Q2 2015 Earnings Call

Company Participants

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

Other Participants

- Andrew J. Ritchie, Analyst
- Farooq Hanif, Analyst
- Frank Kopfinger, Analyst
- Jon M. Hocking, Analyst
- Michael I. Huttner, Analyst
- Nick Holmes, Analyst
- Paul C. De'Ath, Analyst
- Peter D. Eliot, Analyst
- Thomas Jacquet, Analyst
- Thomas Seidl, Analyst
- Vinit Malhotra, Analyst
- William H. Elderkin, Analyst
- William Hawkins, Analyst

MANAGEMENT DISCUSSION SECTION

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Ladies and gentlemen, welcome to the Allianz Conference Call on the Financial Results for the Second 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, Adele. Yeah, good afternoon from my side as well and welcome to our conference call about the results of the second quarter 2015. There is nothing specific to add from my side. So without further ado, I hand over to Dieter.

Dieter Wemmer {BIO 4755450 <GO>}

Thank you very much, Oliver, and also good afternoon and good morning to the U.S. colleagues to our second quarter results call. I am very pleased to present today another excellent quarter. Before I go into the number let me just start on the business highlights. We continued to drive the digitalization of our retail products. We added a new claims app to the system to simplify and improve the service to the customers. And on the investment side we had a very successful quarter, actually including a very successful July really, to gain a number of important and large real asset investments. And also on Asset Management we have opened a number of new products which should help to secure future process and future success in the Asset Management.

Now let's go to the number. €30 billion revenues for the quarter, internal growth, corrected for foreign currency at minus 3.8% driven by Life and Asset Management where P&C is still growing organically but resulting in an improved operating profit over the quarter of €2.842 billion adding a value to a very good quarter in Q1 and with €5.7 billion out of the half year we are 5 percentage points ahead of our suggested midpoint. And therefore before we forget it, we are increasing and lifting our outlook to the upper end of the range. That means €10.8 billion, which would be exactly a 4% growth over 2014 full-year results and we are confident that we can reach it.

Net income, up 15% for the quarter, 13% for the half-year, clearly indicating that we can, together with the solvency we have reached, support a very good dividend payment but we will certainly, I assume, in the questions talk about this in more detail.

Let me move on directly our solvency numbers and shareholder equity is flat to beginning of the year, the additional gain and unrealized gains at the end of Q1 with a low point of the yields curve vanished so that we are more or less flat actually. Unrealized gains in bonds at the half year are slightly lower than beginning of the year, very simple. The interest rates are a bit more up than the beginning of the year and additionally the bond got six months older; therefore, there is a natural amortization of the unrealized gains.

So the solvency ratio, 212%; and most of you expected more 202%. So actually what has happened? And when I use our own disclosed volatility from Q1 I can actually explain already a lot of it. So the interest rate movement is actually more than 50 basis points. The most relevant point in the interest rate growth is the 20-year euro swap. The 20-year euro swap moved 92 basis points in the quarter so when you take our disclosed sensitivity of 9 points for 50 basis points, I have taken this simple math, 16 points for the 92 and that is also how the more detailed analysis confirmed it.

Equity markets are roughly down by 5% when you take a mixture between U.S. and Europe; that has cost us 2 percentage points in the solvency. Credits spreads, a little reignited euro crisis with the whole Greece and Greek debate, that cost us 3 percentage points in the solvency ratio because credit spreads are up by 30 basis points and that is in our credit disclosure, 100 basis points equal to 11. And then corporate spreads up in the quarter by 15 basis points. We said 100 make 8 points, so 15 make roughly 1 point.

So, when you add all these numbers up, you would have seen a 10% improvement, but we moved 20%. So what are the remaining 10%?

Four percentage points are actually coming from the interest rate curve steepening, 4% comes from the sharp volatility decrease and 2% comes from additional management actions where we did much less further improvement than in Q1 because we watched the developments very closely, had our contingency plan in place but only executed in line where we felt what is necessary. We are still doing some more de-risking in the third quarter but only to a smaller extent.

So adding up all the details to end up exactly with the 20-percentage-point movement from Q1 to Q2 and we feel very comfortable with the number, with the development, and in particular, what we have achieved with all the changes in Q1. Also there's the sensitivity. When you look at our shown sensitivities, you will see that in all the spread scenarios displaced the low point is about 200 and that is a very good achievement. And I will show you also additionally a bit later in the presentation why the high volatility in the solvency we still have in our German business, in the end it's not so relevant for your consideration.

