Q1 2018 Earnings Call

Company Participants

- Giulio Terzariol, CFO & Member of Management Board
- Oliver Schmidt, Head of IR

Other Participants

- Andrew James Ritchie, Partner, Insurance
- Arjan Van Veen, Executive Director & Equity Research Analyst of Insurance
- Farooq Hanif, Head of Insurance Research in Europe
- Johnny Vo, MD
- Michael Hermann Haid, Analyst
- Michael Igor Huttner, Senior Analyst
- Nick Holmes, Equity Analyst
- Peter Eliot, Head of Insurance Sector Research
- Thomas Seidl, Senior Analyst
- Vinit Malhotra, Banca di credito finanziario S.p.A., Research Division

Presentation

Operator

Ladies and gentlemen, welcome to the Allianz Conference Call on the Financial Results of the First Quarter 2018. For your information, this conference is being recorded. At this time, I'd like to turn the conference call over to your host today, Mr. Oliver Schmidt, Head of Investor Relations. Please go ahead, sir.

Oliver Schmidt {BIO 2473131 <GO>}

Thank you, Esperanza. Yes. Good afternoon from my side as well. Welcome to our conference call. There's nothing specific to be added from my side today. So without further ado, I hand over directly to Giulio.

Giulio Terzariol {BIO 17125489 <GO>}

Good morning. Good afternoon to everybody. I understand that most of you had time to see the numbers, understand the numbers. So I will go quickly to the presentation, then I'm going to take your questions.

Overall, we had a good start in 2018. When you go to Page 3, you can see a few key indicators. Our revenue on an adjusted basis are up 5%. And this is driven by all segments. When you look at operating profit, the operating profit decreased by 6% or EUR 176 million. We need here, however, to consider 2 effects. First of all, we had a translation -- currency translation effect of about EUR 140 million and also, we had a positive one-off in 2017. And this positive one-off has now materialized again in '18. If you adjust our operating profit for the currency translation effect and also for this positive one-off in prior year, the growth in operating profit would have been 4%.

Then when you look at the net income, we see an increase in net income of 7%. Here, we have 2 primary effects. First, we have lower restructuring expenses compared to last year. And secondly, we had also a lower tax rate in 2018, with about 24% compared to 29% in 2017. The lower tax rate is primarily driven by the U.S. tax reform.

If we move to Page 5, you can see here the IFRS equity and the solvency ratio. The IFRS equity has decreased by EUR 2.3 billion. This has to do with the lower amount of unrealized gains on bonds by about EUR 2 billion, then we had the impacts of the buybacks for the period January to March, that was about EUR 1.5 billion. Then we had also, in aggregate, EUR 0.8 billion because of FX effects and the Euler (OLB) transaction. Net income is also accounting clearly in the shareholders' equity with a positive amount of EUR 1.9 billion.

On the solvency ratio, you can see a decrease of 4percentage points. I'm going to come back on this number in a few seconds. If you look at the sensitivities, there are no major changes compared to the sensitivities that we showed to you at the end of 2017. There is just one exception, when you look at the interest rate sensitivity, the interest rate sensitivity down is now minus 7% for the 50 basis points. At the end of the year it was minus 11%. And on the way up, we have now positive sensitivity of plus 5% versus plus 2% at the end of '17. The reason for the change is a requirement to the model in the way we calculate the interest rate volatilities under stressed scenarios. But in general, I would say the sensitivity level is pretty stable. And if at all, slightly improve on the interest rates sensitivity.

If you go to Page 7, we can speak a little bit about the solvency ratio development. As you see, we had a 4percentage point impact due to regulatory changes. There are 3 main items here. One is the change to the UFR. We had decreased the UFR by 15 basis points following the instruction coming from EIOPA. Then, we had to include some transferability restrictions related to the business in the (U. S.A.) Then we had a collection of minor model changes. So each of these impact had more or less a contribution of 1/3 to the 4percentage point deterioration that you see in this number.

When you look at the operating generation, it's 10%. If you adjust for taxes and also for dividend, the contribution would be about 5%. This is slightly higher than the contribution that we would generally expect, which is more about 4%.

On the market impact, the change is mostly due to FX. When you look at the pure market impact after-tax, that's very minor. Then on the capital management, the management action, you see a minus 5percentage point. Here we have the EUR 1 billion of dividend that we are deducting in the calculation of the own funds for Solvency II and then we have also the impact due to the transaction with Euler Hermes and OLB.

And finally, on the position of tax and other, most of that amount is driven by the taking into consideration for taxes. Overall, the solvency ratio, 225% is very strong. So we continue to be at the very strong level of Solvency II ratio.

And now if we go to Page 9, we can look at the numbers for our Property and Casualty segment. The internal growth was 4.4% (sic)(4.9%). Here, we need to consider that there is some volatility due to the AGCS business. So if you adjust for this kind of volatility, the growth rate would be more about 3.5%. And so this 3.5%, about 2.5% is driven by volume and slightly more to 1% is driven by price.

If you look at the single entities, I would say Germany is standing out, with a growth rate of 4.4%. We see also a good growth rate in Spain. Then also, if you go to the bottom of the page, you see nice growth rate in Allianz Partners and credit insurance. There are only 2 companies on this table which are showing a negative development of revenue. One is the United Kingdom. This has to do, however, with an accounting change. If you adjust for the accounting change, the growth rate would be 3%. And in the case of Italy, you see a minor, minor sign. The situation in Italy is, however, way better compared to the trend that we had one year ago.

And finally, if you look at the change on renewal, overall, you see a situation which is either positive or stable. So from a pricing point of view, we are generally in a good environment.

And now if you move to Page 11, you can see the development to the operating profit by different drivers. The underwriting results has improved by EUR 80 million. This was driven by the combined ratio improvement. On the other side, the investment results decreased by about EUR 60 million.

Focusing now on the combined ratio, the improvement of 80 basis points has materialized despite an increase in the load due to natural catastrophe, which was 2.6% versus a very benign 1.1% in prior period. So now if we adjust our combined ratio for the natural catastrophe, if we adjust also the combined ratio for the amount of runoff, we have an improvement of about 1.8% compared to the prior period. If we also do an adjustment for the large losses, the weather-related claims, the improvement in the combined ratio would be 1.1%. Anyway, no matter how you look at this number, there's been an improvement in Q1 2018 versus the level of Q1 2017. I guess the question is going to be, can we get to the 94% considering that we are 94.8% as of Q1? My answer is clearly, yes. And just to give you a perspective. The natural catastrophe load of 2.6% is 40 to 50 basis points higher compared to the normalized expectation. And clearly, our 94% is always based on normalized expectation. So if you adjust for that, our combined ratio for Q1 would be already 94.4%, 94.3%. Then, usually our runoff at the end of the year is higher than the 3.2% that you see here. So that would already put us at 94%. Then also there is a third element, usually in Q1, the combined ratio, the loss ratio, tends to be a little bit higher than for the remainder of the year because of the winter condition. So when we do a easy possibility check about our ability to achieve a 94%, we believe that under the assumption that natural catastrophe are going to be more or less in line with the average over the last years, we should be definitely be able to get to the 90 -- 94%.

