Q2 2014 Earnings Call

Company Participants

- Dieter Wemmer, Chief Financial Officer & Member-Management Board
- Oliver Schmidt, Head-Investor Relations

Other Participants

- Andrew J. Ritchie, Analyst
- Andy D. Broadfield, Analyst
- Atanasio Pantarrotas, Head of Insurance Sector Research
- Farooq Hanif, Analyst
- Jon M. Hocking, Analyst
- Michael Haid, Analyst
- Michael I. Huttner, Analyst
- Nick Holmes, Analyst
- Paul C. De'Ath, Analyst
- Thomas Seidl, Analyst
- Vinit Malhotra, Analyst
- William S. Hawkins, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, welcome to the Allianz Conference Call on the Financial Results for the Second Quarter 2014. 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, Rhonda. Yeah, good afternoon from my side as well, and welcome to our conference call about the results of the second quarter 2014. For the sake of time, I hand directly over to Dieter, without further ado.

Dieter Wemmer {BIO 4755450 <GO>}

Thank you much, Oliver, and good afternoon or good morning to everybody on the call. Before I dive into the financial of the quarter, let me start with our business highlights page and a short view in the engine room of the company which drives the results.

I think that we are making good progress on product innovations on the Property and Casualty side, as well as Life and Health. I think in P&C, it's about really driving much more modular products for the retail segment, as well as digitalizing the success of the products.

Life and Health, I think when you see the high growth numbers in the segment, it is coming from the fact that we have broadened the answer to the challenge in the Life market. I think the traditional answer that in these times, you can only do unit-linked and risk products to create capital light product was extended by our hybrid products and, in particular in Germany and U.S., they are driving a lot of successful growth.

Asset Management, Allianz Global Investors had great inflows, highest inflow in their short history since they are working under this brand. Investments, we continue to prop up our real assets investments by the proactive investments because active investment process is in these times of low yields really the game. Transactions, that is just an update. The UnipolSai acquisition has now its first closing, 725 agencies out of 729 agencies actually signed a contract with us. So it is moving on as planned.

And on one hand, to improve our scale in Belgium and Netherlands, we merged already the management responsibilities there some 18 months ago, and now we have actually also added the first cross-border of the P&C entities, which is not only enhancing the management but also helping the capital requirement under Solvency II.

And in Branding, I think we are expanding our branded football and rugby stadiums by adding a stadium in Vienna that is now in a build phase and the name Allianz will be then on the new stadium from 2016 on.

So all these activities and that was just a short selection of the second quarter. What did it do to our numbers? We are really enjoying double-digit revenue and profit growth in the second quarter. Revenues up 10%, mainly driven by Life, and I will show you in more detail later. Operating profit, even 17% up. Next to P&C, actually, Life was the substantial outperformer of the quarter. Asset Management, weaker than last year, but as expected for the year. And also the Corporate segment supported with outperformance that we ended up the quarter with €2.8 billion, almost €300 million about our pro rata outlook of €2.5 billion.

The great progress in operating profit translates then also into a 10% net income improvement. Here, the growth is smaller than in operating profit because we substantially had less realized gains than a year ago.

So how did the balance sheet develop? Actually pretty much parallel, almost hitting also the double-digit growth in equity, where – since our payout of €2.4 billion dividends during May actually stopped us from actually having also here more than 10% growth. But the development of shareholders' equity and our top line and risk-taking was very much parallel. You can see that the Solvency figures in both measurements almost didn't move.

And on our economic Solvency, we are still including the sovereign credit risk, so unchanged measurement compared to Q1 when we would exclude the sovereign credit risk as some of our peers doing, we would have shown a 220% ratio instead of the 205%. The dividend accrual continues to be at 40% payout ratio and we are not changing the accrual until we had our announcement as promised in December. And then we will see how it is changing. And whether it is changing, we are not giving any firm guidance here. And I think after the Capital Markets Day, nobody actually should also expect that we would say today anything different.

P&C segment. I'm explaining here the overall numbers. I will then dive into the individual country numbers a little bit later on this new page we have introduced in the presentation. Overall, 0.9% net growth on the top line. FX still a negative impact. Without FX we would have seen 2.6% growth of which volume effect is 3%, and pricing is minus 0.4%. The pricing was very positively in Germany. It continues also to be positive in France. The U.S. also see still a pricing of about 3%, and Central and Eastern - now starting with the negative, that is Central and Eastern Europe, AGCS has still seen weakening, in particular, in marine and aviation. However, with the tragic events around the Malaysian Airlines and then also the other two airline crash we have seen in the recent weeks, that could be the triggering points that we will see going forward, positive rate developments in aviation.

The biggest negative number is Italy. It's minus 7% in the second quarter compared to a year ago, but it is not yet creating actually a lot of pressure on the profit line because when we now turn to the next page, our - or maybe I'll manage completing it here, the Italian story, our accident year loss ratio actually in Italy is still better than a year ago because severity as well as frequency are down on a Q2-over-Q2 comparison. So therefore, the price decreases, it's nothing to complain about.

Is minus 2.2% negative growth in Italy, good or bad? Well, we expect that the market at half year was at minus 4.5%, so we are still growing market share in Italy.

When we now go to the overall profitability, and I have to admit that the combined ratio story is a little bit more complicated than in previous quarters, because we have to sort out some effects. So let's take the simple reading, combined ratio 1.4% improvement, but when you look at cat losses down from 5.3% to 1.6%, that would mean an improvement of 3.7%. When you now subtract the run-off ratio which is 2.3% lighter than a year ago, you end up into the decimal point with the improvement of the combined ratio.

And in the insurance, there's always a however, so therefore, I have to continue with the however. We have a 1.1% worsening of our large losses. So the little bit higher large losses are actually masking that our underlying attritional loss ratio improved by this 110 basis points, which I think is pretty much what our indication was during previous quarters that we still have a very good run rate improvement overall.

So is the run-off ratio of 3.4% disappointing? I will give you a little bit more insight into this in a moment, but let me first look at the operating results by OE and country. So the biggest positive swing is Germany, of course, which had a lot of cat losses a year ago and the improvements which we had the opportunity to present to you in our July 2013 Capital Markets Day, I think we have all outperformed any of the set targets.

France is also a - it's a little bit down in operating profit but actually combined ratio in the second quarter was influenced by the storm, Ela, which hits half Germany, half France, roughly. Italy is mainly less run-off result or it's actually all - less run-off results in the previous year, and AGCS has a really good combined ratio despite that it had actually to bear all the additional large losses in the second quarter. And I will then come to the next page where we are showing a slightly different view and angle of the overall portfolio.

We have split our portfolio into three groups. The one who are performed in the first six months because I think combined ratio looking at single quarters only is not really making solid statements, longer periods offer better insights. So below 95% is the first group; between 95% and 100% is the second; and then also there is still not an empty box above 100%, but I will come to this one.

Let's start with the best group, that is 63% of our portfolio with an average combined ratio of 88%. Big contributors are Germany, Italy, AGCS, and of course, also the credit insurance, but there was not more room in the column, so I could only pick the best suite. And Germany had really, in the first half year, a 91% combined ratio. And actually, they did not benefit too much from the low cat events. The second quarter was pretty much consuming the normal cat losses. But what is really great here is the growth.

