# Q1 2015 Earnings Call

## Company Participants

- Dieter Wemmer, Chief Financial Officer
- Oliver Schmidt, Head-Investor Relations



## Other Participants

- Andrew J. Ritchie, Analyst
- Farooq Hanif, Analyst
- James A. Shuck, Analyst
- Jon M. Hocking, Analyst
- Michael Haid, Analyst
- Michael I. Huttner, Analyst
- Nick Holmes, Analyst
- Paul C. De'Ath, Analyst
- Thomas Jacquet, Analyst
- Thomas Seidl, Analyst

## MANAGEMENT DISCUSSION SECTION

### Operator

Ladies and gentlemen, welcome to the Allianz Conference Call on the Financial Results for the First Quarter 2015. For your information, this conference is being recorded. At this time, I would like to turn the call over to your host today, Mr. Oliver Schmidt, Head of Investor Relations. Please go ahead, sir.

### Oliver Schmidt {BIO 2473131 <GO>}

Thank you, Christy. Yeah, good afternoon from my side as well and welcome to our conference call about the results of the first quarter 2015. I think I can keep it brief. We have published key numbers already last week. You have seen our analyst presentation this morning and for the details, you will now get from Dieter.

### Dieter Wemmer {BIO 4755450 <GO>}

Thanks so much, Oliver, and good afternoon also from my side, and good morning to the ones dialing in from The States. I am using the analyst presentation as usually and mention from time to time the page numbers in case you get lost.

So I start on page 3, the business highlights. I think it's good, easy to read. Let me just highlight that in our joint venture with UniCredit we have restarted on the motor side selling and for a roll out in a large branch network 15,000 policies in one quarter is a very good start. But also we have agreed on a new business plan for unit-linked products and there we had a substantial increase in volume. Well, that's through the bank channel, but also through our financial advisor network, so unit-linked sales in Italy substantially up. Asset Management, PIMCO continues to contribute strong investment outperformance. Allianz Global Investors, good inflows we will talk about later.

On our real investments, the largest investment of the quarter was Colchester Garrison facilities in the UK, where we are now the new landlord for the British Army and Fireman's Fund transactions, the sale of the personal lines business got closed on April 1 that means the proceeds are in Q2 and not Q1. And with this one I would move on to the numbers.

So let's start with the high-level overview of the operating results. Headline figure, the €2.855 billion, so 5% up compared to last year, but admittedly there are three one-offs included in the numbers. In P&C, a minus €100 million restructuring for the commercial part of the Fireman's Fund, in Life I would say €200 million unusual realized gains, and I'll come to this later; and maybe €100 million net in the corporate segment out of changes of our own pension schemes in Germany. So the net one-off I see at €200 million for the quarter that means the quarter had started with €2.655 billion. I think we can stick to this for the rest of the year. That is probably a very good number, plus the €200 million outperformance in Q1, even if it was one-off all counts for the full year results.

Net income 11% up. We have a slightly lower tax rate. I explained this in more detail and I have not forgotten to talk about the revenues. They are 11% up, where we have to split it between the various FX. It's 3.7% internal growth in total. Foreign currency makes a good 5% and then we have the first time consolidation of the Unipol acquisition and also the smaller acquisition of in Australia Northern Territory. And with this one I would move on to the balance sheet.

I think it was a very good quarter for shareholders equity, €68.4 billion is a huge jump forward, not really surprising. There's on one hand almost €2 billion of additional retained earnings. There is the FX impact. The euro got beat up against most major currencies, and what of course has the biggest impact as the U.S. dollar, but we should also not forget the Swiss franc and also British pound, Australian dollar, et cetera. So broad positive impact and then all assets values went up substantially on a gross basis before policyholder, shareholder split in Texas our unrealized gains are now almost €90 billion. That is a huge jump in unrealized gains and part of it of course goes also into the net asset value.

Conglomerate solvency, it's the old still – the relevant measurement for 2015 is also benefiting from the increase in shareholders' equity. Additionally, we issued a hybrid bond in March of €1.5 billion, which is adding 4 points to Solvency I and also 4 points to Solvency II and I have seen that you were partially surprised that our solvency ratio is sticking pretty closely to the year-end number.

When I take all market movements, we lost through straight market movements 16 points and then there was 3 additional points through, I think, calculation and updates from year-end. So that's for the 19 points drop and we countered it with 20 points on action and including the hybrid, which made also here roughly 4 points. It's quite a long list of activities that is derisking on pension schemes that is lengthening duration through our whole list of instruments. We have clearly looked in each Life unit how we can reduce sensitivity and also improve the situation and still keeping enough money at risk because I think it is easy to close out now the volatility, but it is more important that we keep enough capital at risk that we can benefit from positive developments going forward.

What certainly has helped us is also our equity exposure. We have sold and reduced some equities, but in market value our equity holding still increased by almost €6 billion to €47 billion, and also this increase of course supported the development of the balance sheet, as I said. But it is also, I think, a good support in the risk return which we are taking. So, overall, a quite positive development, and actually S&P rating unchanged, and when I look at the S&P Q1 numbers, actually we are very solid above the AA level.

So now moving to page 9, the P&C growth. I think that is one of my favorite pages of this quarter. We continued to grow on a very broad scale. 3.5% internal growth adjusted for currencies is really a good number. You see here the total growth including currency and the already-mentioned acquisition 14 points. That is, of course, that would be really great when we would have 14% without the currency movement, but 3.5% is actually nicely ahead of our 3% average ambition level, and also you can see that the price effects were positive, and it is actually reconfirming what we said at year-end that we expect positive impact from price increases in Germany and France, but also UK, Australia continue to contribute to this.

So how does this translate then into the combined ratio development? First of all, you can say yes, all the positive news, but operating profit €200 million down. €100 million is under other, that is restructuring charge for the integration of Fireman's Fund Commercial business. We had actually planned it as a second quarter event, but I think the integration is so well advancing that we booked it in Q1. And then we have a weaker underwriting result, mainly driven by catastrophe events. And that is, in Germany, we had €150 million of winter and spring storms in the quarter, so 1.9 percentage point cat loss compared to 0.5% last year. 1.9% is still light, but when I take all weather-related events then we are at 2.8% in the quarter and that is roughly our normalized expectation for a quarter. So the quarter was on a normal level, but it was not excitingly positive.