If we move to Page 13, you can see the operating profit and the combined ratio for the different entities. I believe what is eye-catching here is the combined ratio in Germany with 100.9%. Here, we need to consider that we had a significant impact of natural catastrophe. Indeed, I would say that almost half of the natural catastrophe that we had for the group happened to be in our German operation and also, we had some large losses. So if you adjust the combined ratio Germany for the large losses and especially for the natural catastrophe, the combined ratio would be in the range of 93% to 94%, which is in line with our general expectation.

In France, you see a slight deterioration, this is driven by lower runoff. But the underlying business is proceeding well. Then you have a bunch of companies with very good combined ratio. Also then in Australia, United Kingdom, you see a normalization, the results compared to the level of Q1 2017. And in Latin America, we are making continuous progress towards a better combined ratio.

In Turkey, you see a deterioration of about 6%. And this is driven by the change in regulation, which happened in the Second Quarter of 2017. But overall, we still have a good operating profit in our operation in Turkey.

Then AGCS, you see also a better combined ratio compared to last year. And in the case of AGCS, we had higher natural catastrophe compared to 2017. But on the other side, the amount of large losses has been significantly lower.

So overall, I would say the group picture, you can see lots of improvement in different companies.

If we move to Page 15, we show here the operating investment results, which decreased by about EUR 60 million. Of the decrease of EUR 60 million, I would say almost 60% is explained by FX effects. And then as you see the current yield has decreased by about 2 basis points. Now if you annualize the 2 basis points, that will be about 8 basis points growth for the year, which is definitely consistent with the expectation that we had set in our plan. Indeed, I will even say that what we see now is slightly better compared to what we had put in our plan. But that's very important, when you look at this number, to consider really for the impact of the FX, because sometimes we forget that component and clearly, there you need to run this FX effect across all line items in the P&L, not just investment results. But that's something that has to be considered as you try to work out your numbers.

And with that, I will close my remarks on P&C and come to the Life segment. In the Life segment, at Page 17, the first thing to highlight is that the mix of preferred product is now 83%. Our target is 80%. So as of Q1, we are better than our target of 80%. This is also not necessarily surprising for the First Quarter, because in the First Quarter, we have a little bit more production in Protection and Health compared to the remainder of the year. Still, we are confident that we're going to get to 80% or very close to 80% mix, by the end of the year. So from a mix point of view, we are moving definitely in the right direction. I'd like also to tell you that in 2013, the amount of preferred product was less than 50%. So we had a big change in the quality of the business.

When you look at the production level and the growth, adjusted for FX, the growth rate was 5.4%. And you can see very nice growth in Germany Life. You can see, in general, nice growth also in France, Benelux, Asia Pacific. U.S.A., where you see a negative amount of 9%. If you adjust for the FX, the growth rate would be plus 4%. And I would say the only notable exception on the growth, as I mentioned, is Italy where you see a decrease of 12%. This is related to a high level of unit-linked production in prior periods. But overall, from a growth point of view, after a successful 2017, you can see that also in '18, we have growth back in our Life business.

If you move to Page 19, we show here the operating profit, which decreased by about EUR 90 million. On the one side, there is the impact due to FX. And this was about half of the EUR 86 million deterioration operating profit. And the rest of the impact is coming from Allianz Life. In last year, the market condition in the U.S.A. were very good. Just remember how low the volatility was in the United States, with the mix being at 10% or even lower. And now as we went into Q1 2018, we saw higher level of volatility. As you maybe remember, the conversation that we had in the last months, we had also anticipated somehow that we were going to see higher volatility in overall. And especially in the U.S. in 2018. So when you look at the operating profit for the segment, we are at almost 1.1%. Our outlook is 4.2%. So from the point of view of how we are performing against our expectation in general, despite having some more severe condition in the U.S., we are doing fine.

And just as a note for you, the impact of what is happening in the U.S. is visible, especially under the guaranteed savings and annuity, where you see a swing of about EUR 80 million. This is all driven by the VA business of Allianz Life.

Moving to Page 21. The value of new business has increased by 8%. And generally, you see an improvement across the board. The improvement is driven by, in general, by higher production and higher new business margin. Now focusing on Germany, you can see very nice growth, both in value of new business and operating profit. When you look at the U.S.A., the value of new business is down. But that's due to FX effect. Adjusted for that, that would be flat. Then on the operating profit side, you see a big swing. And this is a reflection of what I was saying before, last year was extremely positive. And this year, we are just behind plan a little bit. But that's very important to understand the results, a big swing from one period to the other period.

In Asia Pacific, it's down on value of new business due to FX. But when you look at the operating profit, you can see a healthy operating profit growth, even without considering the adjustment for FX.

And with that, I will move to Page 23, where you can see the investment margin. Investment margin for Life has remained more or less stable at 23 basis points. If you annualize the 23 basis points, you get to 92 basis points on a yearly basis, which is in line with the guidance that we provided to you of 90 to 95. When you look at the net harvesting and other, you can see definitely a lower amount in Q1 2018 versus Q1 2017. This is clearly putting some pressure, if you want, on investment margin. But on the other side, the profit share is also going down. So eventually, the profit share is going to be somehow adjusted also according to the level of harvesting that we are getting on an IFRS basis. So the end result is the investment margin is pretty stable and especially is consistent with the guidance that we provided to you in the past.

Now coming to Asset Management, Page 25. The situation in Asset Management is as follows. The assets under management has remained more or less stable. And as you see, we had also in Q1 2018, a good level of inflows at the GI and clearly, especially at PIMCO. But both entities have showed a nice inflow level. On the other side, we had a negative impact due to FX and also a negative impact due to market development, both on the equity side and also on the fixed income side because of the increasing interest rates. So net-net, when you put altogether our assets under management have slightly decreased compared to the level at the beginning of this year.

And when you move to Page 27, you can see that the revenue growth adjusted for FX and also for the inclusion of ACP and AGI, I'm going to speak about that in one second, is about 9%. Clearly, the revenue growth is very strong at PIMCO, with plus 14%. And in the case of AGI, you see a minus sign. The point here is driven by lower performance fees. This is not evident when you look at the slide, because the performance fees, they look like they reduced only by EUR 8 million. But in reality, in the EUR 19 million performance fees, we have also EUR 15 million coming from ACP. ACP is our Asset Management, which is managing private equity, alternative equity investment for our operation and starting with Q1 2018, we have included this business into AGI. So when you adjust the number for ACP, you will see that the revenue, the performance fees at AGI have been lower compared to the prior period and this is explaining why the revenues are overall down.

What is very important to notice on this slide is the development of the fee margin. And as you see in the case of PIMCO, it's pretty stable. And it is very much stable when you compare to the level in Q4 '17 and the previous quarter. In the case of AGI, it's even up about 1 basis point. This is also driven by the fact that we don't have our Korean entity anymore. Adjusted for that, anyway, the increase in fee margin would still be positive. So overall, we saw over the last 3, 4 quarters, a lot of stability in this indicator, both at AGI and also at PIMCO.