We have 6% internal growth and over the half year 3.3%, clearly outperformed expectation. And our target for the year was at 26% expense ratio, and we are with 25.6%, clearly ahead of this one. Italy, I mentioned already that despite lower rates, accident year loss ratio including motor is still improving. And AGCS I think has another a very good quarter or half year of good loss ratios.

So second group, 30% of the portfolio with an average of 97%. U.K., you have just seen at the Capital Markets Day half year almost 10% growth. Actually in the second quarter, we had 15.5% growth stand-alone. France, almost made it to the below 95% combined ratio group but also the other half of the cat loss in the second quarter stopped them to moving there. But I'm confident that they have good opportunities to move to the below 95%-class. And AWP, as we also presented at the Capital Markets Day, that is of course the OE, which is strongest, focused on growth and also delivering it.

The class, which I would like to have completely emptied by now, we have still three companies in the above 100% category. And as I've said before, let me start with the runoff results. We are showing for the whole segment 3.4% positive runoff and the three companies who are listed here are actually consuming 1 percentage point out of it. That means without reserve increases in Russia, U.S. and Brazil, we would have shown a 4.4% runoff results for the year - for the quarter, sorry. And these two effects more large losses and the negative runoff of these three countries are certainly a breakdown on an excellent combined ratio, so you can also say a potential upside for the future.

So what is wrong with the three places? Well, Fireman's Fund is a true disappointment because the target of making a little underwriting profit this year is completely out of reach. We have three effects – there was already the bad start and the first quarter with weather-related losses. The weather-related losses continued in the second quarter. We were hit by two large settlements of individual large claims really from the past, some 10 years to 15 years old, and certainly we have revised our accident year loss ratio assumption for the commercial business and this together with – well, actually the negative reserve fund offer the two large claims I mentioned already.

Russia, the change in the rights to litigate a motor claim that was some – almost two years ago, the law changed in Russia. And in particular, the areas far outside Moscow and St. Petersburg are making heavy use of this option to sue the insurance company after a little car accident. And this has made the market, I think for all motor players, very unattractive. And in particular, I feel that the foreign insurers in Russia are getting the more difficult part in this game. And that's why you'll see a withdrawal of foreign retail insurance in Russia to some extent. And we will also reduce our branch network substantially. And we have already started to reduce the branch network, and we'll focus on the large cities only.

Brazil continues what I explained already in Q1. The IT platform issues have not been fully resolved and have been aided by a lack of pricing in the Health segment where the inflation has outgrown our pricing assumptions so that we have now to deal with two issues, get the IT platform fully aligned with what a Brazilian broker wants to see in processes; and secondly, get the re-pricing of the group health portfolio done. But we have worked out a very detailed action plan already, and I think we are very positive that we can solve this problem ourselves without any help.

P&C operating investment results is holding up very well. I think also the reinvestment rate is even slightly higher than last year. That affects from one hand the U.S. but also some emerging markets, and also a stronger shift to corporate bonds. And we have started again, some months ago, to buy Spanish government bonds, which we had spent for quite some time.

Now, the Life segment. Strong growth as indicated. Germany, very successful with our new hybrid products but also with some standard single premium products and group benefit schemes, leading to 20% or 21% growth in revenues and 40% in new business premium. And Germany, our leading Life company, is then also representing the average of the segment, which shows that everybody else continues to grow strongly.

In Germany, we are certainly grabbing market share. Please remember that on a business-in-force basis, our market share is probably 17%, or by now maybe 18% of the market, where in new business, I would not be surprised that we would go close to 30% in market share this year.

Italy, continued success of, on one hand, the unit-linked, although the growth, after the strong sales volume last year, could not be repeated but we kept the high volume unchanged. And then we had non-unit-linked business growth, mainly sold through UniCredito, our partner in Italy.

The biggest sales success is our fixed-indexed annuity business. We have actually – when you look at the internal growth figure, that means in U.S. dollar terms, we doubled our revenues in the U.S. and our new business volume grew 86%. So – both are very strong numbers and that is one fixed-indexed annuity product, which is exclusively using one Barclays index, which is a dynamic combination between S&P 500 and Barclays Aggregate, and that sells very well and it's also a product which is not only good for the customer but also giving us a 3.8% profit margin, which I will show you in a minute.

Besides the big balance sheet, we should also not forget that actually Asia Pacific and Switzerland are also on a good growth in new business. Also, our German Health business is back on track in growth, and also Central and Eastern Europe.

Before we go to the new business margin and volume, let's first talk about the operating profits. €984 million quarterly operating profit, almost €1 billion, actually has never been reached before. So how did we do this in this difficult market? The big jump is in the investment margin. It's a plus of €330 million. And to be very fair, I think this result is about €120 million of positive one-offs. And what I would actually do is when you compare second quarter 2014 to second quarter 2013, so it's a good €300 million improvement.

I'm memorizing these numbers, very simple. The whole difference I cut into three pieces. The first third was a negative one-offs from last year, mainly losses – foreign currency losses on foreign currency investments. The second third is really underlying profit improvement, and the last third are the positive one-offs of the quarter.

So what are the positive one-offs of the quarter? So around €120 million half-and-half between Germany and U.S. Germany benefited strongly from its interest rate derivatives which are of course, were really increasing substantially with the bund going down in the second quarter substantially.

Then the other point is we had some additional harvesting in Germany, but not on equities. We sold some old real estate buildings, as part of our normal renewal of our real estate portfolio. And in the U.S., there are – there it's mainly a positive hedge results which are the driver for the one-offs.

You can also see here in this information that actually our risk margin went down by €78 million that it's two-halves of it, one, is a change in the German law, which we discussed also at the Capital Markets Day, which did cost us including the catch-up for the first quarter, some €40 million. That means, for the whole year, you have roughly to calculate that our technical margin compared to previous year's is €90 million lower.

This has been compensated by more investment margin as we are changing the policyholder/shareholder split on the investment margin in Germany and that is also a sustainable change. So in total, our German customers are getting the same amount as before, only the source of profit is shifting slightly between mortality and investment margin.

So now our value of new business. The value of new business is €380 million; it's a substantial increase over previous year, so driven of course by 40% higher volume, but also by nice improvement in the new business margin, which shows that our new product generation and it is not only unit-linked and risk business, are really addressing customer needs and are creating really sellable products.

We had in the quarter, which I did not mention before, around €4.2 billion, €4.3 billion of net inflows, which shows that a substantial investments from the customers is going to our balance sheet. And also, this substantial volume of new business, of course, did cost something – I should have mentioned it – so the operating profit of the new business of the quarter was a negative of a bit more than €60 million. That means, probably without the substantial increase in new business volume, we would have ended up as €1 billion, instead of the €984 million.

So the investment margin, I think I have almost already explained that the combination of the negative and positive one-offs and base improvements that our new business margin moved up from 17 basis points to 25 basis points. So we have given so far as a guidance that's a normal level at 75 basis points for the year. I probably would increase it now closer in the direction of 80 basis points.

What is also important to notice is actually the growth in our aggregate policy reserves. There is, on one hand, accrued interest rates, which is growing nice but on the other hand also to a substantial net inflows, so that actually is the basis on which we earn our investment margin is around 5% higher than in previous year and 5% more base times a slightly higher investment margin results then also into a positive shift of our overall outlook for the Life segment.

