Q3 2015 Earnings Call

Company Participants

- Christian Becker-Hussong
- Jörg Schneider

Other Participants

- Andrew J. Ritchie
- Andy D. Broadfield
- Frank Kopfinger
- In-Yong Hwang
- Kamran Hossain
- Michael Haid
- Michael I. Huttner
- Thomas Fossard
- Thomas Jacquet
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- Vinit Malhotra
- William Hawkins
- Xinmei Wang

MANAGEMENT DISCUSSION SECTION

Operator

Good day, ladies and gentlemen. Welcome to the Munich Re Third Quarter 2015 Financial Statement Conference Call. Today's conference is being recorded.

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

Christian Becker-Hussong {BIO 19080254 <GO>}

Good afternoon or good morning, everyone. Thanks for joining for our call on our Q3 2015 earnings. Today's set up is pretty simple. Today's speaker is Jörg Schneider, our CFO, and we will kick it off right away with Q&A, as we are certain that most of you have taken a closer look to all the presentation material we have put out this morning. Just one request, as usual, please limit your questions to a maximum of two per person.

Jörg, the floor is yours.

Jörg Schneider

Hello. Good afternoon also from my side. And I am only waiting for your questions, nothing to add.

Q&A

Operator

Thank you. Our first question today comes from Andrew Ritchie of Autonomous. Please go ahead.

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

Hi there, Jörg. I wonder if you could just give us a little bit more color behind some of the investment noise in the quarter. I was a bit surprised at the extent of the impairments on equities. But also just remind us again - I mean, a lot of the noise is coming from your inflation hedging strategy, which is causing this noise in several quarters. I mean, have you kind of looked at that position again, thought about it? Is there a different way, you could treat it in a different way from an accounting point of view? Is it still a position economically you think you want to keep? That would be the first question.

The second question, in terms of the primary P&C businesses, there was fairly weak performance at the technical level both in Germany and internationally. Is there any - is that all kind of large loss on specific UK legal expenses - sorry, large loss on Germany and specific UK legal expenses, international? Is there anything else going on? Is there any review of the businesses going on? Maybe just give us some color as to what your thinking is, as to when they can get back to your targeted profitability. Thanks.

A - Jörg Schneider

Hi, Andrew. Thank you. First, on the noise with regard to our investment results; so the impairments on equities are pretty in line with the market developments. That means we had equities in the order of €10.5 billion and the major stock indices fell by between 7% and 10%. And we had a strong weight on European and here a little bit of more overweight on Germany equities. And so the absolute decline in value was fully in line with the market.

Whether it results in equity, in impairments, or whether it's just a change in the balance sheet value, that is partially random, I would say, because it's dependent on whether the triggers are reached. One is that we either have to have a decline of values of 20%; or the rule once impaired, always impaired. So there were some stocks in it which we had already impaired a long, long while ago, but since they have been uninterruptedly in our portfolio without reaching the 20% threshold, we had to write it down.

We also, for example, wrote down the Volkswagen share and many of these stocks had a decline at the end of September which was clearly above 20%. Meanwhile, most of that has been recovered and could now be seen in the form of unrealized gains again.

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

So, this is a data (05:02) metric through the P&L to the extent these are impaired securities will only get downside – the upside (05:07) will always go straight through the balance sheet?

A - Jörg Schneider

That is true, yeah. That is absolutely true. We will not write it up...

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

Okay.

A - Jörg Schneider

...before we sell it. Second, your question with regard to the hedging strategy, and here especially we had substantial losses from our inflation derivatives and our commodity derivatives. This is also something which is annoying for us too, because it requires a lot of patience here from us internally and especially from you on the capital market.

But we believe in economic hedging, as you know, and we have an exposure to inflation, which is only partially hedged. This exposure especially comes from our P&C reserve. And as long as we have this very low inflation we have the benefit in the ever-growing buffer in our P&C reserves on one side which we only partially realize in the form of reserve releases, and on the other side we have the losses with the derivatives.

As you know, we really believe in this form of economic protection as being in the best interest of the shareholders, because you can have an accounting issue like we may have had in the third quarter, but we can exclude to have an economic issue. And it's much easier to deal with an accounting issue than with an economic issue.

Your next question was about our performance in primary property-casualty. In Germany, we were hit by a number of mid-sized losses, which, for such a portfolio had an impact, an impact in the order of 1 percentage points to 1.5 percentage points in the combined ratio. That means, on an adjusted basis, we would be clearly below 95%.