So, let's move on to – sorry, I lost my paper. Yeah, so let's move on to the P&C results. First the growth, 1.6% internal growth for the six months, 9% including the currency effects and the small acquisitions we did over the last year. It is still a okay number. We had some movement in Germany and France between March and April, so therefore the second quarter growth of the two countries look fairly weak but a strong Q1. If you look at the whole P&C segment over the six months, I think you get a better picture of how it is developing, also supported by the net-earned premium growth which is 8% in euro nominal and it is close to 3% in currency-adjusted. So, I think our organic development is still pretty fine.

The biggest contributor to organic growth continues to be Allianz's worldwide partners, our global assistance and health business with almost 10%, and not shown here on the page, our Turkish business which is the market leader in P&C and held in Turkey is growing with 22.8% without currency effects.

So, how did this all result in our operating profit? Operating profit up exactly €400 million; on one hand supported by a very strong combined ratio of 93.5%, and I'll come to this in a moment, and plus additional premium growth makes €178 million plus in underwriting profits and in the line Other, that is mainly benefiting from €220 million net gain on Fireman's Fund we booked in the second quarter.

The one-off results at 3.4% level or 3.3% for the half year, a very stable development without any big impact. The 1 percentage point improvement in our combined ratio can be split, half in lower cat or weather-related events of 50 basis points less than last year and the same improvement level in the expense ratio, where I would expect that in the expense ratio more 30 basis points are probably sustainable and 30 basis points are less sustainable. So, it's Fireman's Fund sale, altogether for our half year, a positive one-off. Well, actually when I add also payments and benefits around Fireman's Fund I'm coming in total to a zero and let me explain why.

We booked already €90 million restructuring charge for the integration of the commercial business with AGCS in Q1. We book here a €220 million gain that is again $365 million

U.S. dollars of sales proceeds minus restructuring costs. So when you take the €220 million minus the €90 ml booked you end up at €130 million and we had additional reserving for the Fireman's Fund commercial business of €134 million so when you add all figures up you actually end up pretty exactly with the zero and to some extent that was the concept of the personal lines disposal. On one had we didn't see the opportunity to scale up the business on our own and pay for the new systems necessary so therefore the sales proceeds are exactly paying off restructuring of the commercial business and helping a successful integration with AGCS. That has already happened very much on the sales fund and renewed premium broker appreciating in new set up commercial premium volumes above our expectation also in Q2 and A.M. Best has also welcomed the integration by lifting actually the rating for the Fireman's Fund Company have now in the U.S. for both entities together an A+ rating which is the best rating possible. So we are really here very much on track what we want to achieve.

Moving on the page showing the individual results of the largest P& C units, page 13, Germany with a stellar combined ratio of 86% certainly supported by low weather better events. In Q1 it was the opposite so Q2 is a bit the offset for Q1. Italy continues to perform at a mid-80% level which is a very strong performance because the market environment is getting tougher and tougher in Italy. France at 95%, really very good.

AGCS looks bad on this page, but that is now the reserve increase for Fireman's Fund included. When we separate out the two pieces, AGCS also in the second quarter a 94% combined ratio that is actually on page 57 in the appendix that you can see the half-year numbers of AGCS separately which is a 93.6% combined ratio. So we continue to see a strong performance.

Fairly light second quarter in large losses. We had more large losses in AGCS in Q1, but Q2 was fairly light. In the UK we have seen more weather-related claims, but also our startup costs for growing our motor direct events have deteriorated the combined ratio in the UK. Australia, also a deterioration against last year, driven by a lot of hail damages we had in the area of Sydney. And Latin America is an improvement over Q4 for sure, but we couldn't completely have sustained good development as in Q1 in particular in Brazil. We have – are seeing a more soft market or more of the impact of the soft market in industrial lines, in motor and we are still having some cleanup on the Group Health business.

Central and Eastern Europe very good improvement because of the clean-up Russia and the closure of the business progressing very well and the other Central European markets always had a very good combined ratio. I think still without Russia the 96% we show here is a 94% ratio. Russia has still a combined ratio about 100% but at a very small premium volume.

Investment income in P&C, probably a surprising positive €840 million is a strong number for the quarter. Q2 has – of course accounting for the dividend yields of our equity investments and we have increased over time our equity investment and also company is paying better dividends.

Still the low yield environment is visible because our current yields is falling 6 basis points and will continue to fall as the reinvestment yields with 2.2%, a big number for P&C reinvestments, but it is still substantially lower than our running yield of the portfolio. We have slightly increased the duration further in the second quarter and also we have invested a bit more in emerging markets where we hedge the currencies to a larger stand.

Moving on to the Life segment, premium volume, as I said, 6% down, adjusted for currency minus 1.4% and nominal – the driver for the reduction is our German life business where we are writing less single premium business. That is not a question of can – is the markets drawing out, it is a question that we reduce our risk appetite here a bit because we want to close the business with our new product stronger so it is about driving the new business mix. And I will talk about the German life business in a few moments in much more detail.