Now, let's come to the Asset Management category. And I think it is pretty much delivering what we believe in the beginning of the year and what we've set with our outlook for 2014. We see a good performance based on the AUM development. Sure, it's driven by positive market developments. Outflows at PIMCO continued, €20 billion in the second quarter. Certainly still too much; however, less than in the first quarter. And Allianz Global Investors, actually it's showing really good positive net inflows.

Overall, our assets under management compared to the beginning of the year are up €40 billion on the third-party volume and substantially more including our Group assets. And actually our Group assets are benefiting here really from a good performance of our asset managers, and we are very happy with the returns because that is certainly also a driver that we can speak more positively about the investment margin in our Life segment.

The revenues in Asset Management based on the outflows of the last four quarters and all the developments we have already discussed, they are 9.4% down in euro terms. Still the weaker dollar consumed more because on a dollar basis, reduction would only be 5.8%. So looking at the euro-dollar exchange rate – actually, the pressure from the dollar should go a little bit away and I would expect a more positive contribution from the exchange rate going forward that would also take away the negative, which is so pronounced with the double movement of the underlying and the dollar, so that we have then only to deal with the underlying.

And with the underlying, I think we are dealing well. PIMCO's performance has recovered measured as outperformance on the funds. The 12-months' performance is at 83%; the three-year performance, 89%. So that means short- and long-term measurements show really strong numbers. And also the recovery here should help us to turn around the outflow or inflow picture going forward.

When we look at the operating profits, as I've said before, operating profit is a target. We are quite happy with the €90 million operating profit of Allianz Global Investors, in particular as it includes the €23 million one-off on non-income taxes. That means without the negative one-off, we would have clearly beaten the €100 million mark for the quarter. And that is a very strong performance for an asset manager of this size.

So PIMCO continues to deliver €600 million. And actually, when you look at the operating profit, the €600 million is higher than what we have seen in the first quarter delivered by PIMCO. So overall, I think operating profit is as expected but it is not repeating the double-digit growth what we all got so nicely used to.

Now, finishing the presentation with the short look at the Corporate segment, there are actually three or four changes which influenced the €50 million additional profit or less losses, to be more precise. We have less admin costs, actually €24 million at the Holding & Treasury segment. We made €23 million more investment income based on the cash we collected from all the countries. I presented you the cash flows and the excess capital repatriation program a few weeks ago at the Capital Markets Day. A negative was that actually our centralized IT unit has charged out €70 million less to all the countries but I think that is just a delay between months.

The Banking segment slightly improved. That is more the absence of expenses due to the closure of Allianz Bank. So we have closed this negative operating profit contribution. And I think all the banks are delivering now a small positive profit and it is, I think, now back to normal.

So how are we then now translating the 17%-plus in operating profits to the net income number? Our non-operating items in total are minus €39 million. So close to the zero line. The realized gains are about half of what they were a year ago, so that means the results this year has less volatile positive one-offs than a year ago.

The €243 million this year is actually – I think it's a good €30 million from equity realization, €33 million, and the rest is fixed income area that is mainly in the P&C segments playing the yield curve, whereas the €33 million in equities is probably slightly below what you would expect long-term from the equity portfolio we keep in our Property and Casualty segment. All the other numbers are pretty much normal, very low write-downs, and the income tax is still at our expected range, around the 32%, 33%, so nothing very special.

And with this one, let me just summarize. I think you'll see a great growth in revenues, operating profits clearly beating our own outlook, and shareholders' net income hence also substantially up, and that all was achieved with the strong capital and balance sheet growth with Solvency ratios at expected and reliable high level.

Our outlook overall, the €10 billion plus or minus €500mn, we still think it is adequate to keep it unchanged. However, we believe that we can reach the upper end of the range, which should not surprise you. And this is when I would stop here and hand over to Oliver.

Oliver Schmidt {BIO 2473131 <GO>}

Okay. Now we're happy to take your questions.

Q&A

Operator

And we will take the first question from Paul De'Ath of RBC. Please go ahead.

Q - Paul C. De'Ath

Yeah. Hi there. Good afternoon and thanks for taking my questions. And a couple of questions, please. Firstly on the P&C business, you've obviously gone into a quite a lot of details on the areas where you've strengthened reserves. I just wanted to check on that. How large are the reserves strengthening in each of those three areas? And the second part of that question I guess is on Russia. You said that you're kind of scaling back the operations there. What's your view on that I guess longer term? Would you ever think of just pulling out entirely like some of your peers have? That's the first question.

Second question is on the Life side. And just a quick question on the duration of your liabilities. The duration seems to have gone up a reasonable amount in the quarter sort of over Q1. And I'm just wondering if there's any reasoning behind that or if there's any more detail you can give on that, that would be great. Thanks.

A - Dieter Wemmer {BIO 4755450 <GO>}

Okay. Thank you very much, Paul. I think the Life duration, that is a – I think this creates a question and answer, what's the duration, of course is dependent on the interest rate level. That means when interest rates are where they are and we have mainly – our long duration comes from Europe, so therefore, it has to be lengthened with lower swap curve.

On P&C, well, I think when you look at the combined ratios of the three entities and I said that in total, 1%, that means €100 million is spread over the three entities. I think you can almost do the math yourself and I think that – we are usually not giving run-off results on this detailed level. It was only more for confirming that the positive run-off of all the large and successful OEs is running at a very good level that we had. Last year, the total absence of negative run-offs, but this year we are showing it and I believe we should be fully transparent when we have soft spots in our portfolio, then we should talk about the soft spots.

Russia. I think a complete pull out is not in our strategic direction. I think it is – really the issue is here, that in the countryside, the interaction between courts, lawyers and the customers are for us too in-transparent. Therefore, we prefer to stick to the areas where we better understand what is going to happen.

And also, of course, Russia is under the caveat that we have now also evaluate whether the European and U.S. sanction will, to some extent, limits the Corporate business that is, as we speak, probably unpredictable. But long-term, I think the situation is probably improving again and then also Russia is an important market for us for the large customers and our international customers which are all doing business in Russia.

Q - Paul C. De'Ath

Okay. Excellent. Thanks.

Operator

Thank you. We will take the next question from Jon Hocking of Morgan Stanley. Please go ahead.

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

Hi. Good afternoon. I've got three questions, please. I wondered if you could give a little bit of color on PIMCO. You seem to be very confident that the performance is improving. I wondered if you could give us some color in terms of how you're seeing flows with retail versus institutional and what's the commentary you're receiving from institutional intermediaries is whether they're worried about performance and governance of PIMCO. That's the first question.

Second question. I wondered – you mentioned large losses, and you've specifically talked about Fireman's Fund, but I wonder, are there any other trends in large losses either by a country or a line of business? Second question.

And then thirdly on Solvency II, you mentioned getting your economic capital numbers that you've included sovereign asset charges. What are your discussions with BaFin? Do you think this is going to be something which is going to be a fundamental part of Solvency II or do you think there's a chance you're going to reverse this from your final Solvency II calculations? Thank you.