And now, we come to Page 29. As you see, the operating profit has increased by 4%. And this is driven, at the end of the day, by higher revenue and also lower cost/income ratio. When you look at the PIMCO numbers, you see an operating profit increase of 8%. Adjusted for FX, the increase at PIMCO will be 24%. And clearly, you see here also a substantial reduction of the cost/income ratio. In the case of AGI, you have a decrease in operating profit. This has to do with the lower amount of performance fees and also last year, we had a positive one-off in AGI of about EUR 10 million. Now I think the expense ratio is kind of eye-catching. It has increased by 4percentage points. Here, we have the effects of ACP, which is a company, which is, as I was saying before, managing our own assets. So we are running this company using their cost plus markup method. So from a cost/income ratio, the cost/income ratio of this company, if you want, is particularly high. So if you adjust for that, the increase in cost/income ratio at AGI will be 2.8%. And this increase in cost/income ratio is then driven by the lower amount of performance fees. So once you do some math, you can see that the cost/income ratio of AGI is relatively stable.

And now we come to Page 31, where we have our corporate segment. Here, you see a decrease of EUR 140 million. There are big portion is driven by, or the substantial portion is driven by Holding & Treasury. As I was saying before, we had in prior period a one-off related to the cost allocation scheme for our pension provision between the German subsidiary. So there was about EUR 150 million. And this EUR 150 million is not repeating this year. It's not going to repeat also for the future and that has been the main driver for the decrease in operating profit in corporate. And this was also part of our outlook and our plan.

And now coming to Page 33. Here, we are showing the non-operating items. In general, there are 2 things I want to say here. First off, the restructuring charges are lower compared to Q1 last year. So that's a driver, also, the improvement in net income. Then clearly the effective tax rate, the 24%, is definitely below the last year level. Here, we had 2 effects. First, we had the tax reform in the U.S.A. with an impact of 3percentage points and then also we had tax-free income and the impact of that was about 2%. So at the end of last year or the beginning of this year, we gave guidance that our tax rate should be between 26% and 28%. Based on the numbers, how they are coming along, I would definitely guide you to the bottom of the range. So the expectation is that we're going to have a tax rate of 26% by year-end.

And so now I am coming to the last slide, where you can see the snapshot with the KPIs for the Renewal Agenda. I would like to draw your attention to the number Life/Health OEs, with an ROE higher than 10%. Right now we stay at 71%. Our target is to be at 100%. And we are still confident that we are going to get definitely over the 90% level and close to the 100% level. We have 3 entities, mainly France, which is a big entity, contributing, I will say, more than 15% of our IFRS capital, which is very close to the 10% ROE. But they didn't make it in Q1. But we know that they're going to be able to make the ROE by the end of the year. So from that point of view, also their number, which looks like distant from the 100%, is going to look definitely better at year-end of 2018.

So my final comment is we had a strong quarter starting to the year, with good revenue growth. Also, if you look at the operating profit development adjusted for FX and one-offs. If you look at the KPIs, like the combined ratio, the value of new business, the mix in Life. And also if you look at the growth in PIMCO and AGI for the First Quarter, the development was, in general, pretty solid. And clearly, there is still some work we need to do. But we feel that we are on track to get to our objectives for 2018.

And with that, I would open up to your questions.

Questions And Answers

Operator

(Operator Instructions) And we'll take our first question from Michael Huttner with JPMorgan.

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

It's such a delight and such easy -- well, they look like simple numbers. So thank you. Then on the organic capital generation, the 5%. And I think you kind of said that in there, the underlying rate is around 4%, which is -- well, maybe I'm mistaken. Maybe you could talk us through how you see it developing? And I'd be interested if -- you know, there clearly is going to be a positive variance versus your target of 10% net of divi and tax by the end of the year. And I'd be interested to understand where this variance comes from and how long it's likely to persist? I'm trying to kind of reconcile it to the EUR 500 million figure you showed at the Inside Series in London in November, where you showed the EUR 500 million. That'd be the first question. Then the new business value growth is fantastic. It's really nice. And none of this is easy. And I just wondered how much more do you think it can, grow given that you have your target mix and everything, or would you expect it to be stable at these levels? And maybe. But optional, what is the solvency figure at the year-end? Anyway, there we are.

A - Giulio Terzariol {BIO 17125489 <GO>}

Okay. So where we start? I'm not so sure I got fully your first question. But I think I got it. But if I didn't, yes, just ask again. Anyway, I believe the question was how we look at the 5% operating profit generation, First Quarter, compared to an expectation that we have. I will say that our expectation would be more around 4%. And now if you look at the number for First Quarter, you can see on the Life side, we had a EUR 1.7 billion contribution. Now you can almost (inaudible) this EUR 1.7 billion by taking out about EUR 500 million of value of new business pretax. And that will be EUR 1.2 billion. Usually, we would expect the operating profit contribution to be about EUR 0.9 billion. So there is a gap of 0.9 to 1. So there is a little bit of an excess this quarter, if you want, of 0.2 to 0.3. And if you put the number after-tax, you get close to the 1% of -- get to the 4%. As far as the guidance that we gave before, we said about 10%, we have been most likely conservative. So it might be that we are going to run higher than 10%, as we said and we might run somehow substantially higher than the 10%. But we are always very cautious with somehow, with this number. But we feel pretty good that definitely, we should stay about the 10% level. So we don't have doubts about that and most likely we are going to end up more towards the 14% or 15% level. Does this answer your question?

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

It does, indeed.

A - Giulio Terzariol {BIO 17125489 <GO>}

Yes. Then you had a question on how the solvency ratio is at the end of the year. So I tell you, nothing changes. I gave you pretty much the numbers to do your math. So in theory, that solvency ratio can go also towards 235%. But then you have, as usual, market movements and that might change the picture. And clearly, then this raises the question what are we going to do from a potential buybacks point of view, whether we are going to have M&A. But if you just let this number go up, then the expectation will be, everything else being equal, that we will be about 235%. Now I'd like to, anyway, show you something. When you look at the Slide 7, you can see that our operating profit generation -- operating Solvency II generation was 10%; after tax, after dividend, is 5%. And as you see, we had deployed in 2018, the First Quarter, also 5% of capital. Here, you have for example, the 2.5% would be the amount due to Euler Hermes minority buyout and OLB, the consolidation. So from that point of view, we are already deploying some of this capital generation, the rest is dividend. So from that point of view, we are taking definitely action in order to put our excess capital to work in a productive way. Then the last question was the new business value growth. On the margin, which is right now at 3.3, we don't expect to have much of an improvement. In reality, the 3.3, if you think about that, is already 3.5, because in the First Quarter, France is very low. So when you adjust for that, you can expect the new business margin to be even higher than 3.3. But fundamentally, from a margin point of view, I will say we are very happy with the situation where we are right now and so the growth is going to come, at the end of the day, from production. And I would expect that we might have the same production in the future that we had last year, in the First Quarter this year, which is about 4% to 5% when you adjust for FX. So at the end of the day, I would expect the value of new business to grow, more or less, by that amount.