Italy, very nice growth with huge volumes of unit-linked in the U.S. We had this really fantastic second quarter last year when we introduced the Barclays product, the fixed index annuity product with a special index from Barclays. Now we are the victim of our own success and we couldn't exceed it. There is also more competition on this product class, so therefore it was also expected that the big number could not be repeated.

Asia Pacific, important growth in unit-linked business in Taiwan, in which we sell to various local banks to avail diversified unit-linked growth; and the other market is Spain where we have launched a new product which is being sold through a Banco Popular savings product, this takes benefits.

Moving to the operating profit, maybe some of you would have expected a bigger number than €850 million, but I think it is not surprising as the second quarter saw in some instances the opposite financial market movements from the first quarter. And when we showed €1,100 million profit of the first quarter, I mentioned – I believe I mentioned in the call that it's the €200 million positive one-off included, among others, the high positive derivative results in particular in Germany. We had in Germany about €1 billion gross derivatives result, which is, under the 90-10 split, roughly €100 million for the shareholder, and in Q2 we had exactly the opposite. So that means the two derivative results over the half year, so companies who only have half-year reporting would have shown you a zero movement, and we showed €100 million up in Q1, €100 million down in Q2.

And the other negative one-off is we have further reserve increases – out of reserve deficiencies in the Korean business. Here the guarantees required more reserving so therefore Korea in the current yield environment will from time to time pop up as an entity consuming some of the well and half-earned operating profit.

So taking this into account, the €850 million is a very strong result for our Life business and in particular when you now add it up in Q1, I think both numbers together make a really strong first half year.

Where do you see the Korean impact that is on one hand hitting the investment margin with 95 and when you look on the right-hand side where we show the operating profits by line, it is actually in protection and health, because these are some health write-ups with savings share and guarantees products being written some 20 years ago.

So now moving to the new business margin and mix analysis. The new business margin at 1.5% may be still below your expectation; I think it is a very good result compared to Q1 because we have achieved more mix changes and have actually stabilized the new business margin. And please remember we are calculating the new business margin with the opening interest rates of the quarter. So we are using here the April run numbers for calculating the new business margin. When you do the same calculation with July 1, the new business margin jumps from 1.5% to 2.6%. So maybe if you want to have a fair rating for the quarter, that is the average between 1.5% and 2.6% as we are selling policies every day and not only on April 1. But I also believe that when you add up many quarters, that is anyway averaging out and it is probably not so relevant. Certainly for beginning of July our new business margin calculations are substantially easier.

Are we happy with it? No. I think with all the plans we are setting up for the rest of this year and in particular for the next year we will work even harder on getting a more stable new business margin and also continue to reduce the interest rate sensitivity on this one.

U.S. was 2.6%. I think it is a okay new business margin. We have further done re-pricing during the quarter so you probably will also see further recovery of the new business margin in the U.S. over time.

Page 23 is only a documentation and to create transparency, how safe are the guarantees, can we still afford to pay the guarantees, can we still afford to take out a sufficient shareholder piece. And I think when you looked at actually the 20-basis-point investment margin for the quarter is being fully paid out of the current yield as net harvesting; that means the movement of all derivatives, all realized gains and everything, end up above (24:55) zero across the portfolio. We have really a good quarter because 21 basis points means 84 for the full year and I think that is a really very relaxing number, supported by a reinvestment yield of 2.8% during the second quarter, and we have also kept up with the duration management and I think the mismatch is pretty small.

So now turning to page 25, there is a lot of recent press about the sustainability of continental European life businesses and the German life insurance business in particular. I read all these articles with interest, all these experts who after they have finalized to analyze the banking crisis 10 years later are now trying to work on the insurance industry and try to understand what could be the next crisis. I am absolutely not sharing the analytical papers I have all read because they are all missing important points of our industry. And certainly I should now not start to speak for the whole European insurance industry; let me focus just on our German Life business.

So page 25 gives you a number of additional details. First of all, and that is still important because we are living from our customers' money and nothing else, we are selling products which are attractive for the customer because we have an annual crediting rate still at 4.2% and we are sharing all investment returns we are producing with more than 90% for the policyholder.

So how sustainable is the model? Well, look at the middle column. We are showing here for our German business, the investment margins above the guarantee. The guarantees you can see on the left-hand side, so that was in 2014, 2.8% on average. And the 1.9% we show under 2014 in the middle column is the excess the running yield above the guarantee. And that one is not including additional harvesting but obviously it is not including any noise and movement coming out of derivatives.