In particular, the personal lines business of Fireman's Fund is actually leaving the group with a very poor quarter, and that has been driven by the long and hard winter season in the U.S. where we had quite a substantial list of homeowners losses in our personal lines portfolio, so that will certainly – that has certainly stopped on April 1. Run-off results 3.2%, a bit higher than last year, but 3.2% is actually our long-term average in run-off results, and we have here actually a positive contribution in run-off from many countries, so there is no concentration in one unit; it is very broadly supported as in most of the last series of quarters.

When you go to page 13 and look at the overall operating profit combined ratio contribution, I think also continued to have a strong contribution from many markets. So how is Russia and Brazil doing? And actually I should have mentioned this. The attritional loss ratio first quarter 2015 looks 1.2 percentage points weaker than 2014. And I think in the first quarter of 2014, we did not yet fully recognize that the situation in Russia, Brazil and also Fireman's Fund was as bad as it is. I think the full run rate attritional loss of these three markets is better reflected in the Q4 numbers. And compared to Q4, I think we see a slight improvement and that is also visible in the Brazilian results. Yes, still a combined ratio of 111%, but an operating loss only of €8 million in the quarter. And remember, in Q4, Brazil contributed almost €200 million operating loss in the quarter.

Russia also is a driver for the decline in premium in Central and Eastern Europe, so the Russian business is shrinking as planned and we are fully on track with the closing of the retail business. And Fireman's Fund, as I said, personal lines business had a poor farewell quarter and the commercial business is in volume terms, I think, picking up nicely. The broker market in the U.S. clearly supports and encourages us with our One Allianz strategy and acceptance rate of the change is very high, and that was the main focus of our change that we get back on track with the broker market.

When we move on page 15 to the investment results, operating investment results €50 million higher. That is probably slightly distorted also by foreign currency changes. All numbers look in euro absolutely stronger. But also we have to see that the negative net harvesting results was driven by foreign currency losses, so where we held emerging market bonds mainly in euro balance sheet and this year the same bonds had a positive FX impact. So it's more – actually it's a turn of the negative harvesting results and both added makes €50 million more investment income.



Reinvestment yield actually substantially holding up was 2.1%, but I think that is driven by three effects. On one hand, we invested mainly right at the beginning of the quarter then we increased duration slightly and we had also from the mix of investments; there were maybe more investments outside the Eurozone than inside as we increased also our buildings and corporate bonds. So all helped with the 2.1%, but I would expect that this number is hard to keep for the rest of the year.

Moving on now to the Life business. Life business internal growth, 5%, as I said, a strong growth in Italy. This is a two unit-linked business without any bells and whistles, so we have actually 108% growth in unit-linked only, and the other business shrank by 5% in Italy. In France, we carved out International Health business, which is now shown under AWP that explains part of the negative numbers, but also we have reduced our single premium business in this market environment.

In Asia Pacific, it's Taiwan contributes with a strong growth that is almost all unit-linked business, so very positive. And in the U.S., we have seen a little reduction in volumes. Well, first of all, we had a really strong quarter a year ago, but also with the repricing to keep the profit margin up in this falling interest rate environment, we lost some volume so that was well-directed and not surprisingly.

So let's move to the Life operating profit. I mentioned already in the beginning that maybe of the investment margin, you have to apply a €200 million haircut to get to a longer-term average number, but also a €900 million operating profit is a very strong number driven by the volume increases of last year. Then also here our U.S. operation has a bigger share in the overall pie with stronger dollar.

And so what did drive this €200 million one-off in the investment margin? Well, that is quite a composition of events. On one hand, there are the trading results from our derivatives. They are the derivatives to protect against falling interest rates, so they had obviously a fantastic quarter in Europe. Then there are trading results from equities and also some trading results from foreign currency exposures, emerging market bonds, as I also mentioned on the P&C segment. And then we turned over some of the public equity and also we lengthened duration on our fixed income portfolio and some OEs. And when you sell at the moment any investments, you always feel like a gain because I think we have almost non-investment left with unrealized loss. Everything has a strong realized gain.

So the big swing in loadings and fees, I think that is more a technical change based on quite a number of foreign currency impacts. So in the operating profit, it has net a less visible impact that is some – Taiwan is growing nicely and has products with high loadings, then also Taiwan dollar is higher against the euro. And then, also the U.S. and then also some other market that is less of a change in the overall profit line.

Then I would move on to the value of new business. New business margins 1.5% is a drop of 1 percentage point and I have to make here an additional explanation. We are moving forward fairly radically and with full confidence to the Solvency II world, and therefore we have also adjusted our new business margin calculation. So what does this mean? Under the Solvency II world, the contract boundaries are quite different. So you cannot assume that a 12-month contract is renewed with a certain probability which was the old actuarial calculation. So, for example, our French group business, which are all 12-month contracts, most of them are being renewed after 12 months, but in the Solvency II world, you account for them as a 12-month contract. That means also the new business margin calculation for this business is then more or less being reduced to calculating a combined ratio. Make it very simple, that is actually also nice that some things are getting simpler in life actuarial terms.

But that has as a consequence that the new business margin might look slightly different, and I come to this point later, and you have much more recurrent premium new business in your books. And when you go in our appendix, you will see that actually the French business shows a huge increase in new business recurrent premium and that is the contract boundary effect.

So now, what would have happened to last year's new business margin with the new contract boundary? It is plus, minus a few basis points the same 2.5 percentage points we have shown last year. There are pluses and minuses. This statement is not true for each OE, but for the overall portfolio, and therefore we didn't make a big restatement page and started to go through all the analysis because the number variation in total was so small. But I think for the analysis of the profitability, it really doesn't change the picture.

But internally it makes the calculation much easier because now the market consists the balance sheet of Solvency II and everything we do for the Life business profitability calculation is now all integrated into one calculation, and therefore there is also no different assumption setting which makes everything in the long run easier for everybody.

