I'm -- on the following page number eight, 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 channel 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 brackets only because the rest is just 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 the -- what we called product provider, that is with the risk-taker of P&C and life.

On the administration side, on page number nine, 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'll spare you the process and how we dealt with it, 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 growth.

Page number 10, refers to you third workstream, which is the international organization in which we have basically only now decided two things. The first thing is that we change the governance model and basically move 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 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.

Workstream number four, the use 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 remained into ERGO VORSORGE, because currently it 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, 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 principle.

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. Workstream number five and workstream 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 fruits then 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 laying the good ground work for this, we will also in parallel, go in more digital and more agile IT structure. So for example, on the digital IT, we will come up and building corporations was 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's what help us to have a much faster reaction time, and this will be the two key infrastructural 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 a real state-of-the-art IT throughout the entire value chain. And it's very obvious to me that once this is completed, we'll 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 series 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. If you 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 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 number eight is basically a 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 digitize that. That means that, we will develop product exclusively for the Internet age and for the digitize age, which will then, and that is a quiet and of misunderstanding not only be available digitally, but these products 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 an opportunity which we cross fertilize into the classical offline sales which is another growth opportunity.

Also, and I would like to re-express that because it's such an important synergy, we would like to embrace the opportunity that we have at 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 and that's why I believe that will be another very important way of performance. Modulization and providing and pricely attractive basis products 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 an hour and we start now once we have 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. If the customer who seamlessly wants to be integrated between sales agents internet portals, call centers et cetera.

That obviously require significant investments not only in the IT which I've already alluded to in the work stream number five and six, which again cause fertilizer 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 the very much growing segments, and we are very well positioned because, in order to succeed in that market you need one regional sales forces 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 to convince in direct presence and this ERGO Direkt. We have, as you know, one of the most successful direct players in our group.

So the combination of the growing segment, the regional sales ERGO Direkt in our group plus the IT investments, I think gives us further support position to take advantage of this market trend and that's why I believe this will be a very important course of 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 with their pure online only. This is the 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 portals, very lien, 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 start-ups, that can be IT platforms, that can be other providers, we will try to partner with them, come up with efficient platform, and use a new brand and put that in the marketplace first, with the motor product in 2007 and we then plan to extend that both in terms of product range and we'll 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 more international areas. On number 12, ERGO Mobility Solutions, there is something, which we will use to increase our initiatives in the B2B2C segment. You're 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 segments with Karsten Crede, he released that and I think given his personal background plus the market overture, 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 into plan. But, it's too early to tell because, that Crede will only join us in the 1st of January, but again in this plan, we made a foundation for further growth in this regard.

Last but not least, before I hand over to Jurecka, the international expansion will be revisited in H2 2016, as you see, we have -- as you have seen as we have just announced that we have 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 go and our portfolio, especially in Eastern Europe and South East 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 the new strategy statement in this regard by the end of 2016. That was my brief 20 minutes run through this strategic context, and I will now transfer -- 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 over 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 following slide are 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-oriented product and Biometric products that where we also aim at a 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 this overall 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. Rie also referring to, and this is something where depending a little bit although on the price adjustments we are going to see in the market, this will be in line with the market and maybe slightly above, maybe slightly below market, but that -- that's something where we will for sure be on the market level. The focus of our growth of -- that will be in the P&C in the Direct segment, 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 type of the customer segment. And then in P&C Germany, over the full period of 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 -- that also in those pickup there is a clear footprint of the growth initiatives Mr. Rie was also referring to.

On page 25, you will see the investments we are going to invest until 2020, the overall amount of roughly 1 billion was already mentioned. And here you see the split over the years, and to start with in 2016, we are talking about roughly 300 million of investments. I would like to highlight that around 200 million of that are restructuring expenses net, our net figures, which we are going to book in Q2. So those are included in -- in those 300 here.

And then you see a reduced amount of investments going down from year-to-year until 2020 and 2020 still a substantial amount being there, and you also can see that the major amount in later years are in the digital segment, which shows that the IT investment is something which takes more time and Mr. Rie was referring to the basis IT and the digital IT, and both are included in those figures here in the digital in the sense that built on base. So it's clear that it takes a little bit more time. And overall, 1 billion net effect of investments so I think a sizable investment to strengthen our competitiveness in the market.

Page 26, you will see the total cost savings. You'll see on the cost base until in 2020 and onwards we have roughly 540, so 536 million of cost savings, the net effect would be 279 and this is went up over the year from '16 until '20, so year-by-year cost savings increased. And on the right-hand side in the upper column, you see that the cost savings are primarily driven by the pillar Fit, 340 million, Digital also contribute by 96, and Successful of course, doesn't because it's mostly about growth initiatives, so that I wouldn't expect something here.

And then we have 100 million of an overall channel Productivity Enhancement also included in our figures, coming up with 536 million costs overall. To achieve that, we'll reduce our FTE number or Full-Time Equivalent by roughly 1,900 by 2020, and the net effect I mentioned that already of the cost savings of 279 million.