So that shows that this margin is pretty high and in the internal model we have filed with our German regulators, the BaFin, the solo Solvency II ratio for our German life business, without applying any transitionals, is above 300%. That is a big number and also shows how well sustainable this business is standalone. So now don't start to calculate what does it mean for the remaining legal entities of the group because in the group solvency ratio the above 300% number is (28:26) to a number slightly above our average 212% for the quarter.

So it is not driving the average highly up because this – a lot of this capital is non-transferable because it is high-put capital which sits actually in the customer accounts and will finally, eventually, go the customer but temporarily not there as a risk buffer. And this risk buffer actually allows us to invest stronger in real assets but also to bear some volatility in the interest rate market, so even if the markets are moving, you will not see that we are investing any capital in the company but also the IFRS equity in this company is fairly limited, we can also not take out a lot additional beyond a very strong dividend which we take out every year.

So from looking at the volatility of the solvency ratio, it also drives the volatility of our group solvency ratio but it is in the end a bit capsulated in itself and it is not – this volatility actually does not affect the rest of the group. And that is in particular visible on the right-hand side because we are producing fairly strong and stable operating profit and we have also a good flow of dividends. We are now at a €500 million level which is a pretty strong number because that is 50% of the operating profit or when you do it as percentage of net income, so subtract another 33% tax from the operating profit, you see that is a very stable, a very nice payout ratio.

And in ROE terms, it actually generates return on equities between 15% and 21%, which is in today's world for a financial institution a very strong ROE, and that for a business where everybody is now writing that it's so dangerous and not sustainable. I must say I am absolutely not sharing the analysis and I really don't understand how people are getting it.

So let me move on to the Asset Management business after this ex-cost to the German Life business. Asset under management, pretty flat over the half year, lower than end of Q1. Continued outflows at PIMCOs, some negative market movement quite obvious, interest rates went up, equity markets slightly weaker, and also the dollar weakened a little bit over the last three months so actually all three factors added to in total €70 billion of outflows. The PIMCO outflows reduced to €29 billion, $32 billion in U.S. dollar. Slightly – a bit less than half of Q1, so actually very much on track with what we said how we are seeing the progress. Allianz Global Investors, with another €7 billion of inflows, continue their very successful development. I think that is now the eighth quarter of continued growing success.

Is PIMCO with its product policy, with its customer management, on track? We believe yes. We believe that the returns of the funds are actually in very good shape. Customer service had anyway not a blip over the last quarters and years and when I look at the July outflows, which are around €3 billion for July standalone, I think we are also developing in the right direction. And the income fund for example is one of the most successful mutual fund product in the U.S. market, very good inflows, very high performance almost at the top, I think 98%, I love something like this. So, very strong performance and overall in Europe and Asia we see inflows in PIMCO in the U.S. we still have some adjustments, also in the old core funds, the non-core businesses have already in total inflows overall.

So I think we are really developing in the right direction, but it still affects negatively our operating profit and our revenues. So in the revenue page 29, it is more pronounced than on the AUM page PIMCO in revenues, 10% down, yes, Allianz Global Investors a very strong 20%, but a number still too small to compensate fully for the reduction at PIMCO. But I think overall in a very good development. To be fair the PIMCO number is helped by the dollar and the minus 10% is a minus 27% when we adjust for foreign currency.

So when we now look at the waterfall for the operating profits, yes, operating profit in the segment Asset Management is down to €500 million from €676 million the year before; that is 37% down corrected for currency or 25% down when I allow for the appreciation of the dollar. That is driven by a non-corrected expense base at PIMCO and I said already last time that we are not planning to shrink the company, that we keep management team and the stock in place because portfolio performance and customer service comes first and then the other things come second. But I think we are now also prepared to work hard on our cost-income ratio and we believe we can get it back to a 60% level at the end of the year and then we have to work even harder next year to get it also below the 60% mark.

And that allows me already to come to the last two pages. The corporate segment is more or less unchanged, a little improvement in the banking sector, the Holding and Treasury segment shows a small worsening but that is mainly driven by higher expenses for all the employee pensions which we have in Germany because they are all booked under the corporate segments. And here we are off course suffering from the low yield environment. Actually the quarterly booking is up €47 million, that means the rest we have reduced some expenses in particular for internal loans as our cash flows are really running very highly and the cash flows to the corporate center are at record positions.

And now let me summarize the results. From €2.8 billion operating profit to €2 billion shareholders' net income, yes, realized gains are up. On one hand we realized equity gains of about half of the number and the other half is active management of our debt portfolios. And please be reminded that these are the position in our P&C portfolio and our Corporate segment.