A - Dieter Wemmer {BIO 4755450 <GO>}

Okay. Jon, just a second. You were so fast at speaking, so I was writing down your questions that I'm not forgetting any. PIMCO actually is a – the biggest outflow number comes from retail and that is very visible when you look at our mix.

We had a year ago 35% of the business - or the money was retail money, and now we are down to 33%. So that 2-percentage-point shift shows that retail is still most of the outflows. Of course, there is also some institutional outflows, but I think institutional is less driven by PIMCO. It's much more when institutional investors decide that they do something completely different with their money. And there are two reasons a corporation could use the money for operating expansion and if they do a total shift in asset classes, if somebody wants Japanese real estate, certainly we cannot offer this from our two asset managers. So therefore, there is also sometimes that investors change completely their investment strategy.

But overall, I think that the discussions with institutional investors are still quite positive. And actually, Allianz is the largest institutional investor in PIMCO with close to €300 billion. And I can tell you, our investment margin in the Life business would not look stable and good when they would do a bad job.

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

(45:03).

A - Dieter Wemmer {BIO 4755450 <GO>}

That is simple. And we are not - we are also - PIMCO is running fiduciary obligations towards their customers and we do the same. And our Life managers could not stay with the PIMCO funds when it would be under pressure in the performance, and we have to play it here very much arm's length. And I can tell you, we are quite happy with the development.

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

You're comfortable that it's not just the institutional clients are reacting a little slowly to the historic performance issues in the last few quarters?

A - Dieter Wemmer {BIO 4755450 <GO>}

Well, that I cannot exclude it, because I'm not speaking to every institutional investors. So - but I think in the end, it is about the true performance of an asset manager, and the institutional investors are usually much more rational when doing their investment decision.

I think a retail customer is not the only one influencing the decision. There is also always an advisor in between, and usually switching funds from one firm to another, it's for the advisor, usually a good job.

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

Okay. Thank you.

Operator

Thank you.

A - Dieter Wemmer {BIO 4755450 <GO>}

I forgot the large losses, sorry. Sorry, Jon. The large losses is - that is pretty, pretty easy. I don't think that there is any trend. We had at AGCS two big losses. One was - well, actually, two are - both are related to the oil industry. One in Far East Russia and one in another place. So that are the two big individual losses. And I would take this as business as usual.

And on Solvency II, your question on the sovereign bonds, I assume that there is more a trend in the EU that sovereign risk would be included. So I think the whole overall judgment goes more in trend to include it and not to exclude it.

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

Okay. It's very clear. Thank you very much.

Operator

Thank you. We'll take the next question from Farooq Hanif of Citigroup. Please go ahead.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi there. Thank you so much for taking my questions. First one, just on what you mean by the sovereign charge. Is this the same as the 10-basis point deduction from swaps or is it a specific charge for spread risk in government bonds? Just want to understand exactly how it's working. That's question one.

Secondly, in light of your still strong economic capital position, can you talk about some of the asset allocation shifts you would be making to counteract below yield environment? And related to that, can we therefore expect the actually realized gains in harvesting as part of the operational results in Life could be something that we continue to see for a while in your numbers? Thank you.

A - Dieter Wemmer {BIO 4755450 <GO>}

Farooq, yes. I think a stable harvesting is certainly what we want to achieve and I can maybe give it in more detail on the P&C segment, because there the calculation is easier as we don't need to split it with the policy holder. We have roughly €6 billion at the moment in equities in P&C and of course, I'm not talking about it whether we would increase it or decrease it, because that would potentially influence the markets.

So €6 billion should allow us to create €180 million to €200 million a year on realized gains only in this segment, and when you see that we had included this quarter only €33 million, so that is certainly below a long-term average line. So that part I would see continue. And I think on the bond portfolios, as long as the steepness of the interest rate curve is not changing, I see also a continuing of our realized gains from the debt portfolio.

Our other investments, that will take more long-term, because what we are expending currently in real estate, we are not planning to turn these buildings around in the short-term, that are more longer-term developments. And the infrastructure investments and our investments in wind parks, that is mainly held to maturity of illiquid assets that is just supporting our base investment income, which I think is also holding up nicely.

Q - Farooq Hanif {BIO 4780978 <GO>}

Can I just interject very quickly on that? I mean are you assuming that this is going to use up economic capital, or was it economic capital-neutral in everything you're doing?

A - Dieter Wemmer {BIO 4755450 <GO>}

We have allocated more economic capital over the last quarters. On the other hand also, our overall risk management has actually also freed up economic capital. For example, when you're lengthening your asset duration and you reduce your gap, then you free up economic capital and this freed up capital, we have then reinvested in more risk taking.

So therefore, lengthening of the portfolio is, on one hand, consuming those capital; on the other hand, freeing up. So therefore, it's probably allowing us to create more spreads without using up capital. And your sovereign risk charge, no, I think on sovereign bonds what we have included in our calculation is going full distance. That means spreads, defaults, migration risk, all included like a corporate bonds.

Q - Farooq Hanif {BIO 4780978 <GO>}

Okay. Thank you very much.

Operator

Thank you. We will now move to Andrew Ritchie, Autonomous.

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

Hi there. Just one question, following up on the last question. I'm slightly confused on the new - on the reinvestment strategy in P&C. It sounds like you're encouraging us to think that you are going to continue with high levels of realized gains on bonds. Surely, that will accelerate the running yield at the time. I'm not sure how that generates economic value. So what exactly are you doing on the reinvestment side in P&C and why - when you said you're playing with your - the yield curve, are you seeking to buy longer duration, sell short, or just - I'm confused. To clarify that would be helpful.

Secondly, in your introductory remarks, you used the phrase not yet in reference to Italian P&C profitability as in it had not yet deteriorated. Are you expecting that this year? Do you have any view on whether frequency and severity starts to normalize a bit, or whether we'll start to see more of an impact of lower rates coming through, lower pricing coming through?

And then final question, in the U.S., you talked about you had changed accident year loss picks, as well as prior-year reserve issues. I mean, that often is an indicator that you might start to look at reserves in general again. So is there going to be more reserve review of Fireman's Fund in the second half? Thanks.

A - Dieter Wemmer {BIO 4755450 <GO>}

Okay. Starting with P&C, I hope it was not too confusing, but actually, when you have a bond which still has a 3% coupon and that was a 10-year bond and it is now approaching the last two, three years, the total return you make in the last two years of a bond is, well, is 0.3%, 0.4% or something like this because the...

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

Because of the pull to par?

A - Dieter Wemmer {BIO 4755450 <GO>}

Yeah, but still, you are not earning anything anymore in the last two years. Therefore, it would be completely wrong to wait the last two years of a maturing bond. You better turn it around and reinvest it in a longer-term bond. That is pretty much because you are economically keeping the money for 40 basis points, 50 basis points in the last two years.

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

Okay.

A - Dieter Wemmer {BIO 4755450 <GO>}

So why would you do this? Because you can – that is when you go again seven years, eight years, you are still getting more than 40 basis points, 50 basis points. Sure, that is a total value and market value consideration. It is not the consideration only of running yield. But I think you should also see that in total, we can also, with the strategy, afford to create the realized gains because our running yield in P&C stayed pretty much up.

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

What are you – you're reinvesting longer duration though than you have been.