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

Just one question on the 235% you mentioned being at hopefully for the year-end, does that include the negative you mentioned on U.S. tax?

A - Giulio Terzariol {BIO 17125489 <GO>}

Yes, okay, that's a good question. Yes. At the end of the day, the negative on the U.S. tax is now between 1% and 3%. So we guide you to 3% at the beginning of the year. But now, it looks like there is a change in the way the regulator is going to set the charges for the capital model. So most likely, it's going to be more towards 1%. Then we have the Taiwan transaction, which is coming through in Second Quarter. This should improve our solvency ratio by 1%. So at the end of the day, the 2 things are more or less of a wash. So yes, the answer is including also the impact coming from the tax reform in the U.S.

Operator

And we'll take our next question from Peter Eliot from Kepler Cheuvreux.

Q - Peter Eliot {BIO 7556214 <GO>}

If I could just ask a couple of questions on Asset Management, first of all. I guess the overall flows for the Q1 were fairly similar to what you've given us at sort of full year results, first H. So it looks like possibly, they didn't continue quite strongly in the second half of the quarter. I'm wondering if you could comment on the trends there and what you've seen in Q2 to date? Equally then on performance, I guess, AGI, I was wondering if you could say how much of the drop in performance fees might be attributed to any change in strategy there? And at PIMCO, cost/income ratio a lot better than your target. I'm just wondering if you can say how -- comment on the expense of that feat and what's driven that? Then if I could ask on a different subject, the corporate and consolidation, I guess, if you annualize the figure that you got in Q1, you get to EUR 0.7 billion rather than EUR 0.9 billion guidance. So I'm just wondering is there any one-offs in there, any reason it's light in the quarter?

A - Giulio Terzariol {BIO 17125489 <GO>}

Okay. So starting from the flows at PIMCO, that's a good question, by the way. So when you look at the flows at PIMCO in U.S. dollar for the First Quarter, they were $23 billion. And of this $23 billion, we got about $15 billion to $16 billion in January. So you saw a slowdown, or we saw a slowdown in February and March. And that's because of the fear, if you want, in the investor base that's about increasing interest rates. As we -- so there was, first it was down, as we go into April and in the Second Quarter-to-date, we saw outflows coming from the institutional segment of about USD 5 billion. Now so this is, if you want, a negative. But in reality, when you look at the fee margin between the outflows that we get and the inflows that we get from a revenue point of view, we are still accretive. But clearly, we see on the institutional side, that there is -- that there was a slowdown first starting February, March. And then also in April, we saw even some negative outflows at PIMCO. So how we look at this moving forward? We think we're going through a transition period. So we need just to see how this transition period is going to play out. And how long it's going to be. We take comfort from the fact that from a revenue point of view, the revenue mix is still positive. And we then believe that since our performance is still very good and outstanding, we believe that when the situation stabilizing, we're going to be able to take full opportunity of higher level of interest rates, which should be a positive for PIMCO. On the Structured Alpha that was your question, at the end of the day, regarding AGI, that's not due to the decrease in performance fees; it's not due to a change in strategy. Or if you're thinking maybe about also the pilot that AGI is doing by changing the product to a low base fee and performance fees, that's nothing to do with that. We have a strategy, which is called Structured Alpha, which is deploying option and in the case you get is market volatility, then this options, there must be a short gamma position. So it means that we are not outperforming the benchmark and then we get lower performance fees. So that's just part of a strategy which is not performing so nicely in a high volatility environment. Then you had a question about the cost/income ratio at PIMCO, with 56.6%. First of all, what is driving the cost/income ratio at PIMCO at that level is just operational leverage. And so from that point of view, this is a number that, in theory, can stay there. Now, at PIMCO, we like also to invest. So we're going to invest in distribution, we're going to invest in artificial intelligence. So there is a plan there to invest over time. As you know, our target is to have a cost/income ratio at PIMCO below 60%. And I will say, most likely what you're going to see in the course of the year is going to be a cost/income ratio which is between the level that you see on this slide and the 60%. But clearly, operational leverage has a big impact on the efficiency level of PIMCO. Then your last question was on corporate and other. Yes. It's a little bit better compared to the guidance that we gave you of EUR 900 million. But there is nothing really special going on. Usually, I would expect that we are going to see maybe some more expenses, especially on the corporate level as we go through the year. But there is nothing really significant there. And also, if you want to be precise, the number of EUR 900 million that we gave you was rounded up. And so then the reality is, there's not much of a get to our real final plan number.

Operator

And we'll take our next question from Thomas Seidl with Bernstein.

Q - Thomas Seidl {BIO 17755912 <GO>}

First one on M&A. I think you said this morning that M&A is not priority #1. And previously, you quoted the high valuation as a hurdle. So could you update us on the financial hurdles you would apply to M&A. And in particular, whether you would be willing to sacrifice your 13% ROE for a potential M&A? That's first question. Second one on Life. You reported on the one side, close to 0 harvesting. But then also a strong drop in the policyholder participation. My question here is this purely mechanical. So should we see for the future then, harvesting going back to normal and also policyholder participation? Or is the policyholder participation structurally declining from here? And the third question, P&C pricing, 1.3% up in Q1. It's markedly lower than full year and last year Q1. I think main drivers I've seen is Australia, Spain. Maybe you could comment on how you think about this price change and to what extent does that it still covers claims inflation?

A - Giulio Terzariol {BIO 17125489 <GO>}

Okay. So starting from M&A and the question was what is the hurdle rate that we apply to M&A. So we know that our cost of equity is 9%. And so we believe if we do an M&A, we need to be able to price at higher than the cost of equity. In theory, the cost of equity should be enough. But as I say, we want to price higher. I'm assuming also here that the quality of the target is consistent clearly with the quality of our business. So we would look definitely to go into a double-digit hurdle rate in the case of an M&A transaction. This, however, doesn't mean that we would not sacrifice the 13% ROE, because I will say every time you deploy a substantial amount of capital, you don't need necessarily to deploy the 13% ROE. Just to give you an example, if we deployed that capital at a 11% ROI, that would be my opinion, which will be somehow dilutive to the 13% ROE, that's still value accretive. So the answer is definitely, we price above the cost of equity. It doesn't mean, however, that price above the cost of equity is now somehow dilutive to the ROE.