Are we satisfied about it? To some extent, yes; but not fully. Historically, we have been performing very well and we believe that, over time, we will be back to a better territory here. And the issues were more severe in international, in ERGO International property-casualty. And I would like to mention here Poland where we see a strongly increased competition, we have a very strong company in that market but we are part of the market, and, therefore, we've been suffering from a number of developments here; also from the regulatory side, where our motor third-party business was affected by new regulations with regard to claims handling.

In Turkey, we observed an increasingly challenging market, here also with respect to historic third-party liability cases, motor cases, and we had a negative actual versus expected for the underwriting years pre 2010. Having said that, we are quite confident that our current business is in order and that we will also gain importance in that market.

And then you also mentioned the most severe one-off hit which affected our legal expense business in the UK where we had to make some corrections in our accounting reserve strengthening for the business, which I would quite clearly call as non-repeatable here.

So perhaps also a random accumulation of negative messages, but the international business is challenging, remains challenging. There are a lot of chances but also still a lot of challenges here.

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

So it sounds like – I think it was 97% was your aspiration in that business. Was that right?

A - Jörg Schneider

That is true but we are at the moment some way away from that.

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

Even if I allow for the kind of one-offs it sounds like that...

A - Jörg Schneider

For the third quarter, on a standalone basis, I wouldn't agree. But 97% is quite a stretch at the moment, especially with these developments in our very important markets like Turkey and Poland, which – where we are positive and optimistic mid-term, but short-term it's a challenge.

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

Okay. And just back on the investment return, so any gains that you had on your equity hedges are, I mean, have netted off against the equity impairments?

A - Jörg Schneider

That is true and these gains were substantial. So, for example, for hedge purpose, gains with equity derivatives, they were in order of over €360 million, but they were somewhat compensated by non-cash investments like in the form of futures, yeah, therefore, the net amount was in the order of €150 million.

I'm quite pleased that we increased our equity exposure in the course of September. We were hit by the impairments at the end of September also partially due to that development, but we continued in the beginning of October and seen, from today, that was a good decision.

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

And there's no – you cannot change the treatment of your inflation position, I mean – in terms of, you wouldn't consider getting it out of the operating profit line? I mean, have you looked at possible – different ways of reporting it?

A - Jörg Schneider

We haven't thought about it, because on a nine months basis it's okay. So we – and we can deal with that kind of noise. So on one hand, I regret it, because it always forces us to explain again and again, but sorry. But we also take with a lot of gratitude that the analysts seem to understand it quite well. So the reaction is moderate. And we will continue giving a lot of transparency on our strategies here. And perhaps we should be a bit better in also explaining the sensitivities.

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

Okay, great. Thank you.

Operator

Thank you. We will now move to In-Yong Hwang of Goldman Sachs. Please go ahead.

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

Hi, good afternoon. This is In-Yong from Goldmans. Two questions from me. Firstly, on the guidance for next year, obviously, this year's guidance is €3 billion, but we've had a quite good year in terms of low nat cats and you still got some of the tax benefits coming through. Given that you started the year with €2.5 billion to €3 billion net income guidance, is there anything in your mind that will kind of change that dramatically going forward in your thinking for next year?

Secondly, you mentioned a kind of comprehensive review in ERGO in your press release. I was wondering whether that's just a kind of normal process as you get the new CEO taking over, or does it indicate some underlying issues worrying you like you just mentioned in the international business in the P&C side? So just a bit more on the rationale and then kind of what we can expect from that review, please? Thank you.

A - Jörg Schneider

Thank you, In-Yong. With regard to the €3 billion or €2.5 billion to €3 billion, so I would rather orientate myself to the €2.5 billion to €3 billion because that we are now at the upper end of that range or even above is mostly due to good luck with regard to the major losses. And the noise we had from the investments in this quarter was more or less compensated by the very good tax result. So that means, when I compare 2015 to 2016, I wouldn't be so courageous to say 2016 should be better than 2015; we are still faced with the impact of the decline in the underwriting in the reinsurance rates which we experienced in the last couple of renewals and part of that will be earned only in next year, no matter how the Baden-Baden renewal will work out. So with that regard, I think even a parallel movement between 2015 and 2016, also taking into account the decline in interest rates, is already somewhat optimistic.