A - Dieter Wemmer {BIO 4755450 <GO>}

Yeah. Yeah, well, I think you have a bond which matures in 2016 and you sell it now because the last two years, you are earning – you have a decline in market value versus the coupon. So the net-net out of the two is 40 basis points. And instead of cashing in the 40 basis points the last two years, you are now reinvested still at 2.5% or 3%. And that is the additional value you are creating by this activity.

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

Okay. I might revert...

A - Dieter Wemmer {BIO 4755450 <GO>}

Are you doing something different with your own portfolio?

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

I mean you're reinvesting at lower rates. So...

A - Dieter Wemmer {BIO 4755450 <GO>}

Yes. But the total value you get out of both is still – if you add both sides of the equation, you get more than keeping it.

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

Okay. I'll revert offline on this one.

A - Dieter Wemmer {BIO 4755450 <GO>}

Yeah. Yeah. I think you need investment advice.

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

I mean I guess I was interested what are you reinvesting in, in the P&C? I mean, obviously, you're not investing in German bunds at this point, or at least that's not (56:37)

A - Dieter Wemmer {BIO 4755450 <GO>}

No. German bunds are actually at the moment blacklisted not because we are (56:43) country but with 1% return for 10 years, we are absolutely not happy with the 1%. We are certainly more reinvesting into corporates than before. We are also – we have opened up again a little bit our investment into Spanish government bonds, so which also helps our average, and that is I think the main change on the P&C side. And we have, over the last two years, increased slowly, but also supported by market, is equity allocation.

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

Okay.

A - Dieter Wemmer {BIO 4755450 <GO>}

So Italy. The word not yet – and maybe I need English training – instead was only referring to the fact when people are seeing, renewal rates are 7% down, that actually our accident year loss ratio is still improving. And I am not linking the severity and frequency improvement to the Italian economy. I think it is still our continued selection in the Asian channel. So certainly...

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

So it's structural, not a cyclical?

A - Dieter Wemmer {BIO 4755450 <GO>}

Yeah. And – but I think we have to be very careful. Certainly, the Unipol portfolio will not come in at the same average combined ratio as our current Italian portfolio and that is – if you look at the pricing of the transaction, then Unipol would have done a very bad deal when they would sell a 80% combined ratio business at such a price. So therefore, there will be a mix, certainly a higher combined ratio in Italy at year-end, but we will disclose completely what is old portfolio, what is new portfolio, and what are the mix effects.

And in the U.S., certainly U.S. reserves have to be reviewed very carefully every year, but when we would have today any indication for increased reserve needs then we would have booked it. If it is different in a few months, then we'll let you know.

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

So – but you've increased, to be clear, the current accident year loss picks, is that right? You said I think...

A - Dieter Wemmer {BIO 4755450 <GO>}

Yes, we increased. I think the underwriting improvements which were planned were not achieved in this way and therefore, we took a more conservative step.

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

Okay. Thank you.

Operator

Thank you. We'll take the next question from Michael Huttner of JPMorgan. Please go ahead.

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

Fantastic. I hope you can hear me. I'm on my mobile. Two questions please. On the Russia and Brazil and the U.S., you said €100 million roughly is the reserve amount and I worked out – I'm really good at math here. So, I'm joking. That the total underwriting loss for those three countries was around €200 million. I think the slide figure is about €195 million. So it implies there is also €95 million in terms of a – still above 100% combined ratio for those three countries.

Can you talk a little bit more because reserve additions plus actual claims, I know you mentioned to Andy Ritchie that, yeah, the U.S. is (01:00:26) it seems weird. Normally, it's either one or the other. Here, we see both, and I'm just wondering a little bit what is happening and what we could expect for the next quarter here.

And on the other thing, you mentioned on the dividend, December, I thought the decision would depend on the Solvency II and that could be November. But I heard you say – and I may be wrong – December, and I just wondered if you could just comment on that. Thank you.

A - Dieter Wemmer {BIO 4755450 <GO>}

You are giving me all a hard time today. So I thought that we had such great results. Starting with the P&C, yes, it is true that the run rate of the three is above €100 million also on an accident year combined ratio.

And in the U.S., we had the weather-related impact and then the, what I said the change in loss picks for the accident year, so both are resulting in a combined ratio above €100 million. If you look at the half year or the second quarter combined ratio for Russia, it's €160 million if I'm not mistaken, €165 million precisely.

So that is also – it is absolutely not making money. And in Russia, the retail third-party liability premiums for motor are defined by the government, so you cannot change your pricing. If you could change your pricing, the Russian market would be easy. I should have mentioned this that this is a fixed tariff. So therefore in the end, the only thing what you can do is close the shop and don't write new business until the pricing and the losses are in balance. So I think that is the more important point.

In terms of the dividend, we said always, yes, somewhere at year-end, we will tell you what will be the new number for the year. I think we have all understood your expectations. You have all seen that we have a range of options and I think we come together at year-end to Solvency II numbers, probably at some point stabilizing. That is, beside Solvency II, we are also a systemic important company. There are also some capital requirements coming from this calculation. So we have to take a decision here at some point and see how we can work through it.

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

Brilliant, that's very helpful. And sorry, I wasn't trying to give you a hard time, they're the only bits (01:03:31). That's all. Thank you.

Operator

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

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah. Thanks. Good afternoon. A number of questions here. On the P&C side, the rate changes have come down again this quarter. I think we are now at a level where this is below expected inflation. Is it fair to assume that the P&C segment hence has reached a certain peak in terms of the performance here?

Secondly, on the Life side, you mentioned these enormous growth rates. I wonder as a CFO, don't you get nervous when you see such enormous growth rate in a mature market, and what makes you comfortable that Allianz is not suffering what is called the winner's curse here?

And thirdly, on Yapı Kredi. There is a quite substantial drop in volume on the non-Life side, I wonder would you buy Yapı Kredi at the same money that you bought it for, and hence should we expect some goodwill impairment, I think it's €220 million on Yapı Kredi?

A - Dieter Wemmer {BIO 4755450 <GO>}

I'm happy to start with Yapı Kredi. I think we are far away from a goodwill impairment. Certainly, the Turkish P&C market was always very sensitive to underwriting profits and remember that over the long run, Allianz and Yapı Kredi were always a winner in this underwriting game. And when the market is, in some areas, too soft, then we have just to be careful this writing new business and I think the profitability is more important.

But what has really made up for it is a substantially higher investment income which is, I think, we calculated the transaction with a 6% yield and Turkey is, I think, in the double-digit area for – even for short-term money.

On the Life side, yes, certainly, in the German markets it's a flight to quality. I think, in Germany, all our products are priced very sensible. I think we are only promising what we can really deliver over the long run. I can tell you that that the regulators and as part of the systemic process, they are all over us with long-term scenarios and calculations so that means that our knowledge of scenarios and long-term risk is substantially higher than it was in the past. So we are also learning with these processes but the learning is very positive in the sense that we are maybe even more confident on our Life business than we were before.

And look at our reinvestment yield which is very stable year-over-year. And the risk we are taking, I think we are still comfortable from a risk management point of view. The other big growth driver is actually U.S. There, we are selling, in principle, one product that is one fixed-indexed annuity special product. I think we have done all our testing. We have looked at it. Nobody got very nervous over this product. So as long as we can sell it at this large volumes and actually the scale effect is very positive.