And end of the first quarter, I think compared to the end of the first quarter we had maybe realized about 1% of our unrealized gains in the two segments, or a little bit more. So that is a tiny portion when you do active management; otherwise you have really to sit on all your papers to the end of maturity which is hard to do on equities. So, at some point you need to trade and adjust to what you believe is the right outlook for the paper.

The equity realizations were all in areas where they were tax-free so we have picked the places wisely and that supported the reduction of the effective tax rate so that the savings in the tax rate are all linked to our realized gains.

So in total another very strong quarter operating outlook up at the other end, so 4% up over the year and our shareholders net income 15% up or 30% for the half year and I think we have a really good capital position and balance sheet to accompany the future direction of Allianz.

And with this one I stop here and I'm curious to learn about your questions.

Q&A

We'll now just take our first question from Farooq Hanif of Citigroup.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi, thank you very much. My first question is going back to the German Life business. Do you think BaFin will still stop your competitors paying dividends if they take transitional rules or stop them growing and do you see a source of competitive advantage in your not taking transitional? And also do you think this is going to be ironed out? That's question one. And the second question is going to your – into Fireman's Fund, you obviously made a massive reserve increase, you're joining it up with AGCS. Just wanted to get a feel for what you think is left and if you didn't have this reserve increase, is the underlying profitability still pretty poor there and what's the trajectory for fixing this problem once and for all? Thank you.

A - Dieter Wemmer {BIO 4755450 <GO>}

Okay. Thank you. Yeah, let me start with Fireman's Fund. That is obviously the easier question. The other one I have still to think what is the politically correct answer. So Fireman's Fund, the €134 million additional reserves have to be split in three categories. And all are actually linked to businesses which we are not actively doing anymore. We had an external review of our workers' comp and construction business reserve. That was a very small increase compared to the work we have done internally. And as we are transferring the business to a reinsurance subsidiary, which is manning the – managing the run-off costs, San Francisco Re, the regulator has asked us to transfer the reserves exactly at the amount of the external review therefore we increased the reserves there slightly. Otherwise we would have not done it, because the two reviews, internal and external, are too close.

The second part is that we increased slightly the unallocated lot adjustment expenses. Our colleagues at AGCS felt that this was needed, so we supported this and the biggest point of the €134 million, almost €90 million or €100 million out of it is linked to professional liability for law firms. That is a line of business Fireman's Fund enjoyed for some years which was already shut down some years ago and this in the end excess policies which have a very late reporting and this developments you have to face from time to time, that is not a question of how well is your actuarial process, that is also to some extent a random pop-up of large losses which were not known before.

So from this one, we feel that we also in this point have reduced the likelihood of further pop-ups of surprises but that would be rally naïve to say you know this for 100% of sure but we have certainly taken here a bit step – a big step. On all the other I say, "normal" lines and continued lines we have not seen any reserve movements. We are not yet at an underwriting profit in the commercial business in the U.S. because we have now put up a lot of restructuring costs. We have also reduced already some expenses but expense restructuring, that was still take some time and that is still the key element to make this business profitable.

So the German Life business on the transitional, look, I think as we are always seeing ourselves as a very conservative standout on our balance sheet management to go for transitional would be of a very strange decision and for me a clear sign of weakness which we don't have. Above 300% at Q2 2015 with a 10-year German government bond somewhere at 70 basis points, that is a very, very strong solvency ratio for a large German life business. And we're talking here about on in-force business 20% market share, on new business close to 30% market share. So therefore I think we are representing here really a very strong dividend.

And what BaFin is doing with the one who have applied for transitional, whether there are certain restrictions on dividend payments or restrictions on growing into business or policyholder sharing, I don't know. That is a question you better ask to BaFin. Sorry for this – a bit evading the answer.

Q - Farooq Hanif {BIO 4780978 <GO>}

Okay, I tried, thank you very much.

Our next question comes from Thomas Seidl of Bernstein.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah, thank you good afternoon. First question on PIMCO flows, still negative, but I think I understood you expect it to be a level in Q3, revenue margin down 42 bps because of a mix away from mutuals, and thirdly cost-income ratio sharply arising. You mentioned you're going to act to bring it down below 60%. If you fast-forward yourself 12 months, can you give us an indication on all those three dimensions where you expect PIMCO to be in 12 months' time; that's my first question. And secondly, capital, as you outlined very clearly, strongly up and even and (46:11) above 200, and you have, in addition as you outlined of course, contingency plans. So my question is what keeps you from a modest capital action in the order of 10% or €3 billion now?

A - Dieter Wemmer {BIO 4755450 <GO>}

I think, as you have seen, we are really in a very good capital position. I think it is – nothing is keeping us. As I said, we are really prepared for supporting Oliver Baete's decision in the next quarter with the balance sheet. So that is certainly not stopping us to renew the company.