New CEO with ERGO, we didn't want to announce anything here. It's much too early. He is working quite hard with his colleagues on necessary changes on the first program and we intend to disclose that in the second quarter. At the moment, we just don't know it. What I wanted to make clear, like I did a quarter ago, that is – that there are some downsides in the ERGO result. When I talk about €500 million expectations, we must see that we still have ahead of us the regular testing of goodwill for impairments and also some other more intangible items which are somewhat dependent on the level of interest rates. And since the low interest rates seem to be somewhat sustainable, when it comes to the valuation process, it might be a stretch to keep all these values. That is what we wanted to flag here, nothing specific with regard to major steps.

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

Sure. Just quickly on the guidance again. Are you expecting still to see some tax benefits coming through next year as well? I know you said we should still see some in the next quarter, but for 2016?

A - Jörg Schneider

Yeah, with the taxes, we seem to have been a little bit conservative with our reserve setting here in that area and I can't exclude that it's going on for a while, it was also due to some very specific effects, had to do with losses we experienced on a pre-tax basis at the end – at the beginning of the millennium, and, therefore, it will not be repeated with the same extent. Having said that, I'm still confident that we are rather on the conservative than on the aggressive side. So as for Q4, like for 2016, I very much hope that we will stay clearly below our long-term tax rate, which should be in the order of 20% to 25%.

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

Great. Thank you.

Operator

Thank you. We will now move to Thomas Jacquet of Exane BNP Paribas. Please go ahead.

Q - Thomas Jacquet {BIO 4110153 <GO>}

Hi. Good afternoon, everyone. Can you give us an update on the capital position of ERGO? Earlier this year, you stated that you had no need to inject capital. Do you stay with this view? And my second question regards regulation. Do you – can you give an update on the systemic insurance issue and what's going to happen to reinsurers? And are we really out of the woods yet on that front? Thank you.

A - Jörg Schneider

Thank you, Thomas. First, on ERGO's capital position, so for ERGO in total we are not faced with regulatory capital requirements. We have the requirements for the Munich Re Group in total and for the solo entities; this is the insurance entities of the Group and here especially we look at our life subsidiaries. Some of the life subsidiaries are, as you can imagine, suffering from the low interest rate which make the valuation of the liabilities extremely expensive, and, therefore, we closely monitor the situation. We look at the interest rates.

It's much too early to say which kind of measure we will take, but there are programs in place which we can use in order to provide these companies with an adequate capitalization. We would not exclude for the time being that we use transition measures, but as things look today, they are at least not necessary. But nobody knows where the swap rates, which are relevant, will stand at the end of the year, and, therefore, it's too early to make an announcement here. But things are well under control.

Your second question about systemic relevance, it's not up to me to comment on it. We are convinced that for many reasons we are not systemically relevant, up to now we are not on the list. The list has been somewhat revised for the primary insurers. As far as we know, no decision has been made, no explicit decision for the reinsurers, also no explicit decision that they stay out. We think that would be the right decision, but it's too early.

Q - Thomas Jacquet {BIO 4110153 <GO>}

Okay. Maybe a small follow-up, if I may, on the primary side. How sensitive is the capital requirement to the UFR at 4.2%? Because I think that the EIOPA has announced that they will change the methodology and probably lower the UFR.

A - Jörg Schneider

Thomas, we do not expect EIOPA to change the UFR in this year, but if EIOPA would change it, we would be only moderately exposed because the UFR is important for the very, very long-term liabilities. On the bulk of the liabilities, it's much shorter, although being already long, and, therefore, the relevance would be not dramatic if there were a decline in the UFR here.

Q - Thomas Jacquet {BIO 4110153 <GO>}

Okay. Thank you very much.

A - Jörg Schneider

Thank you.

Operator

Thank you. Kamran Hossain of RBC Capital Markets has our next question. Please go ahead.

A - Jörg Schneider

Hi, Kamran. Are you there?

Q - Kamran Hossain {BIO 17666412 <GO>}

Can you hear me?

A - Jörg Schneider

Now we can hear you.

Q - Kamran Hossain {BIO 17666412 <GO>}

Oh, you can hear me, perfect. Okay, two questions. The first one, just on the Tianjin loss. Can you just give us a little bit more detail about how you got to that €175 million number, and whether that's a worst-case scenario? And secondly, just on potentially maybe Q4 loss, is there any detail you can give us on exposures to VW? Thanks.