And now, let's move to the investment margin. There are two things I would like to draw your attention to. Current yield, first line that is IFRS current yield dropped by 11 basis points without deeper looking at it. When you see how strongly the market value of the assets moved, so the average market value of the assets moved from €414 billion to €494 billion where the policyholder reserves only moved €40 billion, the difference in the movement is the market appreciation of all the assets. That means also when the same asset pool, when you calculate the average yield, the yield is already a bit suppressed, because of the higher market values, although you have the same bonds and the same coupons as before. And when you split the effects, then it is roughly half-and-half. I would say 5.5 basis points is true drop in yield and 5.5 basis points is the drop to asset appreciation, and that shows you actually more how slowly the yield is dropping.

Also it shows that based on policyholder reserves we have a much higher, nicer yield, as we only pay the yield to the aggregate policyholder reserves and not to the market value of assets. And then, comes the big item. It's the net harvesting and other that was a 0.7%, which I explained with some realization the duration lengthening and also trading result. But in this calculation most of it goes to profit sharing to policyholder, so that the net margin moves from 19 basis points last year to 25 basis points this year. The 25 basis points is, as I said, still too high for an average quarter, so probably more around 20 basis points is a more reasonable and that is equivalent to my €200 million less in investment margin.

So with this one I move to Asset Management. I think you all know the whole discussion and story around the PIMCO outflows. Again, market and foreign currency helped us a lot, because at first glance third-party assets are actually up to €1.4 trillion. I think the movement chart on the right-hand side of page 25 shows you that FX is a big driver of it and the outflows of PIMCO were at €68 billion. That is actually half of the number we had in the fourth quarter and the vast majority of the outflows is in the traditional business and only a smaller number in the non-traditional.

Before we forget it, Allianz global investors actually were €6 billion inflows for the quarter, a very strong number, and it's now the ninth quarter with this net inflows at €6 billion is so far our biggest number. Market appreciation also supported strongly the development at Allianz Global Investors and that is then also in the assets under management included.

When we move to the revenue page, also revenues are slightly up in the overall Asset Management business where PIMCO is 3% down in euro terms. In internal numbers, that means excluding FX, it's 20% down in revenues, and Allianz Global Investors is strongly up in all measurements, driven by market inflows. And that results then on page 29 in an operating profit development which is in euros 14% down. And excluding the dollar we would lose another 12%. And here it is the volume decrease has a big effect, but expenses stay more or less stable in euros and are not falling and that is certainly – in U.S. dollars, sorry – the expenses stay stable in U.S. dollars and therefore the cost income ratio at PIMCO is deteriorating by 10 percentage points.

We have not reduced our staff and we have additionally some one-off expenses. There is the higher – there is the retention package which we started in October. There are additional marketing expenses. There are some provisioning for the legal actions, defend cost, and there is also additional one-off proxy fees for some of the major funds because the lead manager is changing and then we have to redo all prospectus and everything.

So I would say in the PIMCO cost income ratio there might be good 2 percentage points of one-off costs in Q1, and please also remember that we said with our February outlook that we expect still a substantial amount of performance fees out of private funds maturing in the fourth quarter, so the whole annual result for PIMCO will be very much back-end loaded.

Finally, the Corporate segment a small €100 million loss including the €100 million one-off net because there were actually two one-offs €150 million from a pension provision but also some write-downs on software, so I would say the net one-off is €100 million and that is coming from a still restructuring or I should say bundling of the German pension schemes from local subsidiaries to the holding company and additionally we will in the second quarter also do some de-risking of this pension schemes in Germany, but also in other markets also to continue to manage our Solvency ratio.

And I now move to the last page with numbers only to mention that a tax rate is 2 percentage points lower, but for my perspective it is lower for the wrong reasons. The reason for the lowering as the mix of pre-tax profit PIMCO has a 38% tax rate which is above the average that means reduced PIMCO operating profit creates and also a lower effective tax rate and that is for me the wrong reason to get a tax rate down.

And now, let me come to the summary. In euro terms, revenues going double-digit, profit 5% and shareholders net income up 11%. Overall, I think we are reconfirming our strong capital and balance sheet basis in all measures, IFRS, Solvency I, Solvency II and as a B rating. And I think also in the Q1, we are showing the really substantial progress on all the promises we made beginning of the year and the promises starting with that we manage our Solvency II ratio actively finding a right balance between the risk taking and risk avoidance, because we want to benefit from the changes in the financial market. We I think on track to correct the developments in Brazil closing in Russia, integration of Fireman's Fund and also the outflows at PIMCO in line with our expectation for the first quarter, so I think that is a successful start in executing plan 2015 at Allianz.

And with this one, I open to questions.



## Q&A

### Operator

Thank you. We will pause for just a moment to allow everyone to signal. We will now take our first question from James Shuck from UBS.

## Q - James A. Shuck {BIO 3680082 <GO>}

Good morning. Thanks for taking my questions. I had three questions, please. Firstly, on economic capital, I mean obviously, you've managed the development since year-end to Q1 to be broadly flat. There's a number of moving parts in there. There's a certain amount of subjectivity around the calibration of economic capital. And I think in the past, you targeted 160% plus a 30% buffer on top of that and what's clear is that you have a certain degree of subjectivity around how you calibrate it. So my question is, what is the kind of additional buffer that you have to play with, with regards to how you actually calibrate the economic capital model? You've made some changes around policyholder participation rate assumptions, for example. I understand those are still above statutory minimums. But I just want to get a feel for kind of what scope you've got to actually manage that number, if possible.

Secondly, on economic capital sensitivities on slide 42, I was just a bit surprised to see that you're still fairly positively exposed to a higher yield environment. So, plus 50 basis points adds about 9 points to Solvency II. I was surprised to see that given the closing of the duration gap on the Life business. So if you could just explain where that's coming from, please.

And then, finally on the MCEV disclosure on slide 67, could you just talk through some of the movements here? I'm particularly interested in the asymmetric nature of the differences between the German-speaking countries and the Western and Southern Europe part of that. So, for example the interest rate being positive for Western Europe, but negative for Germany, obviously the German-speaking is clear, but the volatility differences and the equity differences. And I suppose there's a sub-set within that. Could you just talk about the negative experience variance you've had on Allianz Life U.S. following the very strong growth there, please? Thank you.