On page 27, you will see the overall net income impact of the strategy program. And you'll see that in 2020, the positive impact of 203 million and what you also can see here is the major contribution is from the 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. Rie was pointing out, we expect the cost of products 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. Overall years, the sum is minus 49, so that the positive impact in this five years period of the program is not fully, but nearly contemplating the impact on the result.

With that, I would like to go to page 28. And this is a very central page from my perspective because it's all sums up the impact of our going from various perspective. First of all, I'd like to mention that the assumptions 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 stable market as the planning assumption behind all figure.

You will see that after 2021, we expect -- or after 2020 or in 2021 we expect at least 500 million based on the 450 million in 2020, so why do we expect that? Well, in 2020 the figure still includes some investments. And then as mentioned before growth initiatives should further accelerate until 2021. So that we clearly can expect the figure above 500 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 was -- basically very much driven by the restructuring provision we are going to book.

On the right hand side, you see the split of the figures on to the different segments. Let me start with P&C Germany. P&C Germany continues to be the main earnings contributor of our Group. So 250 million in 2020 is a very strong signal of an increased profitability by 2020. We then have International 110 contributing. And with that we are back to levels where we already were in the past. And then Life and Health Germany, here health and direct included here, our stable or let's say, 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 to 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. And 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 is 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 a

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 something, a target level which is acceptable from the 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 is 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 threshold 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 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 product. All that areas where a pure reinsurer in the traditional sense would not been 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 that profitability will cover the cost of capital from 2020 and there are also some upside chances, which hasn't been reflected yet, 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 down streaming of capital as part of the Strategy Program. But this is based on the current shape of the capital markets, and it's a potential downside especially from further decline of interest rates, for example.

During the duration of the Strategy Program, it would be unrealistic to expect dividend payment from ERGO to Munich Re.

Short and medium-term, this is a dream [ph] 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, the ERGO 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

Thank you, sir. (Operator Instructions) Our first question comes from Sami Taipalus from Berenberg. Please go ahead, your line is open.

Q - Sami Taipalus {BIO 17452234 <GO>}

Hi, good afternoon, everyone. Thanks for taking my question. The first one, I've got two at the maximum [ph], the first one is on economic cap, I was a bit surprised to not see anything in the presentation or had for the broader discussion about what the impact of this program will be on the economic capital requirement and sensitivity of the economic capital ratio of ERGO. I mean, I guess I am thinking about this from the perspective that roughly one-third of the Group's economic capital requirement related to ERGO and that I guess most for the interest rate sensitivity also relates to that.

So some more sort of exploration 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, if 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 the commission structures haven't changed very much yet.

A - Christoph Jurecka {BIO 17223019 <GO>}

Yes. Christoph here. I'll take the first. Economic capital is, you're right that 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. And if you see that long term, we benefit from cost savings. So long term, there will be clear improvement of our economic position also by that program. We therefore expect also 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>}

Just if I look at your plans there, you're doing quite a lot to change in your business mix and you're also talking about some work on the in-force business. And if I just look at another company based in Munich, they've kind of linked those things to quite significant improvements in -- reductions in the interest rate sensitivity or the 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 something, some other impact there?

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 or the 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 strategic one really to bring ERGO back in the shape and to improve the situation that we are really going forward are very strong player back in German international market.

Q - Sami Taipalus {BIO 17452234 <GO>}

Okay.

A - Christoph Jurecka {BIO 17223019 <GO>}

Operational to them.

A - Markus Rie {BIO 1835270 <GO>}

Shall I take the commission question, yeah, Markus Rie here. What you observed, Sami is absolutely right. The environment for High Commission has changed, we see both regulatory pressure as there is pressure from the customer protection groups on that scenario. And that's why I believe medium-term for risk provisions and 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 Lebensversicherungsreformgesetz in Germany and which we basically transform upon to commissions into a longer-term (inaudible) kind of commission which then obviously retains different customer [ph]site.

And of course, this wasn't responsibility for the agents to retain the business for longer time, which in turn translates into a lower commission ratio de facto.

However, 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 homogenous 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 cohorts of sales agents that will come to us as of 2017, we 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 go 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

Our next question comes from Vinit Malhotra from Mediobanca. Please go ahead, your lines are open.

Q - Vinit Malhotra {BIO 16184491 <GO>}

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 130, if you add back 110 to 240 [ph], 203 you add back to -- it's -- whatever you subtracted 250 something like that. So the underlying trend in earnings is not really changing. So if could you just remind us what is driving the -- this sort of stable outcome excluding this thing or excluding 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. But that seems to be quite a lot because on the one hand you mentioned three-point sort of improvement between 15 and 20, but the improvement in the reported combined ratio is much larger. If you could just comment on both these? If you like me to repeat question one on slide 27, I'm happy to repeat because I think the line was making a bit.

A - Markus Rie {BIO 1835270 <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'd come up with a rather stable earnings development that -- that's correct. I mean, 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's the new investments we invested this little very low rate every year. So the average return in our book already reduces year-by-year, and therefore, let's say that natural development you'd have been expected without any measures would even be a negative one, not even a stable one.