A - Jörg Schneider

Thank you, Kamran. With regard to the Tianjin loss, the market estimates are between €2 billion and €3 billion. This is quite a wide range and this is a clear sign of the high uncertainty. So like our peers, which had already commented on that loss, we can only confirm that there is a very high uncertainty. And our loss estimation is like always, I would call it, a rather conservative estimation but not a worst case.

Then with regard to VW, we have taken care of that loss by setting up a provision, but we can't comment further on this loss, because it's a quite difficult case and we do not want to intervene here to the detriment of our clients.

Q - Kamran Hossain {BIO 17666412 <GO>}

Perfect. Is there really exposure on the investment side, either in equities or anywhere else?

A - Jörg Schneider

We have – sorry, I forgot to switch on the microphone. I repeat. So we have an exposure in our investments in the low triple-digit range and we have already done the impairments in the third quarter on the stocks.

Q - Kamran Hossain {BIO 17666412 <GO>}

Perfect. Perfect. Thanks very much.

A - Jörg Schneider

Thanks to you.

Operator

Thank you. We will now move to Frank Kopfinger of Commerzbank. Please go ahead.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Yes, good afternoon. Thank you. I would like to come back to the underlying negative swing in your non-technical result coming from the derivatives. And my simple question is, for you, what is your advice to us? How should we cope with these huge underlying swings? I think in – just from Q2 to Q3 in the P&C Re segment, this was just a swing of €800 million from the non-technical result. And also where should we see the opposite movements of these swings, as the understanding is it's a hedge is it then an increase in the reserving buffer, or is it simply the real devaluation of your investments?

And the second question would be on – again on the outlook, again also on the statements you made on ERGO. Could you shed some light whether you are rather looking at the goodwills or the DACs there?

A - Jörg Schneider

Thank you, Frank. Yeah, the swing is really not helpful, sorry for that. And unfortunately, we can't show you the opposite side of the coin, that is, especially the technical reserve, the claims reserve, where in this low inflation environment, we should have increasing buffers. What we see in our preliminary numbers for this year, we do it on a quarterly basis in a decently thorough analysis, and at the end of the year then in a broader analysis is that we have still a huge difference between the actually reported losses and the expectation.

So I'm quite confident that reserve releases will go on and perhaps also a little bit or somewhat above our 4% indication for the fourth quarter. But unfortunately, we can't quantify it, because also in the real world there are no clear correlations here which we can precisely measure. Second is the result of ERGO. You mentioned two items, one is deferred acquisition costs and the other is goodwill. Both could be affected, because both are also interest-rate dependent and volatility-dependent, by the way.

And with regard to the deferred acquisition costs, I should also explain that DACs are set up according to parts of the portfolio, to isolated parts of the portfolio, according to product groups and generations which are commonly administered with similar risks. That means we do not have DACs in all portfolios which are affected, and especially the very old portfolios with a guaranteed rate of 4%, typically we do not have any DAC here any longer. And what we do there is we set up premium deficiency reserve and increase the provisions for future policy benefits. And that is what has been happening in the last quarter.

From an economic perspective, it's totally the same whether we write-down an asset, the DAC, or whether we increase the liability. And the latter was much more important here.

Going forward, I do not expect it to happen in the fourth quarter to the same amount, because the annual exercise has been done now in the third quarter, but I can't exclude it for the future, I would rather regard it as being more probable than not that we will see additional hits of that kind as long as the interest rates go on like that.

Second, goodwill, there is a quite substantial goodwill on the Life and Health Germany segment which derives from Munich Re's acquisition of ERGO and it's in the order of €430 million plus some goodwills below this level on individual portfolios, and all of them will have to be tested for impairment in the final quarter. And dependent on the reinvestment rate which we apply in the test, we would have goodwills or we wouldn't have goodwills; it depends also on a little bit of a management judgment here.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Okay. Thank you.

Operator

Thank you. We will now move to Thomas Seidl of Sanford C. Bernstein. Please go ahead.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah. Thank you. Two questions. Number one, has your pricing outlook changed by any means following Baden-Baden in particular? Do you see increasing price pressure in the casualty segment? That was at least what we were hearing post-Monte Carlo following now the nat cat price erosion? And the second question is a bit related to that. How would you see the opportunities to deploy capital organically next year? Looking at your business plan, would you expect markedly lower top line next year?

A - Jörg Schneider

Ja. Difficult questions, Thomas. Thank you. Pricing outlook following Monte Carlo and Baden-Baden, I hear a lot of individual stories on negotiations, but we do not have a clear view yet. We are fighting, as you can imagine, fighting for a stabilization for some improvements in this or the other area. We are not totally pessimistic here for the Baden-Baden renewal, because everybody has to make money and the ever-continuing source of reserve releases and realization of investment gains is not a good basis for doing underwriting in our view, yeah.