## A - Dieter Wemmer {BIO 4755450 <GO>}

Okay, James. Thank you very much. I must say I have to reject the statement about subjectivity in the economic model. If this would be our own internal model, yes, there would be subjectivity. But this is the model we are going to file over the next few weeks with the regulator as part of the official IMAP process. And that model is being accompanied by more than 60,000 pages of documentation, and that is now after three years of intense discussions with many regulators in Europe which are bundled under the Supervisory College who deals with Allianz internal model application. So that reduces subjectivity actually quite a lot.

What of course is still a management decision is how long you keep a certain crediting rate for a policyholder up depending on future interest rate scenarios. And this environment, actually more careful in crediting rates that are management decision, if you want to call this subjective, I think that it's more a careful reflection on what you see in the interest rate development in Europe altogether. But that is a small impact in the overall calculation in Q1. It is much more the active changes we have done to the asset portfolio, but also we are certainly also reviewing in-force business where we can adjust some conditions on group contracts. I think we are careful acting here in the interest of our customers, but also keeping a balance to the shareholders.

The interest rate sensitivity that is a complex thing, I think the better calculation which gives the deeper insight is the full economic Solvency interest rate sensitivity, because here we are modeled through the whole impact. A duration calculation is in the end a simplified calculation, in the end linearizing occurs which is actually convex. And this effect therefore shows different numbers. So even if the duration would be completely showing the same number, you are still not getting out of the interest rate sensitivity because our liabilities are convex. That means when interest rates are falling, the liability duration gets longer, and that is reflected in the interest rate sensitivity of the full calculations and just the shortened duration calculation.

On the sensitivities in the MCEV, page 67, the difference under the column German-speaking versus Western and Southern Europe, I think the totals are correct. I think there is some messing around with the individual numbers because you are picking here a good point. The signs look to me also difficult to interpret. I think we will look at this page 67 and maybe send out an updated version of it. We are this quarter a bit short in time and I think some of the checks probably missed this. Sorry for that.

## Q - James A. Shuck {BIO 3680082 <GO>}

No, that's fine. That's fine. Could you just clarify on the experience variance on the U.S. business, please?

## A - Dieter Wemmer {BIO 4755450 <GO>}

I think that is probably just a trading results out of the hedging, which are not always perfect as the uptake of some small base was clear and that is being updated in the changes, but that is very small. And that is driven by changes in interest rates that is coming from mismatches in the hedging program.

## Q - James A. Shuck {BIO 3680082 <GO>}

I guess, my point is on the U.S. We've seen very strong growth coming from Allianz Life. And I just want to be sure that that business is behaving as you thought it would do when you sold it?

## A - Dieter Wemmer {BIO 4755450 <GO>}

Absolutely. And by the way, there's a positive number.

## Q - James A. Shuck {BIO 3680082 <GO>}

It's a negative number, isn't it? Minus €386 million?

## A - Dieter Wemmer {BIO 4755450 <GO>}

Then I'm on the wrong page. I'm on page 67. I look at the €61 million.

## Q - James A. Shuck {BIO 3680082 <GO>}

Minus €386 million in point number two.

## A - Dieter Wemmer {BIO 4755450 <GO>}

Sorry. You are on table two.

## Q - James A. Shuck {BIO 3680082 <GO>}

Yes.

## A - Dieter Wemmer {BIO 4755450 <GO>}

Yeah. I was on table three. Sorry. Yeah. I think that it's – we need to follow up on this number. I think the operating profit margins are still all holding up.

## Q - James A. Shuck {BIO 3680082 <GO>}

Okay. We can take that up later. That's great. Thank you very much.

## Operator

Thank you. We will now take our next question from Paul De'Ath from RBC. Please go ahead. Your line is open.

## Q - Paul C. De'Ath

Yeah. Hi, there. Thanks very much. Couple of questions for me. Firstly on the duration management that you've been doing during the quarter. Obviously now, as you mentioned, the duration gap on the Life side is practically zero, should we now think that your – that actually you've lengthened the duration as much as you would like to? Or should we expect any more of these kind of actions going through the year? And just a viewpoint on that because obviously that's also impacted the earnings.

And the second point is just a bit of clarification really on the negative new business margin in France. Obviously, you mentioned this is due to the change in the contract boundaries and this turns negative. Should we just be factoring in negative new business margin in France? Going forward here, is this the new normal? And kind of under the real situation it will turn out fine, but under new MCEV guidelines you'll be reporting negative margins here? Thanks.

## A - Dieter Wemmer {BIO 4755450 <GO>}

Paul, I think the duration management's done for the year. I would not say – we continue to look at each OE and will continue to very proactively manage our solvency ratio. But certainly, as of today, as you have probably all noticed, the 20-year euro swap curve at the end of March was 79 basis points and the 20-year is a more important point in the interest curve for the solvency calculations than the others. And now last Friday, we were at 110 basis points, so 31 basis points up. That has certainly a positive impact on the overall solvency calculation, but we will continue to watch it. And as I said, derisking of the pension liabilities will continue, also matching of our pension liabilities because the duration gap in our pension liability is actually certainly bigger than in our customer portfolio, so that is also part of the interest rate volatility. So we will continue to work on this.

And then the French margin, no, actually I think the new measurement is probably giving a better transparent view on the tools. We have two major lines of business in France. On one hand, it is the Group Health business, which has – in combined ratio terms has a combined ratio above 100%. Therefore, the new business margin is negative. And the normal standard capital is a strong product in France is due to the interest rate difference between what we credit to the customers and new investment rates you can achieve in the market is also slightly negative. And we have – because you have to pay in between expenses, and we have to work on to reprice both products to turn positive. So, therefore, I think it is not due to the change in rules. It is a very transparent weakness.

## Q - Paul C. De'Ath

Okay. Great. Thanks.

## Operator

Thank you. We will now take our next question from Farooq Hanif from Citigroup. Please go ahead. Your line is open.

## Q - Farooq Hanif {BIO 4780978 <GO>}

Hi, there. I was wondering if you could quantify what would happen if you moved your U.S. business to now to two times the level of capital that you're assuming and also if you could comment on what BaFin thinks of your U.S. capital assumption that you're making in the equivalence calculation. That's question one.