And then I have also to say that in this base case we are -- which were -- you having as a comparison to that the case including the strategy, there are also some investment required which we need for regulatory purposes or regulatory reasons and then also for lifecycle 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 then stay at this stable level of around 250.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yeah, sorry. Can I just follow-up, so the -- 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 - Markus Rie {BIO 1835270 <GO>}

Yeah, but that I mean we -- I think we mentioned that first of all the digital investment is part of the strategy, so it did contribute to the 203 million. But having said that, all of -- I mean what you were saying is right, I mean the digital development is something which have also a more long-term character, than let's say some 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 to present to get 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. This is the driver for the improvement of the combined ratio, it 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 where we currently are at, and then deduct 4%. I think you end up with the level which is fairly in line which what we are showing here on page 28.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Can you just follow up on page 25? So I can just follow up, the 2015 combined ratio is 98, it goes to 92 in 2020?

A - Christoph Jurecka {BIO 17223019 <GO>}

Yeah, but in 2015 we had to have a year which was also very much burdened by one-off. So these are -- let's say the more average level with average claims and that cut would be more around 96 today. And therefore, the 92 is something where we could get that with the cost measures.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay. Thank you.

Operator

Our next question comes from Michael Huttner from JPMorgan. Please go ahead. Your line is open.

Q - Michael Huttner {BIO 1556863 <GO>}

Thank you. First on the -- you spoke about capital -- both CFOs spoke about capital, because you can give us solid 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 at the moment? So we can judge the numbers you said about clearing cost of capital, that I think. Even if we have to -- you have to provide a trajectory for the capital that would be very, very helpful. For me that, I agree with my predecessors, I was missing some in the presentation.

The other point and it relates exactly to the same issue, because to me Munich is a -- it's a huge pile of cash and I do wonder about all this investment, but what is the risk Mr. Schneider, of capital addition, you mentioned lower interest rates. I mean, what are the assumptions you are making at the moment that there is no risk of capital addition and at what level would you say no, actually now we do -- we are on the territory where we have to consider it? Thank you.

A - Jorg Schneider

Yeah, Michael thank you. With regard to capital you could use the ISIS [ph] 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 somewhere little bit below EUR5 billion, which was 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, yeah, 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 enormously beneficial contribution going forward. 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 find or ERGO can finance a program by itself, but (inaudible) 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 regard to deforce for example, yeah, so as long as capital markets remain as benign as they are at the moment with regard to the credit risk time [ph]. When we see a drastic adverse movement here then this would -- 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>}

Understood [ph]. Thank you very much.

A - Jorg Schneider

Thank you.

Operator

Your next question comes from William Hawkins from KBW. Please go ahead. Your line is open.

Q - William Hawkins {BIO 1822411 <GO>}

Hello, thank you very much. First of all, I think it's risks occurring Munich [ph] question, but with regards to your 2020 earnings guidance, I'm trying to make sure I understand the numbers correctly on slide 25 to 27. Because, if I take the middle of your original guidance for this year, which is EUR300 million and then subtract the 99 million of investments still going on in 2020 and off the 279 and 203, the cost savings and strategy benefit, I get closer to a figure of 680, which is more than 200 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 you were talking about is in it or is it something else?

And then secondly, your -- what's the near-term risks 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 2.3 to 2.8. Other thing is equal, the ERGO guidance is now something like 100 to 200 million lower than we were kind of thinking about previously. So, that's about 10% from what your 2016 guidance would have been. Are you kind of thinking that nevertheless this August lost at the roundings of the overall Munich Re group can continue to maintain the 2016 level in the near-term, or is this actually incrementally hurting 2017 and '18 earnings for Munich? Thank you.

A - Jorg Schneider

I'll start with the second question, William, yeah, and it may sound arrogant. But it is true what you said. Yeah so it's in the roundings, it doesn't make our task easier to fulfill our 2.3 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 this time, my question was about 2017. You are also, this is not going to disrupt 2017 or '18 --

A - Jorg Schneider

Yeah. 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 they are -- that you wouldn't have seen 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 OP [ph].

Q - William Hawkins {BIO 1822411 <GO>}

Thanks [ph].

A - Jorg Schneider

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 adjusted. But let me maybe explained in page 27 and what really shown there. And 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 effects for the various other topics, which are not disclosed in the presentation here. So, you won't be able to calculate as the net profit impact of the overall total program given by other information you find at the presentation here. That's -- that's not possible.

To explain the figures you see in 2020, the 203 and we've discussed it before, if I take those out of the 450, we were -- we are showing on page 28, then the baseline would be around 250 so somewhat below the midpoint of the range you were just referring to. And this is correct, because until 2020 as adjusted before, it was very low in the projection here. And also we have to assume some investments in the regulatory projects and also in lifecycle topics, which we have just have to do. And they are also part of let's say, the base case underlying at the page 27.