And the PIMCO question, that is a more difficult one. I have certainly a dream how PIMCO should look like in 12 months but sometimes dreams are coming true, sometimes not. The 60% cost-income ratio or slightly below that, that has to be certainly our target because a measurement of success is at PIMCO that we can just follow on the success we had in the past years. And as I said clearly, we are not satisfied to be a smaller company. So that is absolutely not our plan. And PIMCO has to come back. By the way, the fee income margin in Q2 has really stabilized. That is very much the same as in Q1, so we are not seeing further movements on the fee margin. And then PIMCO has to create new products and they are working on it. We are not yet disclosing future plans. I think it is much better to speak about it when they are starting to realize and when you can see it in the numbers.

Q - Thomas Seidl {BIO 17755912 <GO>}

On the capital, did I get it right, so do you – you are basically at the moment just holding back until we know what's coming out of the strategic review?

A - Dieter Wemmer {BIO 4755450 <GO>}

Look, I think we have our strong dividend policy in place. You should remember this, that it is a 50% payout ratio. We have another 20% per year tucked away for M&A, so – and if you don't do the M&A then we would pay it out. And I heard from some of your colleagues after the Q1, everybody got nervous whether we would be able to pay the dividend and stick to our policy. I never questioned it, but some of your colleagues questioned it and I think we can clearly stick to it. And with the net income which is also developing in the right direction I think everybody should be happy, so it's a piece in it for everybody.

Q - Thomas Seidl {BIO 17755912 <GO>}

Okay, thanks, Dieter.

We will now take our next question from Paul De'Ath for RBC.

Q - Paul C. De'Ath

Yeah, hi, good afternoon. I have a couple of questions, firstly on the U.S. life business and proposals by the Department of Labor, and I appreciate mainly variable annuities will be impacted by this but jut if you could give any color as to whether or not the fixed or the national AAs selling RM are impacted any way by the proposals. And then the second point is on the new product that you have designed in Germany and the KomfortDynamik.

And is that – I mean, is that a new product? I mean, no one else in the market is doing that and do you think you are going to be able to replicate the Perspektive success with that product in Germany? Thanks.

A - Dieter Wemmer {BIO 4755450 <GO>}

Yes, that is a very good question. I should have mentioned it myself so actually thank you very much for the question. Let's start with the U.S. and the DoL. Well, in the end the proposal of the DoL said when you sell a savings product to the customer, ensure that the customer is really getting benefits and that the value for money is sufficient. And I think the fixed-index-annuity business is doing this and is in a actually easier position also to demonstrate this than variable-annuity business. And you will hear from valuable-annuity producers that they are also delivering value for the customer but actually to demonstrate it because the product is technically much more complicated, it's more difficult to do. So fixed-index-annuity products are much more straight and also slightly lower in the commission schedules. So therefore I am not concerned about it. We would even dare to say that it will increase the market for fixed-index-annuity business mid-term to long run.

And that is all with caveats, because the DoL proposal is a proposal which goes now through many vetting periods and what will be the final outcome let's see and wait. And when there is a change in governments in between, then the whole thing might be completely different. So that is – therefore we are not making any warnings about sales volumes based on this.

So now the German product, yes. The KomfortDynamik is certainly easing a step further than the Perspektive, and maybe I should have explained this in our changed new business mix strategy. Most of the life companies are telling you it's all about biometric risk and unit-linked, and that is the only solution for the growth. We are strongly believing that this is absolutely insufficient to keep the separate status of the life insurance industry from the asset management industry.

And the missing third pillar in the life strategy is for us the business, which we call business with alternative guarantees. Actually internal, we call them capital-efficient alternative guarantees. That are products which are offering a guarantee to the customer but a guarantee which is really measurable, plus they offer the customer upside from investing in real assets, but managed by us and not managed by a customer decision what unit-linked fund I am picking. So therefore the customer gets the comfort of the high-quality investment management plus a small guarantee but a manageable guarantee. And Perspektive has roughly a 0.4% guarantee, let's say, on average for 20 years instead of the classical products of the German market, which are still at 1.25% guarantee and guarantees including the annuity phase of 60, 70 years.

When you compare the products, a Perspektive product consumes 30% of the risk capital under Solvency II of the classical product, so you save 70% in risk capital for, in the end, debt (54:22) because putting capital behind asset liability mismatches, nobody is earning anything. And this allows us actually to put more money in real assets than our competitors and that is the real competitive advantage we are having.