Deploy more capital, I don't really know, yeah. So we are prepared. We are also prepared to make acquisitions. Is it probable? No, it isn't. Because since everybody is desperately looking for growth, we see a lot of negative forces in the market; and therefore, it's not highly probable that we will see companies with decent prices which we could acquire, but we can't exclude also that.

And I didn't answer precisely your question on pressure in casualty. I haven't heard that from my colleagues, but the market is extremely diverse. So the very sophisticated players, and I'm pretty confident that we belong to them, they must now especially thoroughly select what they write and what they don't write. And the closer we are to the client and the more we can provide the client with tailor-made solutions, the better we can somewhat distract from the competitive forces in the market.

Q - Thomas Seidl {BIO 17755912 <GO>}

In terms of – maybe a follow-up question on the capital deployment, while not a full-fledged M&A, there should be a quite strong demand in transferring the one or the other back book in life, be it longevity, or be it something else. Is that an area where you would see Munich Re playing, or rather not?

A - Jörg Schneider

We are very skeptical with regard to growth in longevity business, because, very simple consideration, we write that business but with a very careful hand, because in that kind of business where you get the outcome only many, many years after you have underwritten it, you need high margins. And is it - would it be normal to get high margins in a business where those who underwrite it get the answer whether it was profitable or not 15 or 20 years later? We don't believe it.

Therefore, for these very simple reasons, we look with a lot of care to that business and we write it, but we do not expect it to be a source of substantial growth. The same applies for other areas of living benefit business, especially, which is also particularly difficult. So we continue writing it, but we could somewhat lag behind with regard to growth to some competitors.

Q - Thomas Seidl {BIO 17755912 <GO>}

Okay. Thanks, Jörg.

A - Jörg Schneider

Thank you, Thomas.

Operator

Thank you. Our next question comes from Vinit Malhotra of Mediobanca. Please go ahead.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Hello. Good afternoon. Just - one thing on portfolio management and in the context on the liability on the book, on the reinsurance book. We've seen the underlying normalized combined ratio has slightly improved and I know it could be quarterly volatility. But is there some evidence - or how do you feel about these new risks, Jörg? Because we have seen a new - we have seen a reasonably well-publicized case in the UK recently of cyber risks - of cyber theft. And one of the reasons I ask it is because in Monte Carlo, there was a lot of talk about how Munich Re is doing innovation. So is there some visible effect already of some of the - the focus on pushing out some of the bad business and replacing with somewhat better of these niche product lines? That's just - any comment on that, please.

And second thing is, I have noticed that the interest rate duration, the DV01 has changed quite - quite reasonably changed in the quarter and I appreciate it might be small, but, again, this is in context of the whole discussion we've been having in this call on the derivatives and the - but was that - I mean, is that - has that happened to minimize some risk, or is it just to tactically position the Group a little bit? If you could comment on that, please? Thank you.

A - Jörg Schneider

Thank you, Vinit. On your first question, yes, you saw, and I'm also pleased about it that the normalized combined ratio went down in comparisons with the second quarter. That does not – sorry, for being again negative somewhat, but that doesn't imply a substantial improvement, but it underlines that the very bad number of the second quarter was not sustainable but was driven by one-offs, especially by a couple of major losses below the major loss threshold, so mid-sized losses especially in our risk solution business. But it clearly shows us that it is not a given that we go above 100%, that we can stay within the range between 98% and 100% perhaps.

And the innovative business is very high on our agenda. We are investing a lot of effort and a lot of money I also want to say, not money of the kind you would take notice of, but we really invest in that business and the whole organization is on its toes, because we know that this is the source of future growth and of profitable growth.

Having said that, we must be careful, and we do it at the beginning of each initiative here with relatively low budgets and so we do with cyber business. We expect cyber business to become really a very important line. But we must gain experience here and that's currently happening.

And this improvement from 99.9% in the second quarter to 98.1% in the third quarter has nothing to do with this innovation initiative, ja. It's more random like the major loss impact. But I would guess one year or two years down the road you must see much more impact also in our numbers from the innovation initiatives, because we are really confident that we can create good value out of these.