From a value generation, it's adding value definitely, as long as you're beating the cost of the equity. So that's the way we look at M&A. On the Life side, you had a question regarding the harvesting and also the profit-sharing. With respect to the harvesting, first of all, the 2 basis point you see in Q1 is not, clearly, the level that we expect in the future. 26 basis points that you saw last year is also not necessarily the level. So if I should guide you to a net harvesting level, which you might see is normalized in the future would almost take the average of those 2 numbers. And maybe go towards the 10 basis points. And the implication for the profit-sharing, I will say that in a situation where we are keeping the net harvesting at about 10 basis points, we can definitely keep our investment margin having policyholder participation, which is more or less at the 79% level. So a normal level of harvesting, you shouldn't see the policyholder participation reducing significantly compared to the level that we had in the last year. Then you had a question, the pricing. With the 1.3 -- maybe specific to Australia. In Australia, first of all, the number you see that's kind of interesting, the minus 2.5%, is referring to renewal. And on the renewal side, because of a change in regulation, we are getting pressure. On the other side, when you look at the total price strength in Australia, including new business, the price strength in Australia is actually positive and not negative. So the numbers you see, just a partial representation of the whole story. How I look at the price in P&C, I think the pricing is, in general, solid. I wouldn't say we are in a healthy market. But with the combined ratio that we have, we don't necessarily need a healthy market and the pricing increases that we are getting are, at the moment, definitely okay to support the claims severity and frequency severity trend that we are seeing. So from a pricing point of view, compared to the claims activity we are seeing, we think, in general, we are doing fine.

Operator

And we'll take our next question from Farooq Hanif with CrÃ©dit Suisse.

Q - Farooq Hanif {BIO 4780978 <GO>}

There was a comment recently in your AGM about expense ratios and the long-term ambition to get these down to 22%. Obviously, you were talking very long term. And you were talking about digital future. But just wanted to understand how you're thinking about your expense ratio and the ability now to get that down? So that's question one. Then going back to pricing. I see that the pricing that you're showing is renewal pricing. But still, there seems to be a slightly lower number there, perhaps versus some of your peers, particularly if you look at AGCS, for example. So I'm just wondering, is it fair to say that you are willing to trade off pricing for growth, given the very strong internal growth, would you think that's a fair comment?

A - Giulio Terzariol {BIO 17125489 <GO>}

So on the expense ratio, okay, first of all, you know that for 2018, we have a clear target that we want to grow to 28.4%. So that's the first milestone. And as we look into that for the future, clearly, the 22% coming from the AGM, that was just a presentation of what you can potentially achieve if you simplify and harmonize your business model. But clearly, as you said, this will be a very long-term objective. So the objective anyway in the next years is to do 2 things. First of all, we want to be able to speak about productivity the same way we can speak here about capital management. So if you come to -- I always like to say that if you come to Allianz, you speak about capital management, we can show you a lot of numbers, a lot of indicators, we can speak about capital management from all dimension. If you want to have the same conversation about productivity, at least here in Munich, we will not be able to have the same level of conversation. So we want to change that. We want to have the same level of proficiency as we speak about productivity and then we are targeting continuous improvement in productivity, which means yes, the expense ratio should go down over time. And on that one, I will expect that yes, we're going to be first able to bring down the expense ratio below 28%. But that will be the first step before we comment to other stronger numbers in the future. But that's definitely a top priority for half year at Allianz. On the question about the pricing and AGCS. And whether we are willing to sacrifice premium for growth. I would tell you, fundamentally, my response will be that we should be able to get growth at the pricing level that we have. So that will be my first reaction. There are specific situation where if we have really a combined ratio which is outstanding, then clearly, if you start doing the math, at that point in time, might be worthwhile to do -- to compromise to a certain degree on pricing for growth. But it really depends on the numbers, because if you have a combined ratio 96%, I tell you, there's not much to compromise on profitability for growth, because if you start doing the math, it's not going -- you need a lot of growth to offset for the deterioration in pricing. If you are on a combined ratio of 85%, the math might look like very different. But my fundamental answer to your question is, not really. I had been many years in an operating company. And when you try to play the pricing game, usually, you need to expect that your competition is going to move accordingly. And so eventually you end up at the same point. So if we want to improve, we need to improve in service to the customers, we need to get more productive. So that we can low our pricing because we have a lower expense ratio. But playing the pricing lever is, in my opinion, a very dangerous game.

Operator

And we'll take our next question from Nick Holmes, Societe Generale.

Q - Nick Holmes {BIO 3387435 <GO>}

Just one question, please. Coming back on the variable annuity losses. Could you explain a bit more how the accounting works, since I would have thought your hedging should have prevented such a big loss. So why didn't that happen?

A - Giulio Terzariol {BIO 17125489 <GO>}

On the VA side, maybe just to speak about the hedging cost, right? So one thing is the hedge is the hedge. So the hedging is going to make sure that you are matching, let's say, the equity movement. The cost of the hedging is a function of the volatility and from that point of view, when the volatility is going up, you're going to have higher hedging cost. Just to give you an idea, if you have a volatility of a measure based on the VIX of 15% or you have a volatility of 20%, this makes for a difference in hedging cost of EUR 7 million per month. So if you multiply, this is like EUR 80 million-plus. Last year, seeing the volatility was 9%, 10%. This year, the volatility, the VIX, was even at 30% for a few days. So it's been much elevated. So the hedging program is working how the hedging program is expected to do. But the cost of hedge is going to be a function of the volatility. So this explains why you have this kind of impact. If you ask me, 2017 was more unusual compared to what we see in 2018. The Q1 was a little bit heavy from a hedging cost point of view. But at the end of the day, the level of volatility last year was extremely low. And we had such a level of volatility -- just to give an idea, last year, we made, I believe, EUR 200 million profit on our VA business, if not even more. And that block is less than EUR 30 billion, or less. So it was almost on margin, getting very close to the 1%, which is very high for a VA block. And this is not going to repeat moving forward. That answer your question?

Q - Nick Holmes {BIO 3387435 <GO>}

Yes, I mean, I suppose I am still a bit puzzled, you must have had hedging gains of, where would -- do you kind of treat those on an economic basis. So you don't show them.

A - Giulio Terzariol {BIO 17125489 <GO>}

No, okay. Maybe I would differentiate. The hedging, there is a hedging cost and hedging cost is higher or lower. So I wouldn't call it hedging loss or hedging gain. It's just when you have an hedging program, you need to pay for the hedging. When the volatility is up, you're going to pay more or less. So it's not necessarily a gain or a loss. From a hedging efficiency point of view, the thing that you might be referring to in the VA will be basis risk, that will be an hedging efficiency. And the basis risk this year was pretty much 0. So slightly positive. Last year, we had a very positive basis risk. But that will be what I will call a hedging gain. But the pure cost of hedge is just a function of the volatility. And this is economic and this is going to be there. And we are not removing from the numbers, we are -- there is -- yes, we are putting all the numbers into our operating profit. So am I clear?

Q - Nick Holmes {BIO 3387435 <GO>}

Yes, no, no you're very clear. I mean. But it is economic, rather than -- because insurers present these numbers in very different ways and some, I think, show it on an accounting basis. But you show it on an economic basis.

A - Giulio Terzariol {BIO 17125489 <GO>}

Yes. We show really the hedging cost. Yes. There is some -- the other competitors, they are putting below the line. No, no, we are just showing this into our operating profit.

Operator

And we'll take our next question from Andrew Ritchie with Autonomous.