And now the KomfortDynamik, the new product, is coming on top because the guaranteed part goes, so to speak, in Perspektive, to put it simple, and that is at the moment 70% of the money, and the remaining 30% is then a unit-linked fund paid by the customer so you can go fully into equities. Then you have 70% more or less guaranteed with – benefiting from the strong general account returns of Allianz Leben and the remaining 30% you could have the full benefit but also the full risk of the capital markets.

And I think with this mixture, we are positioning the life business and the service provided by a life insurance company a bit stronger than just being a copycat of an asset management distributor.

Q - Paul C. De'Ath

Excellent. Thanks very much.

Our next question comes from Michael Huttner of JPMorgan.

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

Thank you very much. Excellent presentation, thank you, and lovely results, I love the 86% in Germany. But on the cash flow you said it's at a record level at the corporate center and I just wondered if you could give some figures. It's always enough to dream a bit on dividend. And then similar kind of question, so now the €10.8 billion, you have a fair idea of gains and tax, whatever, for the remainder of the year. How should we think about what it would translate out as net income? The question is, of course, really what the dividend could be. Thank you.

A - Dieter Wemmer {BIO 4755450 <GO>}

Well, as we are not taking the decisions on the realized gains to manage results; it's mainly active portfolio management. Therefore, it's for me hard to say what would be the final outcome for the year. It depends also when you see that the stock needs urgent selling because the fundamentals of the company have changed. You realize a gain or a loss without asking whether it fits your November or December planning process.

As you know, I am always a conservative guy; therefore, I would probably not just double the number for the year, but I think we will for sure end up in a good single-digit growth of the net income.

So – and the cash flows, Well, I only want to reconfirm to you that all our subsidiaries are paying dividends, that they are actually paying all the dividends we put in the plan for them and some have even delivered a little bit more. And our restructuring of the group which allows to lift excess capital is also exactly on plan with execution; therefore, paying the dividend from a liquidity point of view is not the question. That is because you are always concerned about (58:04) your absolute liquidity. So I think...

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

No, no, no, I was thinking there was maybe upside ... (58:07).

A - Dieter Wemmer {BIO 4755450 <GO>}

Clearly there.

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

Okay, okay. Thank you.

We'll just take our next question...

A - Dieter Wemmer {BIO 4755450 <GO>}

If I would tell you the number, that would only be seen as a teaser, and then I think I could only disappoint you afterwards with what out of it is being paid out.

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

Okay. Fair enough. Thank you.

Our next question today comes from William Hawkins of KBW.

Q - William Hawkins {BIO 1822411 <GO>}

Hello Dieter, thank you. Yeah, the 86%, excellent combined ratio in Germany. Can you let us know roughly how you'd normalize that? Obviously NatCats has been very light, I'm not sure about reserve development. And can you just tell us a bit about the future because one of your major peers is talking more concerningly about motor TPL claims inflation. Munich Re was on the record yesterday saying that July was terrible weather in Germany; I'm sorry about that. So if you could just let us know sort of what you think about the second half for Germany and going into next year. And presumably it would be remarkable to maintain 86%.

And then your €1.2 billion M&A budget for this year, are we still roughly at that level? I'm just wondering – presumably we're roughly at that level. I'm wondering if Fireman's has taken it up a bit but I don't know how you treated the reserve strengthening and I'm not sure if there's been other small stuff going on behind the scenes. So where are we in terms of how much of your budget you've used up this year? Thank you.

A - Dieter Wemmer {BIO 4755450 <GO>}

Will, thank you very much for the question. Indeed the 86% translates hopefully in a normalize somewhere between 90% and 91%, not 80 (59:37) would be really great. But we have still a substantial NatCat budget in Germany for the rest of the year and I think July is not tapping too much into it. At least I have not heard anything about it and actually our German CFO is sitting opposite of me and he means if it's really bad, then it would have consumed €80 million in total, which would already be a conservative estimate. So not something which is taking and changing any management decision.

The M&A budget...

Q - William Hawkins {BIO 1822411 <GO>}

I'm sorry, if I could just come back to you, there is no concern on your side about motor claims inflation?

A - Dieter Wemmer {BIO 4755450 <GO>}

No.

No.

A - Dieter Wemmer {BIO 4755450 <GO>}

I must say, I am not aware of it, and in general with modernization of the fleet in the market, you still see a general trend to reduce heavy bodily injuries. So, therefore, I am not sure really what we are talking about.

Q - William Hawkins {BIO 1822411 <GO>}

Thank you.

A - Dieter Wemmer {BIO 4755450 <GO>}

So – and the M&A budget, yeah, we had some tiny acquisitions this year but it's a positive from the Fireman's Funds disposal, so I think the €1.2 billion is still fully intact.

Q - William Hawkins {BIO 1822411 <GO>}

Great. Thank you.