Could you comment on – maybe you said this already, but could you comment on the actual message you used to increase duration, so how much of it was in sort of physical assets and how much was hedging overlay? And could you also, lastly, just talk about what you think the regular growth rate in your reserves is in the Life business if you exclude FX? So it was obviously up on an average reserve basis 11%, but it seems your net flows were also quite positive. Your interest rates are on a normalized basis holding up. So, do you think you could've achieved roughly 4% or 5% growth a year in your reserves and could you possibly quantify that? That would be really helpful. Thank you very much.

## A - Dieter Wemmer {BIO 4755450 <GO>}

I think if I remember correctly from end of 2014, we had roughly 8% net growth in the reserves and half was inflow and half was accrued interest. And three months later, the situation has not changed a lot because a lot of the inflows were from the second half of 2014 and certainly further supported by inflows in 2015. So I would say 7% to 8% is probably the growth effect overall. I think there's actually in our year-end book, there was certainly a disclosure for this.

I don't know what BaFin thinks, but certainly we are filing the model as we explained it and as it is here currently stated. I'm also positive that the EU Parliament will grant U.S. equivalence. And the whole discussion about what is the right percentage of [capital] is a very complicated one. I think you should start talking to your U.S. colleagues and look at the comparability of local solvency ratios. For U.S. VA business, the U.S. regulator has actually adopted a total asset concept. And that means you can either increase reserves or you can have a higher capital charge. And the U.S. regulator looks at the sum of reserves and capital charge. That means to the extreme if you want – if you assume you're a pure VA player, you could have €10 million capital charge and you have in your balance sheet €100 million capital and you would show 1,000% ratio. Or you show the whole €100 million as capital and not as a reserve charged and your solvency ratio would be 100%. But it is the same balance sheet. And this little refinement has to be considered quite a lot before debating what multitude you want to apply to what numbers. Therefore, I'm staying away from all this speculation, whether it's factor one, two, three, four or five because I think that are all debates based on an uneducated view on U.S. statutory requirements.

## Q - Farooq Hanif {BIO 4780978 <GO>}

Actually my question was probably a little bit more benign. What I meant was, obviously, you must have – I mean, BaFin are not going to be completely surprised when you input this model to them because they will have seen it before. Is that correct?

## A - Dieter Wemmer {BIO 4755450 <GO>}

Well, as I said, we are discussing with them all details since more than three years with the same team. And actually when we – I also said in the February call, when we changed to U.S. equivalent, of course, we had a consultation discussion with BaFin and we are not hip shooting.

## Q - Farooq Hanif {BIO 4780978 <GO>}

And is it a bigger factor if you changed your assumption?

## A - Dieter Wemmer {BIO 4755450 <GO>}

Well, in the end, that would go a few points down.

## Q - Farooq Hanif {BIO 4780978 <GO>}

Okay.

## A - Dieter Wemmer {BIO 4755450 <GO>}

And actually probably the gap between internal model and equivalence is, as we speak, smaller than at the beginning of the year. I did not do the test, but U.S. interest rates are on the rise again, credit spreads came down. So probably end of April number, the difference between the two is certainly smaller than January one, but it's not relevant as we will file now with U.S. equivalence.

## Q - Farooq Hanif {BIO 4780978 <GO>}

Okay. Thank you very much.

## Operator

Thank you. We will now take our next question from Thomas Jacquet from Exane. Please go ahead. Your line is open.

## Q - Thomas Jacquet {BIO 4110153 <GO>}

Hi. Good afternoon. So my first question is on the Italian Life new business margin. I'm quite surprised to see such a decline in new business profitability, given the fact that you have a lot of unit-linked, so do you plan to take actions to restore profitability? Or is it something linked to the calculation methodology? And my other question is regarding your – the management actions you've taken to save the solvency. Can you give an order of magnitude of the different things you've done? And can you specify whether you used some hedging techniques and some – buying some options, for example? Thank you.

## A - Dieter Wemmer {BIO 4755450 <GO>}

Yeah. Well, the drop in Life new business margin, it's – I think they have a good new business margin on the unit-linked business, but also the classical Italian general account business has a small negative new business margin. Why is that? Because the old fund credits to the customer a higher interest rate than what you can achieve in the investments so, therefore, you are in the end making a loss when you calculate it standalone, and that is what a new business margin should reflect. So, therefore, it is not a surprise and we have to do repricing or changing of the traditional business to get the overall new business margin back to a good level. The unit-linked sales standalone are absolutely fine.

So what did we do in ALM? I think, to a large extent, we just bought longer physical bonds. But then also we have extended our swaption programs, but I think the bigger part were actually futures, which we executed and which we are using in hedge accounting. That means they are not – you are not seeing any derivative impact in our P&L.

## Q - Thomas Jacquet {BIO 4110153 <GO>}

Okay. Thank you very much.

## Operator

Thank you. We will now take our next question from Jon Hocking from Morgan Stanley. Please go ahead. Your line is open.

## Q - Jon M. Hocking {BIO 2163183 <GO>}

Hey, there. I've got three questions please. Firstly, could you go through the movements in the solvency ratio? You were talking faster than my ability to write unfortunately. I think you said market movement 16 points, 20 points of action, 4 points of hybrid. I think I missed something in the middle. That's the first question.

The second question, on the duration gap narrowing, has all of that been achieved on the asset side or have there been some changes to modeling on the liability side? I'm just wondering whether some of the currency rate adjustments you've put through have actually made a difference to the duration liabilities.

And then finally just on the reinvestment yield for the Life business, on I think slide 23, you sort of break out a lower number due to the impact of derivatives. Just wondering if you can explain what the difference is between the gross number and the lower net number? Thank you.

## A - Dieter Wemmer {BIO 4755450 <GO>}

I think with the last question you lost me. What is...

## Q - Jon M. Hocking {BIO 2163183 <GO>}

So just on slide 23, Dieter, there's...

## A - Dieter Wemmer {BIO 4755450 <GO>}

The new investments?

## Q - Jon M. Hocking {BIO 2163183 <GO>}

In brackets, or in the bubble actually. The 2.2% down from 300 (sic) [3%] the prior year, and there's a breakout bubble, so in the economic reinvestment yield including derivatives.