Q - William Hawkins {BIO 1822411 <GO>}

Thank you. So I think, I was misunderstanding. So just to be clear, the 279 cost savings for 2020 is part of the 203 benefits from synergies. And the reason is --

A - Christoph Jurecka {BIO 17223019 <GO>}

That's right.

Q - William Hawkins {BIO 1822411 <GO>}

Because you've got to drill down the restructuring costs and other stuff, yeah.

A - Christoph Jurecka {BIO 17223019 <GO>}

That's right.

Q - William Hawkins {BIO 1822411 <GO>}

Thank you. Thanks.

Operator

Our next question comes from Kamran Hossain from RBC. Please go ahead. Your line is open.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi, afternoon everyone. Can I just firstly come up with a very high level question. Buy was now the right time to, I guess to again invest a billion in ERGO. Was this simply just kind of recognition of, I guess, the organization of Mr. Rie's previously came from was running very, very differently to lead the ERGO is now, so I guess that's question one.

And the second question just on the German Life separation of the two book so this preparation for sale or anything else or I just reading too much into that. Thank you.

A - Jorg Schneider

Jurecka, let me take both questions. Right time to invest in ERGO, I would say absolutely, yes. We decided to really make huge steps 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 a very simple answer.

Second, German life, to capsulated its 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, Cameron.

Q - Kamran Hossain {BIO 17666412 <GO>}

And that's perfect. Thanks very much, Jorg.

A - Jorg Schneider

Thank you.

Operator

Our next question comes from Olivia Brindle from Bank of America. Please go ahead, your line is open.

Q - Olivia Brindle {BIO 17273762 <GO>}

I have two questions. First on just in terms of your thinking on the timeline and one of your slide says 500 million from 2021 at the latest, and what is your confidence level of mainly being able to achieve that a bit faster. I'm just thinking that it is, it's quite a long drawn out process to get to that level. So, how are you thinking about the confidence on that?

And 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 you have given today and how conditional are your numbers on things -- at least not getting worth 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 the lot of optimism. No, on worst case scenarios and we -- as Markus described before we are aware of the challenges we are facing, also not only in our own book, but also from market forces. He mentioned regulatory pressure, he mentioned consumer protection pressure and we tackle them and we are confident that we can get good answers to it. And therefore, I would regard to plan as being absolutely achievable but it's just -- it's ambitious. Yeah, it's not unrealistic but ambitious. Okay, Olivia.

Q - Olivia Brindle {BIO 17273762 <GO>}

Yeah, thank you.

Operator

Our next question comes from --

Q - Olivia Brindle {BIO 17273762 <GO>}

And -- sorry, on the international?

A - Jorg Schneider

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

Q - Olivia Brindle {BIO 17273762 <GO>}

Yeah, sorry. My question was just around the fact that market conditions are still pretty difficult in some of those market. So, wondering how you've 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>}

Of course, we are planning assumption behind the whole plan and I think, I mentioned before already that that we have some kind of a nice [ph] prognosis. So we -- as a best estimate take market conditions as they are. We do not factor in any deteriorations but also -- neither improvements also in respective markets.

So from that perspective it's just -- I was referring to it, it is realistic in a sense with ups and downsides, but we won't bet on any improvements in any of our international markets and maybe on top of that anyhow Mr. Rie's was pointing out already that the growth strategy will be reviewed in the second half of the year. So there is also the chance to look into the things again for us.

Q - Olivia Brindle {BIO 17273762 <GO>}

Okay, thank you.

Operator

Our next question comes from Thomas Seidl from Bernstein. Please go ahead, your line is open.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah, thank you. Good afternoon. First question on Life, clearly you are not alone with the issue of running of German Life businesses. So my question is -- isn't that a chance or an idea that your combine forces and run it off together more efficiently like we have seen in other countries and that's 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

And I 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 improvement and then in general, the improved result situation of our Life carriers clearly helps also from a capital perspective. As obviously, two, we look at projections of the earnings into the future so that we expect the right way to look on that. We think it will help us, but it's not the main driver for the topic -- it will help. Actually, I can't give you the split of the cost savings on

Life, but it will be substantial amount which will hit Life, so it will help but it won't be -- it's not the, primarily it's not the main driver.

Q - Thomas Seidl {BIO 17755912 <GO>}

Okay. It's not the main driver, so what would be the main driver then?

A - Christoph Jurecka {BIO 17223019 <GO>}

So the main driver for Life separation was Mr. Rie was referring to it was that -- it's much better from a management attention prospective, prioritization is much easier, we can concentrate of one off running off the book versus new business in a separate entity, so management can contemplate on the respective topic, that's the main reason why we are doing it.

Q - Thomas Seidl {BIO 17755912 <GO>}

As I'm not talking about the cancellation, I was talking about a cost-cuts of the planning, are any of those cost-cuts accruing to the Life back book is it basically P&C and the Life new business benefiting from that.

A - Christoph Jurecka {BIO 17223019 <GO>}

No the accruals which is the life back book that's what I meant before, so the capital will benefit from it, but this -- benefit is not the main driver, we do it for operational reasons. But of course, there is a benefit also for the Life companies both on capital as well as on earnings.