I did not mention this that the U.S. improvement in new business margin is driven on one hand by the pricing and the market impact, on the other hand, but also by the volume impact. We are clearly now – instead of having an expense overrun, we have an expense under-run which of course helps the new business margin.

The P&C rate changes, yes, they have peaked on average in the portfolio, where Italy is probably the biggest contributor at the moment. I think that will also come down at some point in Italy. And I think that – when I look at the aviation market, that would be, for me, the area where probably the first positive rate changes will take place this year.

Aviation is an interesting line of business. We are, I think, overall, probably the largest or at least one of the market leaders. The rates went down since they peaked after World Trade Center event. So we have seen a slight decline in aviation rates for more than 10 years by now. And I think 2014 is certainly a triggering event with – not only with the tragic events around Malaysian Airlines, also with the other crashes we have seen in the last month that aviation rates are probably going up.

So it is a mixture. I think we can drive our profitability. And I think the biggest improvement area is, for me, actually the three highlighted countries where you are rightfully asking me a lot of question around. But actually, what was more – the idea is that we are actively managing our overall portfolio, and we are not shying away from the soft spots and share with you what we are going to do.

Q - Thomas Seidl {BIO 17755912 <GO>}

Okay. Thanks a lot, Dieter.

Operator

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

Q - William S. Hawkins {BIO 1822411 <GO>}

Hello, Dieter. I'm not having a go at you but coming back to Fireman's Fund. Can you just clarify a bit more what you mean in the slide by accelerated improvement plans? I mean, you've given us some information, but my feeling at the end of the first quarter was that you were very clear that there was a cost overrun problem in the U.S. and that was what was being addressed. You haven't really mentioned cost this time when you've been talking about the U.S. And so it seems like much deeper problems have emerged. So I mean, in that context, can you just tell us what you mean by accelerated improvement plan?

And then secondly, again, the aviation losses in the third quarter. Is there any figure or sort of range that you could give us for what those might mean for Allianz? Thank you.

A - Dieter Wemmer {BIO 4755450 <GO>}

Yes. William, I'm happy to start this aviation loss of third quarter. This tragic situation in Eastern Ukraine where the plane was probably shot down, we are only covering half when it was a normal accident.

When it was an act of war, we are not a member of the consortium who are leading the war coverage. So then we would only participate in the liability case and you can put a range about it, but it's an average large loss, and nothing very spectacular to see in due course. I don't know, maybe between €20 million and €30 million. And actually the other aviation losses we have a very, very tiny participation and that would not even make it to a mid-size loss.

Q - William S. Hawkins {BIO 1822411 <GO>}

Great. Thank you.

A - Dieter Wemmer {BIO 4755450 <GO>}

So Fireman's Fund, well, accelerated improvements and management action means to me to look at all levels and do whatever you can do. Therefore, expenses are not excluded.

Q - William S. Hawkins {BIO 1822411 <GO>}

But just to be clear again. I mean you've answered this question – well, you've had this question a couple of times but this is now no longer an issue of just expenses. We are back in underwriting the reserve and problems as well.

A - Dieter Wemmer {BIO 4755450 <GO>}

The reserve – maybe I have not explained this well. The reserve increases were linked to two large losses. So it's not that an actuary looked at it, no. The lawyers settled two large losses and the lawyers did not look at the actuarial papers before. And therefore, we are now paying more than what we had in the case with us.

Q - William S. Hawkins {BIO 1822411 <GO>}

Okay. So I think you – again, in comment to another question, you're not shifting to a view where there may be a systemic problem with the reserves in Fireman's Fund?

A - Dieter Wemmer {BIO 4755450 <GO>}

No. I think we had a review in the second quarter of asbestoses and environmental, so that has been reviewed and also revised. That is P&L neutral because we are keeping a high asbestoses reserve at the center and that is an expected development in the U.S. And that part is therefore neutral for Fireman's Fund.

Q - William S. Hawkins {BIO 1822411 <GO>}

That's great. Thank you.

Operator

Thank you. We will now move to Nick Holmes of Société Générale. Please go ahead.

Q - Nick Holmes {BIO 3387435 <GO>}

Hi, there. Thank you very much. Two questions. First, is with U.S. Life. Wondered, can you tell us more about the risks with the fixed-indexed annuity products, in particular how worried are you that you're putting on a lot of interest rate risk? Because I think that is the principal risk with the product. And indeed, I mean, you're selling the product because basically you expect rates to rise.

And the second question, just looking at some P&C in the expense ratio, there's been a bit of improvement in Q2. And I just wondered if you could remind us how much further improvement you think is possible? Thank you.

A - Dieter Wemmer {BIO 4755450 <GO>}

The last question was improvement on what? Sorry.

Q - Nick Holmes {BIO 3387435 <GO>}

Sorry. The P&C expense ratio, there was a bit of improvements in Q2. I just wondered if you could give us a bit more background about some scope for improvement in P&C expenses, is a general question.

A - Dieter Wemmer {BIO 4755450 <GO>}

Well, I think the 30 basis points we probably carry through, through the rest of the year that were not one-offs. I did not mention that our net earned premium actually grew 3% in the second quarter versus 1% on the gross top line, and that is the reinsurance program, which we explained where we are changing our reinsurance purchases. So that we have a slightly better growth on the earned premium versus the overall premium, that's absolutely correct.

Fixed-indexed annuity products are not taking interest rate risk. Fixed-indexed annuity products are not – the deferred annuity component is absolutely cash flow matched. Then there is this equity option or the option linked to the underlying fund that we are dynamically hedging. And actually, there are – and when you look at the whole space of fixed-indexed annuity players in the U.S., that are the five, six companies, there is – we had last year the private equity guys who entered our two carriers market and they're also the players which are competing with us for a long time.

I think we are the market leader. We had 16% market share over the last five years on average. I would say, we are probably, with the second quarter number, substantially higher in market share, that is my guess. And there are two options in the markets. Some players are buying with each tranche of new business a fixed hedge in the market and not touching the hedge at all, over time. We are a bit more sophisticated in our hedging program that we won a dynamic hedge. And actually, also, using a little bit the – actually, the offsetting co-relation between our VA book and the fixed-indexed annuity book which allows us to be a little bit more efficient on the hedging. So therefore, we are not taking any interest rate risk with this business.

Q - Nick Holmes {BIO 3387435 <GO>}

On the...

A - Dieter Wemmer {BIO 4755450 <GO>}

Only when the interest rates are higher, the pricing of the product on the day of sale is easier. When you have zero interest rate and it is hard to split zero percent between customer and shareholder, so that makes the pricing of course more difficult. And additionally, when hedging would become more expensive due to higher volatility or other market factors, we have actually a variable expense charge in the product. That means, on a three months basis, we could adjust our expense charge going forward to catch up with potential other costs in the hedging program.

So I think that is a straightforward product. And as I explained, our fixed-indexed annuity products, the equity option we have to hedge is a mix of S&P 500 and Barclays Aggregate, there is also almost no base risk in hedging these two indices, because that are the most common indices you can think of. So therefore I'm pretty comfortable with the current product generation.