## A - Dieter Wemmer {BIO 4755450 <GO>}

Yes. The duration extension on the new business, when I include also the forwards and these are more the AAA government bonds, then that reduces the average new investment yield.

## Q - Jon M. Hocking {BIO 2163183 <GO>}

So the model – the economic one, we should be using the 1.7%, that's the number to compare going forward, is it?

## A - Dieter Wemmer {BIO 4755450 <GO>}

Well, that in accounting terms in the next number of years, the 2.2% is what materializes. Because the 1.7% if you buy it forward during the forward period in hedge accounting, that is a zero impact of this one that will only crystallize after the forward period.

## Q - Jon M. Hocking {BIO 2163183 <GO>}

Okay. Okay. Thank you.

## A - Dieter Wemmer {BIO 4755450 <GO>}

And so that was this question. Then the Solvency II movements, I think that was – in total, the downward changes were 19% and the upward changes up obviously 20%, otherwise it's not moving plus 1%. And there is – I think that's mainly the management actions and then, of course, including the hybrid, which makes 4 points.

## Q - Jon M. Hocking {BIO 2163183 <GO>}

Is it possible to break out a little bit the 19%?

## A - Dieter Wemmer {BIO 4755450 <GO>}

Well, I thought actually more it was our result call and now it's becoming a Solvency II seminar. I think you are only using the very detailed disclosures of Allianz to challenge the others. That is fine, but I'm actually not sure whether Allianz gets a lot of benefit out of the details. It seems that every detail creates only a myriad of further reviews of our model, and that is already being reviewed by the regulators.

## Q - Jon M. Hocking {BIO 2163183 <GO>}

Okay.

## A - Dieter Wemmer {BIO 4755450 <GO>}

So the main driver is asset duration. There are some equity hedges in it. There is a better matching of our own pension liabilities and things like that. So in each of our Life OEs I would say it is a list between five and 20 smaller actions and it is all adding up. I think it's for the very orchestrated activity across the group, and the group has demonstrated that they can live in a Solvency II world because Solvency II means active management, and it is not a stable number which you calculate once a year and which is only changing every five years like Solvency I. And I think that is what you have to learn when interpreting it and the companies have to learn to manage it.

## Q - Jon M. Hocking {BIO 2163183 <GO>}

Okay. Thank you. And then the duration gap closure, that was up principally on the asset side, or was there any liabilities?

## A - Dieter Wemmer {BIO 4755450 <GO>}

I think liabilities are naturally going also slightly up because we are in a convex world, and convex actually means that when your credited interest rates goes closer to the guarantee, you get closer to the pure native duration calculation of the guarantee. So, as long as you pay high crediting rates, your liability duration appears further because the crediting of the profit sharing reduces so to speak the average duration. That is the explanation for the convexity.

## Q - Jon M. Hocking {BIO 2163183 <GO>}

Okay. Thank you very much.

## Operator

Thank you. We will now take our next question from Andrew Ritchie from Autonomous. Please...

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

Hi, there. I promise I wouldn't ask about Solvency II.

## A - Dieter Wemmer {BIO 4755450 <GO>}

I buy you a beer in London for this.

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

Okay. I'll remember that. The first question just on normalized. I noticed the – in the roll forward chart of the accident year loss ratio you showed a 1.8% effect of frequency and severity excluding NatCat. I think from your comments you would suggest a lot of that is sort of weather effect underneath the NatCat and maybe some large losses, but maybe just give us a sense as to are there any underlying severity trends?

## A - Dieter Wemmer {BIO 4755450 <GO>}

Yes. There is a bit of the weather. But as I also said, in Q1 2014, we were still too optimistic on Brazil on Fireman's Fund and also Russia and the whole catch up which happened during the quarter during 2014 is of course now embedded also in Q1 2015. So, that has certainly changed also in the numbers. So therefore I think when you look on the same page on the comparison to Q4, you actually see, well, quite a lot of improvement to Q4 and Q1. It is, of course, always tricky because you are as a very experienced analyst know that there are all the seasonal effects in loss ratios and, therefore, we usually compare season by season, but for Brazil and Russia that was less of a seasonal effect, that was really operational deterioration and that...

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

I guess I just observed in some of the commentary you talked about severity in Italy and I think Turkey. I mean is there – what is severity out running in Italy for example?

## A - Dieter Wemmer {BIO 4755450 <GO>}

Well, our claims average is slightly up, that is – and in Turkey as well also on the motor side. But that is I think in the – that is probably not baking in a lot here in the numbers. Yes, our attritional loss ratio also in Italy is slightly higher than a year ago, and that is not surprising as the whole market is reducing rate. And we can also not keep rate completely unchanged.

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

And frequency is no longer falling presumably?

## A - Dieter Wemmer {BIO 4755450 <GO>}

Frequency is actually slightly lower in Italy. It depends whether you look on MTPL alone or whether you look at other MODs. The total frequency in Italy for our book is still a little bit lower.

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

Okay. And then the second question...

## A - Dieter Wemmer {BIO 4755450 <GO>}

MTPL is a little bit up.

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

Okay. Great. Second question was just on the Life new business in the U.S. You mentioned in your comments, I mean you repriced it to maintain the margin, but the margin still fell quite a lot year-on-year. I guess I'M just curious, why did the margin fall on a product that's not that interest rate sensitive, the FIA product? And also I'm a bit surprised sales fell as much as they do. I thought you still had exclusive use of the Barclays Hedge and that still meant that even in your repricing you would still see decent volume growth. So maybe just a bit more explanation on what happened to the U.S. would be useful? Thanks.

## A - Dieter Wemmer {BIO 4755450 <GO>}

Well, I think, first of all, the starting point with last year is a fairly high sales volume. There is also a little bit more competition coming in. And the product is in falling interest rates less attractive for the customer. Therefore it is not surprising when you increase your fee charges that means that the total return for the customer is reduced, that you have less sales. Our bigger step in repricing will kick in in April. We did two smaller steps in repricing in the first quarter and we did not maintain the full new business margin, but the new business margin is still above our 2% level. And it was in the end a local decision to trade off between volume and margin, which is okay from a group perspective as long as the margin is above 2%.