With regard to the interest rates and to our position with regard to duration, you notice that we decreased our duration, our active duration positioning in reinsurance. This is absolutely true. It's rather a tactical move. So we brought down our benchmark portfolio and the very short-term tactical moves of the asset manager MEAG went into the same direction. That means we gave up our long-duration position in reinsurance. We are still not very short as you can see from the numbers, but there is a change, that is true. That means that we do not believe in ever-declining interest rates.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Is it more a U.S. exposure, or even...

A - Jörg Schneider

Yeah. That is true, there's a lot of U.S. exposure and we also have a currency bet still open that is long U.S. dollar and we believe that the U.S. capital markets provide good value at the moment. Thank you, Vinit.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Thank you.

Operator

Thank you. We will now move to Michael Huttner of JPMorgan. Please go ahead.

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

Fantastic. Thank you very much. On the ERGO potential write-down, how much is the risk amount (39:12) we are talking about? So that would be one question.

On the ERGO combined ratio, in the old days ERGO used to be really good, because you had that lovely accident business, which was, I don't know, combined ratios of maybe 50% or 60%. And I just wondered where that's gone. Generali today reported Germany at 91% and you're significantly above. So I'm not quite clear if suddenly that portfolio has been given away or something?

And then the other question on the innovation. I had the impression that innovation was a static number. In other words, you've got it, it's good, it helps reduce the reinsurance, but it's kind of a rolling thing, it doesn't kind of increase. But your comments just now imply that it is increasing. Can you give us a feel for the magnitudes we're maybe talking about? I had in mind that the portfolio was about €400 million. Thank you.

A - Jörg Schneider

Yeah. Michael, it's still €400 million, yes. So there we do not see a major increase at the moment, but I would expect for next year that we see more. With regard to ERGO write-down, did you ask for risk amounts or how much is in the fire, or what was your question?

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

Yeah, it's kind of risk amount. So we've got the figure of goodwill which is potentially at risk of €430 million, which could be already judged in Q4. And I was just thinking what would be the amount we should think we can – the base amount which relates for 2016 for the DAC part of it?

A - Jörg Schneider

Yeah. It's difficult. So in theory you could think of the whole €430 million plus some €60 million which are below the level of ERGO and its subsidiaries, but that would be a very pessimistic view. But I can't say more at the moment. If I knew, we would have booked it.

Then ERGO combined ratio Germany, this is an interesting question. What is the reason for the deterioration? How much is it structural, I would also interpret your question.

There is one structural element that is, we've always been extremely good with personal accident business and the growth in that business is somewhat lagging behind at the moment. So the respective share of personal accident in the whole portfolio has been declining. Also the whole market has had its challenges, motor business on an extreme competitive basis, then home owners business, things like that. So a lot has been addressed and I'm sure that we will at least improve our respective market position in the years to come.

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

Okay. Just going back on the ERGO, so maybe I – just so I understand, so the €430 million plus €60 million, that's the envelope, if I would call it that way, or the potential set the maximum on the goodwill. Is there a separate figure for DAC, or is that everything included?

A - Jörg Schneider

That's okay. Yes, that is the maximum on the goodwill in Life and Health segment, yes, that is true. And then we can talk about other intangibles, but this is now a very negative view. So as far as I see, now we do not have indications that it goes that far.

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

Brilliant. Thank you very much.

A - Jörg Schneider

Thank you, Michael.

Operator

Thank you. Michael Haid of MainFirst Bank has our next question. Please go ahead.

Q - Michael Haid {BIO 1971310 <GO>}

Yes, yes. Thank you very much. Just one question also to – relating to life primary insurance, your DAC write-downs and what you mentioned before, possible additions to the premium deficiency reserve, can you explain how the mechanics work there? How DAC write-downs are shared between policyholders and shareholders? And when you set up the premium deficiency reserve, how does the mechanics work here with respect to sharing of the burden with the policyholders? That's my only question.

A - Jörg Schneider

Yeah. Thank you, Michael. So it's fully shared, because all acquisition costs – so we start with German local GAAP and all – or more or less all gains and expenses are shared between policyholders and the company in a way as part of the whole, (44:12) in German. And also when you set up a DAC, which is an asset here, this is also shared with the policyholders and therefore it's also shared when you write it down as long as you have enough potential on the policyholders' side to put burdens on it. And this is currently the case. So it's basically a 90/10 sharing.

Q - Michael Haid {BIO 1971310 <GO>}

And the same applies for the premium deficiency reserve?