Q - Thomas Seidl {BIO 17755912 <GO>}

Okay, thanks.

Operator

Our next question comes from Xinmei Wang from Morgan Stanley. Please go ahead, your line is open.

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 2016 to 2020, so there in 2020 the majorities coming from P&C Germany, is that going to be the cases throughout the years? That's my first question. My second is just a follow-up on a previous question, I not sure you answered the one about potential sale or considering a potential sale of your Life back book, is that something you 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 driver for it -- for the split over the years will just be how quickly we've been in investing. And the quicker we invest, that the more broadly and less than early years and less than in later years. So from that perspective, we decided just to say 2017, 130, we are back to positive levels. I think it's an important message, and then 2020, 2021 that the target level. But in between it's still very uncertain given the fact that we'll be -- we really have to decide when to invest, how much and therefore, it just don't make too much sense to talk about this.

A - Jorg Schneider

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

Q - Xinmei Wang {BIO 17860767 <GO>}

Okay, thank you.

A - Jorg Schneider

Thank you.

Operator

Our next question comes from Andrew Ritchie from Autonomous. Please go ahead, your line is open.

A - Jorg Schneider

Andrew?

Q - Andrew Ritchie {BIO 18731996 <GO>}

Hello, you there?

A - Christoph Jurecka {BIO 17223019 <GO>}

Yes, yes.

A - Jorg Schneider

Andrew, we are courageous about your question.

Operator

As it appears he has got away from the phone. We now have Thomas Fossard from HSBC. Please go ahead. Your line is open.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes, good afternoon. One remaining question on my side for Markus. And that could be really to the product side of the program today and on the life business. Regarding potentially the need to, we should be able to manufacture, I would say attractive asset management product, something like that. And I think that's in your presentation.

You alluded to working more closely with MEAG. Do you believe that currently, MEAG as I would say strengths on third party asset management, and if potentially you are contemplating an acquisition in that (inaudible) strengthen you as a value proposition of your life product and support your ambitions. Thank you.

A - Markus Rie {BIO 1835270 <GO>}

Thank you very much for the 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 fact was (inaudible) coming up with a 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 costs and low complexity. We have to be very -- we have to be very careful with over complex products in this regards. 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 at 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.

A - Markus Rie {BIO 1835270 <GO>}

Thank you.

Operator

Our next question comes from Michael Hite [ph] from Commerzbank. Please go ahead, your line is open.

Q - Unidentified Participant

Thank you very much, good afternoon, Michael Hite at Commerce Bank. Two questions. First, I'm sorry again, German life, the organizational separation of the new business and the back book seems to me that you create kind of a bad bank -- 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 a significant leverage when you improve costs, because you can give it fully to the shareholder.

And 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 an ease to assume that in this process of industrialization prices remained 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 couple of positives we see. First of all, of course what you were also mentioning, the cost is very important. So the idea is to really contemplate 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 organize our IT more efficiently and then we will also continue to invest in the IT there to have a platform, which allow us to really efficiently -- efficiently thorough the contract we're still having in that back book and it will be lasting for a very long time, this back book is clearly running off very slowly.

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

Q - Unidentified Participant

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 of -- on efficiency, but also I mean, systems, they have a life cycle anyhow. And then, if you look at the back book, I mean, duration of the back book here 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 workmen organization, which is focusing on back book management, because we are just living in a world were life cycle tend to be quicker and quicker and shorter and shorter, and so we see a need to invest and we will invest and of course, the target will be a more efficient administration and -- in a linear management of the back book overall, but this will involve IT investments.

Q - Unidentified Participant

Okay. Thank you.

A - Jorg Schneider

On your question with regards to the competitive landscape, I think your observation is fully right. Lot of other competitors are targeting the same books as we are. And I would like to say the level is in the detail. I mean, just having the ambition of addressing those targets group is not necessarily already a contingent success factor. I believe that ERGO brings a couple of important elements to this strategy that makes it success in this regard, more successful and more and more likely.

First of all, we have ERGO Direkt; ERGO Direkt is currently the direct insurer with a 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 and not to work the 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 B accounted for that sector, because on page 26, you had -- you have a category called Productivity Enhancements, 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 - Unidentified Participant

Perfect. Thank you much.

Operator

Our next question comes from Andrew Ritchie from Autonomous. Please go ahead, your line is open.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Hi, there. Can you hear me this time?

A - Jorg Schneider

Yep, we can hear you.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Great. Excellent. Thanks for that, sorry about that. Two questions, one is, you described the restructuring costs, well you described 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 there 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 still got 60 million or thereabouts, we should just assume that isn't recurring, that's my main -- my first question.