Q - Andrew James Ritchie {BIO 18731996 <GO>}

Just a first quick question or clarification. There's been lots of interviews with members of the management team talking about how concerned they are or cautious they are in the macro outlook and the volatility in markets. I just want to clarify, I mean, you haven't really changed your thinking around the -- in the amount of capital and capital buffer you'd like to retain? Or do you still feel -- is there a feeling that you ought to be at the kind of the upper end of the range for the foreseeable, given some concern on the poorer backdrop?

Second question, the capital efficient products, that is mostly the U.S. FIA products, just clarify there's still no contribution yet from the German capital efficient product. And in the U.S. FIA product, I'm assuming it's a bit harder to manage the spread on that product with rising interest rates. And that appears to have affected one of your competitors in that line. Is there a temporary depression of the investment spread in that line and will it be some repricing and normalization there? And the final question, you have some legacy long-term care business, that's been a big focus of attention in the U.S. of late. When was the last time you've revised your assumptions and what's the remaining exposure?

A - Giulio Terzariol {BIO 17125489 <GO>}

Yes. So coming from the capital and how I feel about the solvency level considering the comments that we are making about the volatility in the market. I will say that I'm always considering the credit spreads are very narrow right now. So this is something to keep in mind. So from that point of view.

And also if you look at the equity market, in general, they are pretty high, even if there were some corrections, if you want, they're still pretty high. So from that point of view, I feel pretty good about running with a solvency ratio which is even slightly higher compared to the 220%. Also, from that point of view, it's very important for me to make the points, the solvency ratio can go up and down based on market developments. This doesn't necessarily mean that the IFRS profit is changing the same way, the dividend capacity of ROE is changing the same way, because there are the restriction. So from that point of view, if you ask me the way I do a check, the way that we are running the company efficiently from a capital management point of view, is to look at the IFRS ROE and as long as we have enough IFRS ROE, which is close to the 15% level, I think we can definitely say in good faith that we are managing the company efficiently. And it is now our interest to clearly use the capital in a very efficient way. So but the bottom line is right now, having a solvency ratio which is at 225% is, in my opinion, a good place to be.

On the capital efficient products, I think your question refers especially to the contribution of the German business to our capital efficient products. For the First Quarter, the operating profit contribution was about EUR 11 million coming from Germany. So from that point of view, we are now in positive territory. You need also to consider. And I don't want to get too technical. But there is a sort of strain, if you want, in that number. And so as we're growing that block, you're going to see more and more the profitability coming through in the future. And on the U.S. FIA, the question was about if rates go up, that might be an issue for managing the spread. I will say that philosophically, yes, if you have a high increase in interest rates, since you are buying the assets, it's an exception. And the customer might change their view about what is a good (credited) rate, yes. But there are 2 things. First of all, you need to see really a substantial increase, in my opinion, in interest rates before this becomes an issue. Second point, we don't have straight fixed annuity. It's an index annuity, since you have a participation with the equity market, I think there are 2 components, if you want, in the value generation. One, is clearly the budget that you allocate to the strategy. And that's clearly the kind of thing that will be somehow impacted by the comparison to the interest rate. But then you have what the equity indices are doing. So when you combine the 2 things, I will say that there is a potential issue that's on managing the spread in an increasing interest rate environment. But I wouldn't say this is something where we are feeling any pain at the moment. Then you had another question, which was...

Q - Andrew James Ritchie {BIO 18731996 <GO>}

Sorry, just to clarify, was there a temporary -- I mean, there was clearly spread compression in the capital efficient line in Q1.

A - Giulio Terzariol {BIO 17125489 <GO>}

No, no. Okay, yes, what's happening there -- okay, that's a little bit of a different story. What is happening there, when the short-term interest rates are going up, the hedging cost, if you want, the budget that you need to allocate, is going up. Now in reality, what is happening, we are passing this to the policyholder. The point is, once you have a situation when the LIBOR is going up every time, we are always playing catch-up. But eventually, at a renewal, we're going to be able to adjust the pricing for that. So adjust the...

Q - Andrew James Ritchie {BIO 18731996 <GO>}

So there is a timing issue?

A - Giulio Terzariol {BIO 17125489 <GO>}

Yes. Absolutely. There's a timing issue. Absolutely, yes. On the LTC, okay, first of all, if you ask me when we do our review, we constantly do a review of our LTC business. So every -- in theory, every quarter, let's say, every year, we do a review of our LTC business. When you look at our reserves on a gross basis, we have EUR 4.3 billion of reserves. Of this EUR 4.3 billion, EUR 2.8 billion belong to the years before 2001. And this is, if you want, a very bad LTC and this EUR 2.8 billion is completely insured, either with GE, everybody knows that. And there is a residual part which is reinsured with other companies. So on the business before 2001, we are completely reinsured.

Then we have a business of EUR 1.5 billion, which is after 2002 or 2001. And this business is largely retained, not completely but largely retained. And on this business, the quality is definitely better. So bottom line is, could we have a negative experience in LTC? Yes. It might happen, depending on how morbidity is developing, depending on the interest rate movement and also depending on our ability to get rate changes. So from that point of view, clearly, there is some uncertainty. But I'm concerned about also that we might have a significant exposure and impact coming from LTC. I will say I'm not concerned about that. So I cannot disclose that we are going to have a strength there in the future. But I don't think we're going to make the headlines.

Operator

And we'll take our next question from Arjan Van Veen with UBS.

Q - Arjan Van Veen {BIO 5197778 <GO>}

On Allianz Global Investors, even if I remove ACP, the cost/income ratio is above 70%, which is quite a contrast, obviously, to where PIMCO is at, below 60%. So I'm just curious as to whether you're going to give them some time to see the strategy to work? Or is there work conversely at PIMCO where you're investing -- you're going to keep it tighter on how you run the business? The other question I had was just a bit around the tax. So if I look at your guidance of 26% to 28% and more like 26% in 2018, does that imply more that the other 3 quarters are running at 27%. So should we think of sort of longer-term tax rate, now that things have settled down a bit, around the 27% mark?

A - Giulio Terzariol {BIO 17125489 <GO>}

Yes. So starting from AGI. And I think your question was whether we're going to push AGI towards the level of the PIMCO cost/income ratio.

Q - Arjan Van Veen {BIO 5197778 <GO>}

Well just improve it, because 70% is not particularly good, around just -- it's going the wrong way now for a while.

A - Giulio Terzariol {BIO 17125489 <GO>}

Yes, I will say, okay, first of all. And that's going to create some noise in the future. If you look also Page 30, you're going to see that we expect the impact from ACP on the cost/income ratio to be about 2percentage points. So from that point of view, in the future, we need always to remove, if you want, that impact to -- from the AGI numbers. Our expectation for AGI will be adjusted for clearly for these impact, is that the cost/income ratio will be below the 70% level. What you had to consider is in the First Quarter of this year, we didn't have performance fees. I really did the math on my own and this makes the difference in the cost/income ratio. And we know the performance fees are going to flow at the end of the year, mostly. So you need to, at the end of the day, look at how we're going to do in the cost/income ratio at the end of the year. And performance fees, they make a difference in how these ratios are coming along. So from a -- if you ask me in general from an AGI point of view, something that you need to consider, the cost/income ratio might be higher. But you need to consider also that the fee margin is higher. So you always have to consider that you should almost take the net margin on the assets of -- when you take the fee margin after the cost/income ratio and when you look at that ratio, AGI is indeed doing actually pretty good. So just to put things into context. That's on the AGI side. Then the other question was on the tax. I would expect the tax rates to be 26% at the end of the year. So I would really see this as a good guidance. So I don't think that...