Q - Nick Holmes {BIO 3387435 <GO>}

Thank you for that. That's very interesting. Perhaps, I can slightly rephrase the question, which is with that fixed-indexed annuity book, what would your view of the impact of rising or falling rates, interest rates in America be?

I mean, would it be if rates do rise, would you see that as positive, presumably your margins could expand? Whereas if rates were to fall, would you think that you are completely hedged forever on this book?

A - Dieter Wemmer {BIO 4755450 <GO>}

Hedged in the sense of the business in-force, yes. If we talk about future new sales volume, that has of course a sensitivity towards the interest rate market. Although, I think that this current index, which goes between S&P 500 and the Barclays Aggregate, I think that has a lot of elasticity even if U.S. rates would continue to fall.

If interest rates going up, I think then the pricing of the new business volume is anyway easier and the attractiveness for the customers comes very well. And worst-case, our new business margin goes slightly backwards from the 3.8% and that is still then a very profitable book, which generates profitability which enhances our overall segment profitability.

So underlying year-over-year, I think the new business volume of the last 12 months has probably created some €50 million is clearly – €50 million-plus in operating profits. And what you have to consider on a fixed-indexed annuity policy, the customer pays in the cash and we are investing the cash in a matched asset portfolio, and the hedging is only done for paying out this embedded equity option which gives a little upside for the customer but it is not changing risk profile for us as a shareholder.

Q - Nick Holmes {BIO 3387435 <GO>}

Understood. And sorry, just one final question which is given the volumes you're writing, do you have a sort of limit on the volume that you see going forward because, I mean, if you continue to grow at this pace, you will turn into a U.S. life company?

A - Dieter Wemmer {BIO 4755450 <GO>}

Well, look. Prudential also gets all the volume from the U.S. and is still seen as an Asian life company. So I'm pretty happy to inherit the P/E of Pru.

Q - Nick Holmes {BIO 3387435 <GO>}

No, that's a very good answer. But is there a sort of limit that you've got or are you happy to just carry on growing at this sort of level?

A - Dieter Wemmer {BIO 4755450 <GO>}

I think we carry on growing with this product. We have still a limit on our VA volume and we are not lifting our limit on the VA volume.

Q - Nick Holmes {BIO 3387435 <GO>}

Okay. Thank you very much.

Operator

Thank you. Moving on to Atanasio Pantarrotas of Kepler.

Q - Atanasio Pantarrotas {BIO 5933123 <GO>}

Yes. Thank you. Good afternoon to everybody. Three quick questions, I hope. First one on the reinvestment yields in P&C, you mentioned that there was 2.5% in the first half. However, I guess, now is a considerably lower given that the narrowing spread also, for example, Spanish government's yield for three years, four years maturities below 1%. Second question – so if you can provide what could be now the reinvestment yield in P&C.

Second question again on the sovereign charge in Solvency II, according to you, is there any chance that only the cross-border investment would be penalized in term of capital or you consider that every bond investments also saw – also if a company invest in its domestic government bond markets would be penalized?

Final question on your acquisition on the Unipol portfolio, I know that it's a work-in-progress, but what is your target in term of combined ratio, at least your target range of combined ratio for the portfolio acquired? Thanks.

A - Dieter Wemmer {BIO 4755450 <GO>}

Yeah. I think we will not disclose the target combined ratio for the Unipol acquisition. I think that would be – certainly, we have a business plan but actually, we are not disclosing business plans to this detailed level. Sorry, Atanasio, you have to understand this.

Q - Atanasio Pantarrotas {BIO 5933123 <GO>}

Okay.

A - Dieter Wemmer {BIO 4755450 <GO>}

The reinvestment yields today compared to the Q2 numbers, I think you probably have to expect that it is 10 basis points, 20 basis points lower. The sovereign risk topic, that is a widely discussed topic among all the European insurance groups as well as the regulator among each other, and there are various scenarios floating around. There is the question should it be excluded completely, should there be a mix solution where only cross-border sovereign bonds are being treated like corporate bonds, but the whole market buyers would allow to consider it still as risk-free, or the full treatment as corporate bonds.

All variations are in the room, and the only statement I have made is there is a higher likelihood that there will be some form of risk charged for the corporate bonds – for the sovereign bonds whether it will go to the 100% of the corporate bond or some middle ground that that could be – but I think that it's at the moment changing in so (01:25:30) time that it's almost not worthwhile to speculate.

Q - Atanasio Pantarrotas {BIO 5933123 <GO>}

Okay. And your model is built according to make a capital charge also on the domestic bonds or only on the cross-border investments?

A - Dieter Wemmer {BIO 4755450 <GO>}

In our own calculation, full distance.

Q - Atanasio Pantarrotas {BIO 5933123 <GO>}

Okay. Many thanks.

A - Dieter Wemmer {BIO 4755450 <GO>}

You should know our risk manager.

Q - Atanasio Pantarrotas {BIO 5933123 <GO>}

Thank you.

Operator

The next question comes from Andy Broadfield of Barclays. Please go ahead.

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

Hi there. A couple of questions, please. I will come very briefly back to that Solvency II question. You mentioned – I think when you first introduced it into the model at the beginning of the year a comment, which referred to the fact that financial services should all be treated the same and that the introduction of this into the banks would be quite a considerable charge for them and that that would create some considerable level of disorder and that, therefore, that was something that the regulators need to think about. Just wondering what your updated view is on that because it seems to me that you've taken a slightly more – a slightly harder view assuming that there will be a charge. That's question number one.

Number two, if for a Friday afternoon you allow me to dream for a moment, the German P&C business has been a long-term work-in-progress and it's really starting delivering or really not starting delivering, it is delivering. How much further do you think this can go, because I get the sense that the momentum has only really started building, we're only a year or two into that momentum, in fact, in terms of delivery, yet it's already delivering great results and great growth. So what do you aspirationally think you can do in Germany?

A - Dieter Wemmer {BIO 4755450 <GO>}

I think I will – let me start with Germany and the delivery of the P&C result. It is true they are outperforming the targets and it is really a great success of the management team which is at the moment also very happy with what they have achieved. And they should be really very proud about it. Our – fairly, I would say, optimistic uplift of that we go to the upper end of the range in our outlook. I think it's certainly based also on the fact that that we trust very much into the German delivery. So now to lift the numbers for 2015, I'm giving new public targets I think that the half-year results might not be exactly the right place to do this. And therefore, we should do this when it is the appropriate time.

Andy, on this level playing field topic, I think that it's really close to my heart, and I have really to look at the sovereign risk charge here in two ways. On one hand, I have to put into our model what we are, in the end, are being forced to include as the reg – our regulator tells us without the sovereign risk charge, your model has no chance for approval, then it would be hard to fight it. On

the other hand, I will not stop saying that the level playing field amongst the insurance industry and also between insurers and bankers is a must. And if regulators are currently falling short of it or potentially are falling short of it, then we will certainly continue to highlight it at every opportunity.

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

I'm a bit disappointed with your German answer. I might ask it again, I'm just hoping you might change your answer, which you...

A - Dieter Wemmer {BIO 4755450 <GO>}

I enjoy the 91% combined ratio of the first half, and take it as booked and planted.