Second question to Christoph, I think you said that the discrete Life business was double-digit loss making in the projection when you give the profit by segments in 2020. My guessing is to understand what's driving that obviously the low rate environment for -- is this reflecting -- there is a complex interaction between local GAAP and IFRS on this ZSR [ph] addition, is that coming -- 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 both questions, Christoph here. The restructuring costs and the investments, yes, you are right, there -- I mean building up a Digital IT will lead to the fact that of course we have to pay for the Digital IT as long as you have it, or that there will some costs remain with us. But on the other hand, with -- I mean, with the overall when view our platform overall, we expect cost savings beyond that also going forward. So that there might be a compensating element on that.

The second question, double-digit loss. I would even say high double-digit loss and then (inaudible) I mean we are talking about mismatches here between local GAAP and IFRS and then probably the two 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, five years we will get through without a major loss, maybe a minor one but without a major one.

In local GAAP you know, we have (inaudible) which is a burden on our liability side, on the asset side we compensated by realizing unrealized gains. And we do so in two ways. One way is doing, just selling bonds to the markets, which will -- just what we would expect but we have a different segment way how to -- how we can do it, which is more efficient and as we sell bonds from one company within our group to the other.

And this clearly add advantage that we get the mid-point, if we don't have (inaudible) so it's much cheaper, we don't -- we have to -- don't have to pay any fees. And so it's efficient to do it that way. And then so being received a way, lots of ways. But the huge disadvantage is in IFRS you don't see them because you consolidate -- just consolidate the amount. So there is no benefit from realizing those gains in IFRS. You have the benefit in local GAAP, so it fits to what your need for a liability, but you don't have the benefit in IFRS, and that's why IFRS looks worse than the local GAAP regularly.

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

And the second reason is that we have the success are in local GAAP and we have related (inaudible) in IFRS, which is called liability, adequacy test and back depreciation. And those are let's say at half 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 (inaudible) or that back on the liability adequacy test are higher. And this gives you an additional mismatch between local GAAP and IFRS.

And therefore, we primarily still in local GAAP with the effect that we do the realizations of bonds unrealized gains in -- to the level we have fit in our requirements. But in IFRS we have two reasons why this deviates and can deviate drastically. And then one, just to say this is a difference between fits in our and taken liability adequacy test, and the second one is that we usually do not have the realized gains in the IFRS result for major part of the realizations because we just sell the bonds from one company to the other.

Q - Andrew Ritchie {BIO 18731996 <GO>}

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

A - Christoph Jurecka {BIO 17223019 <GO>}

I mean in the entire life insurance business, I could comment that in the end it's all about distributing earnings over time. And yes, the management team has a lot of freedom, how to do it. I could realize easily enough unrealized gains, in order to compensate for it. Just to be reasonable from an economic perspective because it costs money and going forward it reduces the earnings base for future. So it's all about timing in the end.

And as there are so much freedom in there, also for the planning assumption we've been just conservative for the planning assumption, we still local GAAP, and as I said there will be no major loss in local GAAP and IFRS itself resulting and those two mismatches we're having and lead to the effect that the IFRS result is (inaudible). But that's nothing to be worried about because it is just a counting mix I would call it.

Q - Andrew Ritchie {BIO 18731996 <GO>}

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

Operator

Our next question comes from In-Yong Hwang from Goldman Sachs. Please go ahead, your line is open.

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

Well, thank you very much for taking my question. Just as two from me. Firstly, I think Jorg you mentioned on the MEAG AG and (inaudible). But with the investment cost of 1 billion, would that be a one effect, I felt like maybe it would be a 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 to the international business that is -- I think earlier in the presentation 30 million and cost cutting assumption. Does the 110 million -- the income assumption within international businesses included that 30 million in that? Thank you.

A - Jorg Schneider

In-Yong, thank you. With regard to German GAAP situation, it's a loss of ERGO dividend which by, 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 400 million or so per year. As in ERGO before the Strategy Program with a lot of problems they had 200 million. And therefore, for us, we can't quantify precisely, but it's a sacrifice by Munich Re but the sacrifice which is a very good investment too.

A - Christoph Jurecka {BIO 17223019 <GO>}

And the answer for the second question is very easy. Yes, it's included. So actually (Technical Difficulty) 10, include the cost savings as well.

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

Fair. Thanks very much.

Operator

Our next question comes from Vikram Gandhi from Societe Generale. Please go ahead, your line is open.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Hello, good afternoon. Can you hear me?

A - Jorg Schneider

Yes, we hear you well.

A - Christoph Jurecka {BIO 17223019 <GO>}

Yeah.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Yeah, okay. I've got two questions, the first one is, amount of the traditional life book is close to new business. Can you please share how much of the existing technical reserves would have run off by 2020. Let's say, taking the end of 2015 number as the starting point, which is about EUR100 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

I understood your questions well, Vikram. Only a small part of the business runs off by 2020. Because, we haven't grown so much in traditional products during the last couple of years or in other words, there was very little new business on that. Hey, Christoph you want to add something else?

A - Christoph Jurecka {BIO 17223019 <GO>}

Yes maybe it's important to mention that I mean, closing it for new business in sales does not mean there is no new business at all because, we have legal applications in our book to take new business in our books for existing policies. And so there will be still some new business because, which can't avoid it. We are legally obliged to take it. And this of course lengthen situation of the portfolio. And so as said before, it will take decades until this portfolio will be decrease substant -- will have to decrease substantially.