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

So the repricing may affect volumes a bit more, but I guess you get a bit of margin back?

## A - Dieter Wemmer {BIO 4755450 <GO>}

We get a bit of margin back in the second quarter, yeah.

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

Okay. Great. Thank you.

## Operator

Thank you. We will now take our next question from Michael Huttner from JPMorgan. Please go ahead. Your line is open.

## Q - Michael I. Huttner {BIO 1556863 <GO>}

Thanks. I'm afraid I'm not going to merit any kind of beer, but I hope this is a Life question. On this Solvency, my understanding, I mean it's very, very high level, it's effectively the big trade-off is that or the big management action involved futures and as you describe them they go through the balance sheet and the impact on earnings therefore is limited for however long the future's hold. Is that the right way of thinking about it? In other words that in a way – let me use my words carefully, the management actions that you took have no immediate impact in terms or very little immediate impact in terms of earnings?

And the other question is the combined ratio. So I was trying to guess what a sustainable level would be. Coming around, because there's a bit of pricing improvement still coming through, maybe the weather was a bit worse in Q1, I don't know, is 94% the right level, 93.5%? Just trying to average all these things out which you mentioned, given that it's a bit worse than Q1 2014. But the other – it seems a bit better than the rest of the year, and the rest of the year seems to have averaged just around 94% and a bit, 95%. And then the last question is on the PIMCO. How much is the – can you give us a rough idea of how much performance fees is to come, just so we know what figure to add? Thank you so much. And yeah, sorry, no beer.

## A - Dieter Wemmer {BIO 4755450 <GO>}

No beer, yeah. I think that was indeed a light question on Solvency II. Maybe you get half a pint.

## Q - Michael I. Huttner {BIO 1556863 <GO>}

Thank you.

## A - Dieter Wemmer {BIO 4755450 <GO>}

So impact on earnings is very small through the actions. I think some of the shorter dates at physical bonds we replaced by longer dated, that was probably the more of – well, economically it was probably positive in operating investment income is small change. I think the futures maybe a third of the whole lengthening program. It was a lot in physical bonds and there are also some additional swaptions which we added. So it was a well-balanced package between all this. We're really looking at the individual situation. You have to remember that actually a lot of the balance sheet are split in segregated funds, and you have to take the right decision for each of the segregated accounts. There are individual policyholder, shareholder rules, there are accounting regimes that vary different from country to country. So therefore you cannot take one strategy to solve the problem, it's really a very detailed bottom up work.

On the combined ratio, I think for me the more important statement was that we are on track with the turnaround cases, and we said that we will keep in the mature markets the combined ratio stable compared to last year. And I think that we are going to do because the small deterioration in Italy, and actually Italy is holding better up than I expected because I thought that the Unipol portfolio will have a more worse loss ratio than our portfolio, but in the end it played out that we are – it is a little bit worse than the Allianz average portfolio. So therefore the average combined loss ratio in Italy, and that is a 20% portfolio extension in Italy, is actually looking very strong, that means supporting our underwriting results.

France and Germany continues to have rate increases, so also support from there. AGCS and Euler are holding up and the turnaround candidates I think are on the right track. Russia will just be diminished to 12 to almost nothing. Brazil is on a good way going forward. The personal lines business Fireman's Fund is sold. And the commercial business before we improve the loss ratio there, that is a longer-term work. But I think we see already some good first steps on the expenses, certainly paid by restructuring charges, but the restructuring charges will also be offset by €330 million proceeds from ACE, so I think that is all balancing out quite well.

## Q - Michael I. Huttner {BIO 1556863 <GO>}

All right. Fair enough.

## A - Dieter Wemmer {BIO 4755450 <GO>}

And PIMCO, you had a question on the performance fees. Well, in the end when you take the midpoint outlook of our Asset Management segment, you can almost easily calculate how much performance fee has at least to come.

## Q - Michael I. Huttner {BIO 1556863 <GO>}

Okay. That's brilliant and well done on the segregated funds and all that. Really well done, that's amazing what you did. Thank you very much.

## Operator

Thank you. We will now take our next question from Thomas Seidl from Bernstein. Please go ahead. Your line is open.

## Q - Thomas Seidl {BIO 17755912 <GO>}

Yes. Thank you. Good afternoon. Three questions, please. I'm also in for a beer, it's only on earnings, not on capital. The first question is on, I come back to the U.S. Life and also maybe Italian Life, and the fact that you repriced the business. From a management perspective, does this imply that the business you sold the last one or two years basically now looks not as good as you thought, and hence the need to reprice. What triggered this need to reprice and how should we think about the back book rather than the new business as you say right now? First question.

Second question, you mentioned of course the obvious problem at PIMCO, the lower scale driving up cost income ratios. So what are the plans here? Do you expect the asset situation to stabilize or even improve from here, or should we expect that you take material action to bring the costs in line with the lower scale?

And the third question is on the P&C segment. We know that the price momentum seems to have stabilized right now. After a number of quarters we're now at 80 bps increase, which is not great, but it's still stabilized. My question here is from here is, your expectations that we basically see a slight upward trend? Or when I just look at the page 59, overall, it seems to be maybe slightly going down going forward?

## A - Dieter Wemmer {BIO 4755450 <GO>}

Okay, Thomas. The repricing in the U.S. is actually a very ongoing activity, and I think in 2014 we have repriced eight times our fixed index annuity business because we are selling the business, so to speak, in tranches. We look every two weeks how did the U.S. Treasury rate move and depending on this, we calibrate our expense charges, but also we take our investment income because we match the received premium with an investment being done. So, therefore, the old business is not affected by this one. It is an ongoing adjustment, and additionally in case that there is something wrong, we can on a yearly basis, but always with one year delay, adjust the fee charges for our fixed index annuity business in the U.S. and, correct, therefore I'm not concerned at all about that business looking in the past.

In Italy, well, I think that the large difference between your old yields you have in the portfolio and your new money yields is creating a problem and that is an inherent problem in most continental European countries for all this general account business and that is simple. You can go to your bank, borrow €1 million short dated and invest it in a life policy and there are combinations in Europe possible, there you can create a positive arbitrage out of it.