Q - Arjan Van Veen {BIO 5197778 <GO>}

But you had 24% in the First Quarter, right? So it sort of looks like more (than that) for the remaining quarters, will be...

A - Giulio Terzariol {BIO 17125489 <GO>}

Yes, okay.

Q - Arjan Van Veen {BIO 5197778 <GO>}

A little bit beyond that as well.

A - Giulio Terzariol {BIO 17125489 <GO>}

Yes. It's a function of the amount of tax-free income that we get in every quarter. And maybe the 26% might be slightly conservative. But for the time being, I'd like to guide you to the 26%. But think about also the tax-free income and how this can develop over the quarter, which is also a function of realized gains that we do in equity; realized gains in Germany, for example, are tax-free. But 26% I think it's not necessarily an aggressive number, let's put it this way.

Q - Arjan Van Veen {BIO 5197778 <GO>}

So the other way to think about it is longer term, midpoint of that 26% to 28%. But maybe even a bit better than that?

A - Giulio Terzariol {BIO 17125489 <GO>}

Yes, I will guide you a little to 26%, at the end of the day.

Q - Arjan Van Veen {BIO 5197778 <GO>}

But I was thinking slightly longer term, rather than just '18.

A - Giulio Terzariol {BIO 17125489 <GO>}

Yes, yes. I will say 26% to be...

Q - Arjan Van Veen {BIO 5197778 <GO>}

So same thing? Perfect, okay.

A - Giulio Terzariol {BIO 17125489 <GO>}

Yes, I would expect 26% to be, based on information we have now, how we are doing things now, I could see 26% to be a good level of guidance also for the future, yes.

Operator

And we'll take our next question from Vinit Malhotra with Mediobanca.

Q - Vinit Malhotra {BIO 16184491 <GO>}

So one question on PIMCO, please. And one on Non-Life and possibly one on Life, just to clarify one thing. So on PIMCO, can you say that is there a strategy or is there a plan to counter this impression in the market that PIMCO will perform poorly in rising interest rates. And so all this outflows? Because in the past, there was a focus on various other strategies and highlighting that PIMCO is not just a long-only bond fund, if you like. That's my first question, on PIMCO strategy. Second question is just picking up and following up on the AGM commentary and that beautiful slide. Is it as simple as just saying, "Let's halve the product number and suddenly customers become more loyal and we are all very productive and everything is very good?" Because if I remember a few years ago, the whole idea was the modular approach was supposed to be the driver of earnings or improvements. I just wanted to hear your thoughts on how you look at that. And if I can just follow up quickly, recently, in Italy, there's been a Supreme Court ruling regarding unit-linked products, whether they are insurance contracts or not. Is that story -- do you have any opinions on that? Do you think that concerns you or affects you or what's your take on that?

A - Giulio Terzariol {BIO 17125489 <GO>}

Okay, I start from the last one. I don't have any opinion on that one. And I need to do some research on that. So on the unit-linked ruling for Italy. On the expenses, no, we have, if you want, I wouldn't call it evidence. But it looks like companies which have a simplified landscape and less products tend to be more efficient. And also, we see customers, the customer service is also better, which makes logical sense. When you see some kind of correlation, then you always try also to make sense out of it. And we think that there is definitely the way to go to simplify our product. Don't think this is so easy, because that's a little bit a point you're making. There are people that might think that customization is extremely important, by the way, customization still matters. But we need to differentiate between what is value-adding customization and what is unnecessary customization, which means only complexity. So at the end of the day, it's going to be also, if you want, a little bit of a cultural change. But we strongly believe that this is the way to go. And this is going to be what we are going to push in our agenda for the next few years. Indeed, if you ask me, that's the cornerstone of our idea, how to reduce the expense ratio and how to get more productivity over time. Then on PIMCO, just to make clear, I didn't say that PIMCO is performing poorly. I just said it was doing good. But we see there was a slowdown in February, March and then there are outflows coming through in April. I want to reiterate, however, from a revenue mix point of view, this is pretty healthy. As far as the environment goes, this is clearly an environment which is tougher for fixed income Asset Management right now. I think there was also an article just a few days ago in the Financial Times. So this is what the environment is. But I will say that PIMCO is doing actually, under the circumstances, pretty good. So I'm very long on PIMCO and the prospect of PIMCO and now we need to go through this transition period. But we are very happy with the level of performance of our friends in Newport Beach.

Q - Vinit Malhotra {BIO 16184491 <GO>}

And can I just follow up, if the U.S. 10-year keeps going up, then PIMCO's strategies are working or should work. Is that also your understanding?

A - Giulio Terzariol {BIO 17125489 <GO>}

Yes, my point is, at the end of the day, customers are going to -- a customer can place money, more or less, depending on the environment. But fundamentally, there is definitely, if you look mid, long term, there is an appetite to put funds into fixed income, especially when rates are going to be higher, I believe we're going to see even more of an appetite, because people are going to use that as a opportunity in order to also do liability-driven investment. At that point in time, usually when the situation is stabilizing, I believe a company like PIMCO, whose performance continues to be very strong, is going to be the preferred Asset Management to go. So that's the reason why what I'm saying, clearly now, there is a transition period, because people are watching what interest rates are going to do. Once there is less apprehension about the near-term development of interest rate and when the investors are going to believe there is stability, at that point, I expect that PIMCO is going to see again, strong flows. Maybe I'll come back on the unit-linked, we don't expect any impact on this ruling from Italy.

Operator

And we'll take our next question from Johnny Vo with Goldman Sachs.

Q - Johnny Vo {BIO 5509843 <GO>}

Just a couple of questions. Just obviously, your solvency ratio is very good. But can you talk about other elements of capital management, such as your rating agency capital and your essential liquidity and how that feeds through into your capital management plan? And the second question is just on the recent SFCRs that you put out. We noticed that a number of your German peers have seen quite big increases in solvency positions in their life and savings books. But your business seems to be much more modest. I would have thought that rising rates would have seen quite a big benefit through lower SCR. And it doesn't seem to have come through. So could you comment on that?