A - Jorg Schneider

On your -- on your second question. We haven't used a transitional life yet and it's opened 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, yes. Thank you.

A - Jorg Schneider

Thank you, Vikram.

Operator

Our next question comes from Anasuya Iyer from Jefferies. Please go ahead, your line is open.

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 revisited, can we expect any more costs there or is any cost related to that revisits already in the plan? And the second question I guess is broader and maybe the risk of repeating some of the earlier questions, but in sort of 2015, early on the guidance for ERGO was about 500 million, now we have 1 billion of investments a full program digital strategy just to get back to that 500 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'll hit less than 500 million or is the risk that it would take up till 2023 or something? Thank you.

A - Jorg Schneider

I'll start with the second question. Yes, it's disappointing, I agree. Yeah, but with Markus Rie's entering the Board, 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, then there were before and therefore it's now a mixture of realism on one hand and of ambition on the other hand, an ambition comes along with the investments.

So, in my view, this prognosis now this ambition of 500 million in 2020 is much better founded than the 500 million which ERGO should have achieved in 2015 before and so I feel much more confident that we can reach it, is it a risk -- 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 the international, I mean, as you mentioned before, we did not really look into it, so that there is something we'll do in the second half of the year, except one thing, and this is expenses. And so expense reductions over the part of that program, and then of course, I mean, some of our investments are of course as you've seen in this of all program, I would like to cross -- at least for that part, it should already been -- it's already now our figures. Of our other topics, I can't really help, I also don't know, but it's a little bit too early, we'll look in to it, but I wouldn't expect large figures here.

Q - Anasuya Iyer {BIO 18981555 <GO>}

Okay, thank you very much.

Operator

Your next question comes from Jochen Schmitt from Metzler. Please go ahead, your line is open.

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 that 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 Rie {BIO 1835270 <GO>}

Thank you very much for that question. It gives me the opportunity to basically pronounce a contradicting view to what you've just said, because, I believe this 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. And the way I have come to see the insurance marketplace is that, the traditional marketplace, traditional customer behavior is very, very fastly evolving into this hybrid customer segment. And that means, people who are part of the agent sales force 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 then might buy it an old age position [ph] 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 a totally different key buying factors, that's basically convenience in the excess, 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 -- telephony, it comes more or less mandatory services, and if you were to basically use 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 -- so 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 too for brand, it holds too for the entire services that you adjust with that, and you can do it as effectively as possible by really separating it as much as possible, and there is -- I think for 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 argue that this might which will in the front-end, but not in the back-end, and there is a grain of tool to that. But for that, you would need a very modular absolutely state-of-the-art mass retail platform. Because on those few digital players you will have between September and October have to calculate hundred 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'm totally rescue that if we were to build this platform on our own, did the synergies that you implied, this synergies that you implied and your questions will materialize. That's why we intentionally set up sort of a partnering network very basically licensed other people's platform who have some sort of this business model in other countries. And then basically have the mass retail platform at marginal cost and the partnership structure put a new retail brand on it. And really put it visibly and organizationally away from our overall business.

And let me finalized by saying, we're talking about 5 to 10 percentage points of new business in only a limited areas of product offerings. However, in those areas it's very important, we all don't know if it's going to possible. Because it created a discount price position but we need to be in that market alone for a strategic hedge.

I also believe it's a good opportunity that even 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've just stated. I hope that convinced you at least to a certain degree.

Q - Jochen Schmitt {BIO 4227302 <GO>}

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

A - Jorg Schneider

Thank you.

Operator

My next question comes from Frank Kopfinger from Deutsche Bank. Please go ahead, your line is open.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Yeah, thank you. Good afternoon everybody. I have two questions. My first question is on your local GAAP accounts, do you see any risk of any potential write-on of the ERGO book value as obviously once you created ERGO, this restructuring program had nothing within the plans.

And my second question is on the sensitivity, on the overall group targets on your P&C combined ratio target in Germany for 2020, the 92% been very low. And I am how confident are you in reaching this, asset sensitivity is very high. If you don't reached 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 shut 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 accounts. 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 low to equity approach, which discount expected future cash flow.

And this program improved ERGO's position and it also improved in this calculation, the benefit from Munich Re. Therefore it is intendancy positive in spite of the high investments. That means it improved our situation also with regards to the book value. I cannot exclude further depreciations subject to a deterioration of the market and the 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 are right, I mean that's a very relevant question. And then yes, of course, there is no plan without risk. But we are confident. And let me explain why. The reduction of the combined ratio is primarily cost for -- only cost for the nine months. And then the cost development is something you have much better under control that compared to your claims development. And therefore we have the confident to achieve that. The portfolio in itself will be stable and the balance portfolio is something we will maintain, but as I said that 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

Your next question comes from William Hawkins from KBW. Please go ahead, your line is open.