And I think what we have to do to ensure that our products are not giving any opportunity to this type of arbitrage and that has definitely introduced limits on the sizes of single premiums in Germany for example. You are in the first – when you buy a single premium policy. The first five years you are not participating in the general account returns. You get a substantially reduced total return because the arbitrage guides are not patient to wait more than five years and there are also steps you have to do when you have such an anomaly in interest rates between existing yields and new money yields.

I think the pricing increase of 18 basis points, I think, that is for the overall portfolio, still a good number, because we are still living broadly in a flat claims inflation growth. You can read everyday how desperate ECB is trying to create inflation in Europe. Italian business – I answered PIMCO, yes, sure, lower scale is correct. Total Return Fund smaller than before. I think with the expense actions, we are more prone to invest in the future and building up the next development phase of PIMCO instead of optimizing next quarter's earnings. But certainly the one-off expenses of Q1 should also be less and as I said, maybe 62% is a too high cost income ratio and slightly below 60% is a better cost income ratio for the year, not counting on performance fees. If you add them, then of course we are back to a very good cost income ratio.

## Q - Thomas Seidl {BIO 17755912 <GO>}

That's true. Okay. Thanks, Dieter.

## Operator

Thank you. We will now take our next question from Nick Holmes from Société Générale. Please go ahead. Your line is open.

## Q - Nick Holmes {BIO 3387435 <GO>}

Thank you very much, there. Hi, Dieter. I've got just one question. I'm afraid it's on Solvency II, but it's a nice Solvency II question. I wanted to ask, looking positively at what Solvency II is doing for the industry, do you think that you will stop writing guarantees in Germany? And do you think the whole industry is going to change, that everybody's going to get out of the guarantee business? And this could actually be a very good thing for the industry overall. Thank you.

## A - Dieter Wemmer {BIO 4755450 <GO>}

Yes. That is indeed a nice question on Solvency II. Well, maybe the industry would not consider it as a nice question. I don't think that we would stop writing any guarantees. I think when you look at our product, Perspektive in Germany, that is exactly our answer to writing guarantees in the Solvency II world, because that product has split the guarantees into two halves and therefore you end up as a duration liability, which you can match with assets, the accumulation phase until people are 60 or 65, whatever they pick as retirement age and then a new market-adjusted guarantee from the decumulation point starting.

I think that is one of the potential answers to Solvency II and also our fixed index annuities in the U.S., which we sell also quite – very well, actually in Germany – also examples, because these products are matched. And you have more options to re-price and react faster to market movement and certainly the industry in Europe has still to become more flexible with the fast changes of the financial markets – that we are living at the moment in this total – extreme yield scenarios driven by quantitative easing exercising around the globe. I think that is something different, but even if this goes away, that interest rates will recover to 6% is very, very unlikely. And also financial markets are today much more volatile than we were all used from previous periods and this volatility is probably more of the driver that this 40 years stable guarantees are very difficult to manage.

## Q - Nick Holmes {BIO 3387435 <GO>}

Thank you, Dieter. So just to clarify, are you actually selling at the moment open-ended guarantees in Germany, ones that can extend 20, 30, 40 years.

## A - Dieter Wemmer {BIO 4755450 <GO>}

To a small extent as everybody else in the market, but I think we do. This is a very large and highly capitalized balance sheet and it's in our new business I think by far the smallest share of all players.

## Q - Nick Holmes {BIO 3387435 <GO>}

Right. And in 2016, would you actually stop altogether writing that type of business?

## A - Dieter Wemmer {BIO 4755450 <GO>}

Look, as we are measuring internally already now for several years under the Solvency II regime and we managed the company like in 2016, why would we act next year differently than this year?

## Q - Nick Holmes {BIO 3387435 <GO>}

Okay.

## A - Dieter Wemmer {BIO 4755450 <GO>}

You cannot start acting under Solvency II on January 1; that will be a bit late. It seems so that some people believe they can start next January, but I think that is a bit late.

## Q - Nick Holmes {BIO 3387435 <GO>}

Okay. Thank you very much.

## Operator

Thank you. We will now take our next question from Michael Haid from MainFirst Bank. Please go ahead. Your line is open.

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

Thank you very much. Good afternoon. Michael Haid, MainFirst Bank. One question on Allianz Leben, certainly Allianz Leben is not amused by the current low interest rate environment. So my question is maybe a little bit broad but aside of lengthening the duration of the asset side, what other measures you take or you plan to take to improve the situation here? I guess, my question goes into the direction, how can you improve the mortality results or cost results or what other measures can you take or you have already taken?

## A - Dieter Wemmer {BIO 4755450 <GO>}

Well, first of all, I actually read your study on the German life insurance industry, was the very well done and very interesting reading material, Michael. So what can we do in the ultra low yield environment? I think we play here our scale and peer advantage. I think that is the product design I mentioned already to reduce duration length. I think that is the deferral period we have on the single premium products, then I think our cost advantage is probably around 80 basis points compared to the average market. And our asset strategy is probably also more exploited and more sophisticated. We – as a part of the

Garrison, I mentioned right in the beginning of my presentation, of course, is being held by the investment portfolio in Stuttgart in our life balance sheet, and that is also a type of investment which is lengthening out our asset duration and gives still reasonable returns.

I think it is really a combination of all of it. And I think the scale advantage and the active Asset Management is probably the main positive. That does not mean that we are sitting idle on our old successes. We are constantly working on further changes and improvements.

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

How easy would it be for you to improve the expense result, which, if it's negative, it has to be carried...

## A - Dieter Wemmer {BIO 4755450 <GO>}

We had the positive expense result.

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

Okay. Thank you very much.

## A - Dieter Wemmer {BIO 4755450 <GO>}

And, Christy, we have time for one more question, if there's any.

## Operator

There are no further questions in the queue.

## A - Oliver Schmidt {BIO 2473131 <GO>}

Great. Great. Thanks for joining the call. We say goodbye to everybody and have a very nice remaining afternoon.

## A - Dieter Wemmer {BIO 4755450 <GO>}

Yeah. Thanks so much and see some of you in the next days. Thank you. Bye.

## Operator

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

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