A - Jörg Schneider

Yes. Absolutely the same. And this is logical because it's economically the same origin. It's just done on the other side of the balance sheet.

Q - Michael Haid {BIO 1971310 <GO>}

Okay. Thank you very much.

A - Jörg Schneider

Thank you, Michael.

Operator

Thank you. Our next question comes from Andy Broadfield of Barclays. Please go ahead.

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

Hi. Good afternoon, Jörg. Two questions, please. One, on the reserve buffer, I think in the past you said you kind of want to keep it static, so you won't be using your reserve. I shouldn't say buffer, but your margin of surplus on the reserves. You had no intention to increase that. But I think I get a sense that year-to-date you probably have. Can we just assume that by year-end you'll true that up to maintain a sort of stable reserve situation there?

And the second question is, just on transitionals for ERGO. My assumption is that you would – will intend to adopt transitionals. I forget whether you said – whether you've confirmed or denied or done neither on that yet, but could you just give us some color on your intentions there, if possible, please?

A - Jörg Schneider

Thank you, Andy. First, reserve buffer; our intention is to keep it stable. So I have a long history here, as you know. I started with a huge deficiency in the United States, which came as a shock to us, and then we said here, internally, never again. And in the course of the following year, we exaggerated a little bit the conservatism, not willingly, but due to the interpretation of our message, of Nikolaus' message and my message here in the internal organization. So we went perhaps a little bit above what had to be done.

We do not have any intention to increase that buffer, but we still believe that with a change in economics, especially with a change in inflation, there could be a spike in reserving needs and therefore we do not want to decrease it. And also, I want to emphasize, we do not want to use the reserves to manage earnings.

In our view, reserves have nothing to do with natural catastrophes, have nothing to do with a deficient market or so; reserves are set as we needed. And we are a bit afraid of diluting and watering down the necessary message of underwriting discipline by pushing reserve buffers into current earnings.

Therefore, at least as a rule, we do not intend to react with reserve releases to weaken the markets. That is at least our intention at the moment. You never get it precisely. That means there's always room for estimation, there's room for error, but our policy is very clearly that we say reserves must be set in a conservative way.

With regard to the transitionals, we also look at the market. So, for example, if interest rates go down to a level where they were at the end of the first quarter with the swap rates way below the average of the last couple of quarters, then I assume that almost each company in the market would have used it. Where we are now, we wouldn't need it. We have other tools in place and the capitalization of the companies will be all right. So we just have to wait. And as far as I see today, we will not use transitionals.

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

Okay. Thanks very much.

A - Jörg Schneider

Thank you.

Operator

Thank you. We will now move to William Hawkins of KBW. Please go ahead.

Q - William Hawkins {BIO 1822411 <GO>}

Hi. Thank you very much, Jörg. Just one question on economic solvency and capital management. You flagged in your prepared remarks that your economic solvency ratio is lower by September, and I'm assuming that's before any impact of the dividend at the full year. So on a like-for-like basis, I'm reckoning, at the moment your economic solvency ratio is in the low 130s. If you could confirm that?

And then, more importantly, how disappointed are you by that? Because Munich Re wants to position itself as an absolute return play with low market risk. Year-to-date we've had one of the best underwriting claims experiences for many years. And whilst there's been market stress, it's not really been the worst market experience one could imagine and yet your economic capital is going down. So I'm wondering what you think about that? And how that may in any way influence your capital management decisions at the end of the year?

A - Jörg Schneider

That is an interesting question. First, I can confirm the low 130s. This is not official; this is not precisely calculated, but it's the right ballpark number. You also mentioned that with such a lot of good luck from underwriting that it should be better than that, there should be an improvement. I do not quite agree, because we had a further decline in interest rates, which is clearly negative for our economic solvency ratio. We had also an impact from currencies on both sides.

So with regard to the available capital and with regard to the economic risk capital, we had widening spreads, which is important here. Widening spreads are one-sided negative. And if you take all that into account, these economic factors are so important that I must say I'm not overwhelmed by the number, but absolutely not disappointed. And we do not expect any negative development from the final calibration of numbers and adoption to the Solvency II world.

Q - William Hawkins {BIO 1822411 <GO>}

And, I mean, just one comment. I still think the eurozone swap yield is actually higher than it ended last year, which I would have thought was the main driver. But what do you think about capital management for the end of this year? Is a tighter solvency rate making you more cautious on your capital flexibility?