Q - William Hawkins {BIO 1822411 <GO>}

Hey, thanks very much, I am very sorry to drive the call out, hopefully these are quick. Markus, this is a Herculean task you've got. Can 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 measured annually or if 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 profits and everything else that detail or will you get rewarded if you achieved on the investment side even if the profits turns out to be poor?

And then secondly, can you just confirm what you think about the key risks here? Presumably, you've had the green life in the trade unions and sales networks by now, but 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 told by other people that a company that tries to completely rebuild its IT infrastructure is normally going to end up in quite challenged place. So, I assume that's pretty material execution risk? Thank you.

A - Markus Rie {BIO 1835270 <GO>}

Yeah, I'd be -- I'm very grateful for the question on the rewards. I have the same question (Technical Difficulty) no, no just kidding. What actually -- I have been currently working this out asking my colleagues from Munich Re and Nikolaus von Bomhard and Jorg Schneider in particular about the detailed question, about the detailed answer to this question 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 -- in Munich Re shares progressed and we will lend you report, and basically it's made up of yearly component, and multi-year component, three-year component that is and a certain proportion of this compensation, then ultimately goes into Munich Re shares which have many minimum holding periods. But that's the basics so to speak.

In terms of the KPI, 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 500 million net income, because I believe that that ultimately is the one figure that sums it up. I would also like to volunteer the below 30% cost ratio in 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 most -- is higher.

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

A - Jorg Schneider

Yeah, just quickly to interrupt, Marcus on that, and there will be an element of economic earnings too, and this is our basic elements everywhere, be it for the annual compensation bid for mid-term. 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 Marcus Rie 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 mid-term oriented and not based on short-term success.

May I hand back to you with regard to the challenges of the program?

A - Markus Rie {BIO 1835270 <GO>}

Yes, thank you. And then again, you can rest assure 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 is Herculean task, because it's by no means my task, it's our task and we really have to staying together those next five years in order to accomplish that.

But I think it's a sure -- that assure the future -- profitable future of ERGO and that's why it's a side 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 they are very (inaudible). 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 an estimated German systems work. As of today my colleague and 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 with our self-interest to achieve consensus from the workers, representatives on this context, and this usually takes between three to six months plus or today it's not the right time to give any indication on that.

I would, however much consider this as a risk to the program because I believe that our program is convincing, the more important risks are basically twofold. The one risk is all around the sale organization because I have just to be very frank about telling you that we do the -- that we integrate the size -- semi-integrated agency sales organizations into one. This will create a certain disruption, and this might lead to lower productivity in those transitional period.

It's something that's -- lot of company 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, lot of mitigating measures in order for this to be avoided.

The second big category of risk is all around information technology. Your judgment is right, we would 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 potential risk because we don't want to underestimate the complexities and the challenges we see in this context.

However, we have to take this risk anyway. I mean there is no way around for us investing into information technology, so really is -- in terms of marginal risk, really something more in terms of do we envisage happen 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 with transformation experience and that's why I believe we are very prepared.

But I will obviously have to make this one of my priority to observe that this information technology improvement is clearly done fast enough, but also careful enough. Because we want to -- 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 is a capital market risk that Jorg Schneider has already alluded to, there are various other risks in terms of losing know-how areas.

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 risk, they do exist, I feel confident that we can mitigate them but we have to be very observant, not to be too self assure, but really have to question ourselves all the time again, are we doing everything to mitigate this risks, and since I have already had the opportunity of complete transformation in programs like these, and I hope that's given this experience, I can calibrate this mindset in an appropriate session. [ph].

Q - William Hawkins {BIO 1822411 <GO>}

Thank you. Best of luck.

A - Markus Rie {BIO 1835270 <GO>}

Thank you.

Operator

Our next question comes from Michael Huttner from JP Morgan. Please go ahead, your line is open.

Q - Michael Huttner {BIO 1556863 <GO>}

Thank you very much for giving me the opportunity. Two questions, one why today because it was weird right. You kept saying beginning of June, but now you gave a date and then suddenly on Monday or likely which is on 1st of June. What happened that today was okay, I thought it was in unions clearly not.

The other -- I'm still a little bit -- for me the elephant in the room is the interest rates and we've kind of said -- actually the program doesn't address the interest rates. It's not or it's not designed to address other stuff. And I mean, what is the risk, I don't know interest rates go negative and then we have to have a -- we've given the opportunity to revisit program maybe in 60 months' time and have because, negative interest rates which change things quite materially? Thank you.

A - Jorg Schneider

I start with the second. So, 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 in tremendous work in the last couple of months and this was in a way that early as possible moment and from now on, there's a very, very long and intensive workspace. 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 are some protection in place that is -- that we can opt for long-term guarantee measures that we can go for the transitional for valuing the -- 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 mid-term, there is no major challenge from that side.

Q - Michael Huttner {BIO 1556863 <GO>}

Brilliant. (inaudible). Thank you.

A - Jorg Schneider

Thank you, Michael.

Operator

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

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

Thank you and 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.