A - Giulio Terzariol {BIO 17125489 <GO>}

So first of all, on the essential liquidity, how we look at capital, clearly, we look at the solvency ratio, then we look at the financial leverage ratio that, if you want, is more -- is a rating agency constraint. And this is more driven by, if you want, almost the IFRS balance sheet with some adjustments. Then clearly also, we look at the liquidity level that we get through the dividend. So we are looking holistically at these 3 things. And from a financial leverage ratio, at the end of the year, we were at about 26%. We have -- we don't want to go over 30%, clearly. And we feel pretty good about the 26% level that we have right now. And from a liquidity point of view, as you know, we're keeping a liquidity buffer here in Munich in order to make sure that even if there is a financial crisis, combined with a NatCat event, we're going to be able to fund our OEs. And on top, clearly, there is strategic reserve or what is on top of that can be deployed for buybacks and for M&A. So from that point of view, we are looking these 3 dimensions. Also, just to give you an idea how we look at, if you want, the risk profile of Allianz, we'll look at 3 levels. One we look at the solvency II sensitivity; then we look at earnings at risk; and then we also look at liquidity at risk. So these are the 3 things that we're looking at. Then clearly, the 3 things are not moving in parallel. And based on the different sensitivity, the different level that we have, we try to strike the best balance. So that's on our -- how we view the world from a capital management, liquidity management point of view. From a question about us versus the competition, we don't think that it's so easy to compare our numbers to the competition, also because of cash flow models are different. And so from that point of view, we believe it's very challenging to make a comparison between us and the rest. If you look at our solvency ratio in Germany are very strong. And on top of it, you need to consider that some of our competition might be using transitional, too. So it's very difficult to compare.

Q - Johnny Vo {BIO 5509843 <GO>}

But how sensitive is the SCR to interest rates, in general?

A - Giulio Terzariol {BIO 17125489 <GO>}

I think there is some sensitivity in Germany of our solvency ratio to interest. This is not something that I personally tracking. But when you look at our sensitivity at group level, we have a sensitivity which is, as of Q1, minus 7%. The numbers of Allianz Leben are included there. There's also a mechanism where sometimes the sensitivity maybe at Allianz Leben might be higher compared to the sensitivity that we see at group level, because of the impact of transferability. But I will say that Allianz Leben, with the solvency ratio of about 400%, is very well capitalized. And also, what we do, we do this for all companies. And we do this also for Allianz, we run different stress tests, as like we run the stress test for the financial crisis, 2018. And we want to be sure that even under that condition, the company is going to have an adequate level of capitalization.

Operator

And we'll take our next question from Michael Haid with Commerzbank.

Q - Michael Hermann Haid {BIO 1971310 <GO>}

Two questions. One, I struggle to understand the combined ratio in Italy. Not so much if I look at the Q1 combined ratio of 80% only. But more when I look at it over time. It has been very, very low for years now. And the question is, how long can it go on? And for the combined ratio for the group of 94%, what combined ratio should we expect for Italy and what is the underlying combined ratio in Italy? Second question on Euler Hermes, now that you own it 100%, can you give it -- or is there an update on plans, how to integrate it, what actions you're going to take, any synergies, any update on the plans? That would be very helpful.

A - Giulio Terzariol {BIO 17125489 <GO>}

Yes, I start with the second one. I cannot give you any update on Euler Hermes. And if and when we're going to do something, then we can speak about what we're going to do there. On the combined ratio for Italy, I would like to have an 80% combined ratio forever. But let's be realistic, this is not going to happen. So now when you look at the combined ratio of Italy, we have a very good accident year. But also on top of that, we have a clearly positive runoff. I'm kind of hesitant to give you the number. But I think that the Italy combined ratio might be close to the one of -- accident year to the one of Spain, maybe slightly better. So we know that eventually, we're going to see, down the road, less performance from Italy, although it's going to be still an outstanding performance. But this is part of our consideration. So as we speak about the 94% combined ratio that we want achieve in, not only in 2018. But also in the future, we are also factoring in that Italy is not always going to contribute an 80% combined ratio. So this is something we are aware of and this is part of our thought process.

Q - Michael Hermann Haid {BIO 1971310 <GO>}

Can you talk a little bit then on the reserving position in Italy? Has it deteriorated? How much has it deteriorated? Just to get a better understanding, because the combined ratio in Italy has been very low for years now.

A - Giulio Terzariol {BIO 17125489 <GO>}

Yes, I'm not going maybe to be specific. Let's put it this way, the reserve situation in Italy is very strong. That's what I can tell you.

Operator

And we'll take our next question from Peter Eliot with Kepler Cheuvreux.

Q - Peter Eliot {BIO 7556214 <GO>}

I guess, just following up on a couple of your comments, Giulio, on the performance. We didn't get the % of third-party assets that were outperforming benchmarks (inaudible). I was just wondering if you have with that. Secondly, on the Non-Life investment income, I guess, the reinvestment rate remains at 70 basis points below the running yield. So is that sort of 8 basis points compression that you talked about, I mean, I guess, that logic would say that should continue for some time. But I'm just wondering if you can add new comments to say why that should slow, possibly given your alternative investments or other? Then finally, on the solvency sensitivity target, I guess, you've overshot the 11%, although the 11% was (that or) better? I'm just wondering if you can update us on your thoughts on whether a lower sensitivity is always a good thing or whether you'd like to have some exposure there? Or just what your thoughts are now that you're sort of well inside that target?

A - Giulio Terzariol {BIO 17125489 <GO>}

Yes, okay, starting from the performance of our asset manager. When you look at PIMCO, we have more than 90% of the funds outperforming their benchmark. In the case of AGI, when you look at the 3-year horizon, it is about 70%. So from that point of view, also we see both at PIMCO, AGI, stability compared to the numbers we had in the prior quarters. Your question on the investment income and how we see this playing out in P&C in the future. So when we look at our plan, we see that by 2020, the decrease in investment income should flatten out. So we still are going to have some decrease happen in 2019. Then starting in 2020, we should have a flat development of the investment income. Clearly, if rates go up a little bit, that might make the breakeven, if you want to call this way, a little bit earlier. If rates go down, that might make it a little bit later. But I will say that by 2020, we should have this headwind behind us. Then you had a question about the sensitivity and how I feel about sensitivity and so on. So I think the question was whether lower sensitivity are always a good thing. And I will say, yes. If you ask me, I believe that if -- I would even trade level for lower sensitivity, because at the end of the day, if you think about that, the capital intensity of a business is a function also of the volatility that you have. The more volatility, the more buffer you need to keep. So from that point of view, yes, lower sensitivities are a positive. Again, as I was saying before, we can bring the solvency ratio to be even more stable than it is now. But then you need to think about implications on other KPIs. But the bottom line is yes, everything has been equal, if you can reduce the sensitivity of the Solvency II and maybe trading for the level. You need to run the math. But there might be good things to do from a capital management point of view.

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A - Oliver Schmidt {BIO 2473131 <GO>}

Okay before we continue, time is almost up. I think we have time for one last question, please, if there's any.

Operator

At this time, there are no further question. (Operator Instructions)

A - Oliver Schmidt {BIO 2473131 <GO>}

Perfect. Even better, then we thank everybody for joining the call and say goodbye.

A - Giulio Terzariol {BIO 17125489 <GO>}

Bye. Have a good day.

Operator

And that concludes today's presentation. We thank you for your participation. You may now disconnect.