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

All right. Okay. Well. Okay. Thank you.

Operator

Thank you. We will now move to Vinit Malhotra of Goldman Sachs. Please go ahead.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Hi. Good afternoon. This is Vinit Malhotra. Just one very quick follow-up. You know, in India we talk so much about the U.S. EIA product. I just also noticed that there is a 50 bps compression in margin between 1Q and 2Q, is it just because of the falling, slight fall in U.S. treasury yields in the quarter, or is there some caution being built because of this explosive growth in the product? That's the first question.

Second question, in PIMCO, we've seen already some calming out in the total return fund outflows in July, but equally, the emerging market bonds and the high-yield bonds are not doing too well. Could you just comment on, is July – is it really getting a little better, if you could just add on that?

And lastly, just a very quick one, is there any – are you already noticing or taking or discussing about the rule changes in India? Because if the FDI rules and the market value rules are there, then it could be a reasonably sizeable decision to make. So I just wanted to follow up. Thank you.

A - Dieter Wemmer {BIO 4755450 <GO>}

In India, I think we have – when the rules are really changing, then we have all options to take up also our higher share in the business. But I think that is also negotiation with our joint venture partner. And I think we would prefer, actually, also here to negotiate first with our joint venture partner and then when the negotiation is completed, then we would announce it. But certainly we would be very positive and the rules are changing. So let's cross fingers that it is really happening.

July changes in the financial market, I don't see too many impacts on our results. I wouldn't see any special write-downs at the moment. So therefore, I couldn't see what you are seeing at the moment.

The new business margin in the U.S. actually includes two effects. You are right. It is 30 basis points lower than in Q1. What we are doing in the U.S. also in the calculation of the new business margin, we are updating the interest rate curve every two weeks. So therefore, our Q2 number is, at the end of Q2, already up-to-date with the latest interest rates. So therefore, you get more or less the impact of the average interest rate of the quarter, and that is – was in the second quarter substantially lower than in the first quarter.

And I think the impact of the interest rate change is probably more than the 30 basis points because the high sales volume was a positive. So therefore, the interest rate impact is probably your 50 basis points as you have mentioned. And then 30 basis points is then the baseline impact, where 20 basis points is being reversed by the volume.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay.

A - Dieter Wemmer {BIO 4755450 <GO>}

Good points. Yeah.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Thank you. I just mentioned because the FIAs margin was 4.3% became 3.8% for just the FI. But that's fine. Thank you very much for clarification. Thank you.

A - Dieter Wemmer {BIO 4755450 <GO>}

Yeah, yeah.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Thank you.

Operator

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

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

Lucky. Thank you. On the pricings, I just checked. So the pricing, going forward – you know that lovely table in the appendix – is down – sorry, it's up. And it is up 1.1%, I think, and it goes up 1.4% at the half-year – at the first quarter. Are we – from your comments, I'm taking we're actually now equal to the run rate of claims inflation. Is that about right?

And then just to follow-up on the three countries which are undergoing a turnaround, could we already see a material change in the second quarter – in the third quarter? In other words, this €100 million reserving or €200 million total underwriting loss, could it maybe be halved in the current quarter? Thank you.

A - Dieter Wemmer {BIO 4755450 <GO>}

I think that of the three countries, certainly Brazil I think we will see an improvement month-over-month. Russia, I think we have probably taken the major part of the full-year loss. Maybe not yet all of it. That depends on how the day-to-day development is. But certainly, more than 50%. Therefore, the second half of the year is certainly different. And Fireman's Fund, of course, depends pretty much on how the wind blows in the third quarter. Therefore, I cannot say that the second quarter result is different from the first half year results.

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

I understand.

A - Dieter Wemmer {BIO 4755450 <GO>}

And surprising, look, I think inflation is in Europe at the moment not a topic. The ECB is even recommending that all German employers should double the salaries of the employees to get more inflation into the country. You'll see where inflation is dense in Europe. I personally think that is a desperate move of our central bankers when they are already coming with such proposals.

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

I'll take the cash-only increase, but thank you. Thank you.

Operator

Thank you. We'll take the next question from Michael Haid of MainFirst Bank.

Q - Michael Haid {BIO 1971310 <GO>}

Thank you very much. Good afternoon. Two questions. First on German Life insurance, could you provide some more color on the breakdown of the new business margin of the traditional Life product (01:36:30) and of the new product Perspektive and Index Select?

Second question, price effects in P&C Insurance. I would like to reconcile two slides, the slide nine, negative price impact of minus 0.4% and slide 62 where you show a positive price impact of 1.1%. How is the delta explained?

A - Dieter Wemmer {BIO 4755450 <GO>}

I think slide 62 is the strict price effect on renewals and not on the total. I think that price effects are probably not exactly calculated to the last decimal point, so there is something, some rounding differences between.

Between the traditional business and Perspektive, the new business margin on Perspektive might be a little bit lower but not a lot. I think the new business margin is not completely measuring the lower capital requirements the product needs because new business margin calculation are not aligned with Solvency II thinking completely.

And therefore, the new business margin gives you only a half of the story. And in particular, in times when investment portfolios are shifting clearly to credit risk, I think the new business margin is a little bit falling short as the measurement in this respect. And I think we need, under the Solvency II world, more comprehensive measurements in the long run than new business margin.

Q - Michael Haid {BIO 1971310 <GO>}

And if you had the choice of selling still a traditional Life product, and I know that Allianz label is very cost-efficient, let's put it that this way, and sell one Perspektive product. You would still go for the traditional product?

A - Dieter Wemmer {BIO 4755450 <GO>}

No. I think...

Q - Michael Haid {BIO 1971310 <GO>}

As a company.

A - Dieter Wemmer {BIO 4755450 <GO>}

As a company, we encourage for both sides, for the customer end as the non-traditional product. Because the capital consumed by the non-traditional product is substantially lower, which allows us to take more investment risk. So therefore, it is a great trait for both sides.

In the end, we are paying the customer for the Perspektive a 30 basis points more return. So we are paying at the moment 4.5% total return to a Perspektive customer to a traditional customer 4.2%. And the 30 basis points are justified because we are taking more investment risk. And to sell products in this low-yield environment with 60 years guarantee that is bad for the company and bad for the customer.

So it is a win-win situation, and I think the people who are still skeptical about the win-win situation, should spend more time with our product designers in Stuttgart.

Q - Michael Haid {BIO 1971310 <GO>}

Great. Thank you very much.

Operator

Thank you.

A - Oliver Schmidt {BIO 2473131 <GO>}

Well, it's Friday afternoon. We can just close.

A - Dieter Wemmer {BIO 4755450 <GO>}

Yeah. And some have already packed their suitcases and off to the airport as I heard shuffling in the background. So I wish you really a great summer vacation for the one of you who were not yet off. August is usually vacation time. And Bavaria is here close to Italy. We all take August off as the school kids in Bavaria as well. And I wish you a great summer and hope to speak to you soon after the summer. And I know what I have to deliver in the second half of the year. That is another good quarter in November. And then a good story on the capital management. Thank you.

A - Oliver Schmidt {BIO 2473131 <GO>}

Thanks a lot. We say good-bye to everybody, wish you a nice weekend and talk to you soon. Bye.

Operator

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