A - Jörg Schneider

No, not really, because, William, we know that this is not our constraint. We are in a very high territory. By the way, we look forward to meeting, hopefully, many of you in the course of an analyst greeting at the end of the month in London at November 30 where we will provide you with a comprehensive overview on our capitalization on Solvency II, where we will do a reconciliation of our end of 2014 numbers to the new world where we will translate the available financial resources into own funds and our economic risk capital into the solvency capital requirement according to Solvency II rules. And there you will see that we are in very safe territory for our Solvency II capitalization also taking into account a substantial buffer which we will need as a reinsurer.

So it's still about our local GAAP earnings where we have to look at, where we are very careful, where we have tools in place to actively manage it, if necessary, and our whole perception about how much buffer do we want to keep. But it will not be the economic capital number, the economic solvency ratio, which will be experienced as the main obstacle to capital management from Munich Re.

Q - William Hawkins {BIO 1822411 <GO>}

Okay. Thanks, Jörg.

A - Jörg Schneider

Thanks, William.

Operator

Thank you. We will now move to Xinmei Wang of Morgan Stanley. Please go ahead.

Q - Xinmei Wang {BIO 17860767 <GO>}

Hi. Thanks for taking my question. It's Xinmei Wang from Morgan Stanley. I have two questions, please. The first is on man-made losses, I'm not sure you've touched on this before, but I see you've kept your annual expectation of 3.5%. And I was just interested in your thoughts, because we've heard some commentary from some of your peers, some saying that they expect the high level of man-made losses they've seen so far sort of normalizing over the next couple of quarters whereas some saying that they've seen an increased frequency of man-made losses and had to factor that in. So I'd be quite interested in your thoughts on that.

And then my second question is just a follow-up on the reinsurance duration comment from before. Is the shortening of duration, is that something you're going to be willing to do in the next couple of quarters in anticipation of sort of an improved macro environment? Or is that where you want to be already at the moment? Thank you.

A - Jörg Schneider

Thank you. So I'll start with the duration. We feel okay where we are at the moment. There are no plans to decrease it further. Especially, we do not want to take a strong bet on rising interest rates.

First question, man-made losses, yes, we observed them having been high in the last couple of quarters. It reminds me of the opposite situation where we had very low man-made losses, very high nat cat losses and where I personally felt that we should revise the split between the two, so we do at the moment, but without a clear outcome. For us, most important is that the guidance we give you in total, that is 12%, still fits. And this I can clearly confirm.

So when we calculate both, the sum is in any way okay. With regard to the split, it may be that the reality in man-made is a little bit higher than the 3.5%, but we would not end up in a totally different territory here. So you can – for the time being, you can rely on 12% being still a very good indication going forward for major losses in total.

Q - Xinmei Wang {BIO 17860767 <GO>}

Okay. Great. Thanks a lot, Jörg.

A - Jörg Schneider

Thank you very much.

Operator

Thank you. Our final question today comes from Thomas Fossard of HSBC. Please go ahead.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes, good afternoon. Good afternoon, Jörg. Just a quick comment from your side on the life re operations; how things are going there? How are you comfortable with the trends in the technical results? I must admit that looking at slide 26 of the slide pack, I've been a bit confused by the first comment on the technical results where, obviously, you're still pointing to large mortality claims in Q3. So if you could just clarify what are the underlying trends, thank you?

A - Jörg Schneider

Q3 was good. Q2 was disappointing. There is always a lot of volatility in it. We regret that. The reason is not that we had huge developments in one or the other direction, but rather that each change in assumptions then has to apply on the whole future of some decades sometimes, and this on a quarterly basis comes with such a high volatility. We had a very big individual loss here. If you take that out, you could already explain the whole difference between 2014 and 2016, or more than that. So we are not worried.

And what we observe at the moment with regard to the basic mortality and mortality trends, which are the most important parameters here, especially in the United States, or our experience with the disability business, no bad news recently. And there's also as far as I know nothing in the pipeline. So our expectation is that 2015 will end up somewhat lower than originally anticipated, but that for 2016 we should be back where we want to be, that is, a technical result in the order of €400 million.

Q - Thomas Fossard {BIO 1941215 <GO>}

Thank you, Jörg.

A - Jörg Schneider

Thank you, Thomas.

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

Okay, thank you. Thanks to all of you for joining us. Further questions, as always, please just feel free to give us a call. Otherwise, we are looking very much forward to seeing all of you or most of you in London on November 30 for our briefing on Solvency II. Thank you very much.

Operator

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