A - Dieter Wemmer {BIO 4755450 <GO>}

It's not been used so far.

Q - William Hawkins {BIO 1822411 <GO>}

Thank you.

Our next question comes from...

A - Dieter Wemmer {BIO 4755450 <GO>}

And it's not at a Greece bank, so don't worry.

And our next question today comes from Thomas Jacquet of Exane.

Q - Thomas Jacquet {BIO 4110153 <GO>}

Hi, good afternoon, I have only one question, it's on Turkey; you achieved a two-digit combined ratio which is probably the – you're probably the only company in the sector to achieve that in Q2. Have you seen like your peers an increase in the motor CPL claims or is there something in your business model that is different?

A - Dieter Wemmer {BIO 4755450 <GO>}

No, you are fully right with your question, motor CPL is clearly up but we have also increased the prices and we have started maybe a little bit earlier than the rest to raise prices. We have also, after we have seen that inflation and the core decisions on larger cases were against the insurance industry, we have actually also increased our reserving levels in Q2 slightly after a review done by our central actuarial team.

So Turkey as a market is a young market you have to watch, but as far as we can see it, also our largest competitors are now starting to increase rates very sharply. And we believe we are doing our rate increases more selective because our service is more diversified. Still, remember from the history that actually we could export in a very early phase our motor service knowledge from Italy to Turkey. And since then, we have really continued to develop the tariffs in the local circumstances and the technical team in Turkey, is – maybe still a little bit behind the Italian colleagues, but pretty close in their professionalism and that really pays off.

I am an absolute believer, we see the same in Greece, it is a very difficult market but our second quarter, our small portfolio increase was in the mid-80%s in the combined ratio, and that in a horrible economic environment but actually high quality pricing is still a competitive advantage.

Q - Thomas Jacquet {BIO 4110153 <GO>}

Okay, thank you very much.

A - Dieter Wemmer {BIO 4755450 <GO>}

And that allows also Allianz to run an underwriting result which is every quarter better than most of our peers.

Our next question today comes from Peter Eliot of Berenberg.

Q - Peter D. Eliot {BIO 7556214 <GO>}

Thank you so much. First one is on the – high level on the life underlying result, I mean if I take your comments Dieter, it sort of sounded almost like one can sort of add back the interest rate impact and if one adjusted for career as well then one, just looking at the run rate of around €1 billion per quarter, which I guess is clearly above your full-year target, I was just wondering if you could comment perhaps on – that's clearly quite an optimistic interpretation but I was wondering if you could just comment on that first. And then...

A - Dieter Wemmer {BIO 4755450 <GO>}

Okay continue, yeah.

Q - Peter D. Eliot {BIO 7556214 <GO>}

Sorry, and I was just going to ask as well given the various comments you've made on the great budgets, in building those, again maybe optimistic, but I am just wondering if you can share anything on how you view the M&A environment as developing at the moment? Thank you.

A - Dieter Wemmer {BIO 4755450 <GO>}

Yeah. I – thank you Peter. I was waiting for the M&A question. It took more than 35 minutes for it. So it's a pretty long time. So the Life result, as I indicated, I would like to look at the half-year results. And in the €2 billion I probably would still take out €100 million from the half year. Yes, you can say Korea is a one-off that we also know that in the yield environment that there might be also in future we are reaching more break points in Korea, therefore the number might be necessary still from time to time to put more money into it. Therefore, I personally like to take the 1.9 as well earned and then use it for the future. It depends always a bit also what we are doing on the investment side. There is some volatility in it and it is a big portfolio and in the end that is about creating long-term value; therefore, we cannot every quarter deliver the accounting results because sometimes the accounting works not in favor with the long-term decisions. And that allows me actually to make a little appetizing when we move to IFRS 9 for the insurance industry faster than IFRS 4 Phase II. We will spend every quarter another 10 minutes on explaining the movement of the financial assets versus the liabilities and why the numbers are one-off and not one-off. The whole story will get even more complicated that I promise to you. But if you reserve 10 minutes more for each call you do and the calls of each of our peers, then it's fine with me. But don't complain afterwards.

Q - Peter D. Eliot {BIO 7556214 <GO>}

Okay.

A - Dieter Wemmer {BIO 4755450 <GO>}

The M&A environment, the smaller assets are all very highly priced so you see high earnings multiples people are expecting both even on some of the bigger deals. So you have really to think through very well what is your strategic move with an acquisition, does it really close a strategic gap? Is it worthwhile to pay a high multiple in this situation or is it just a simple add-on acquisition to help you with your scale and profitability, then I think you are more limited in paying a strategic premium. And therefore as – you have to watch the situations fairly closely, opportunities coming up, it's less easy. We have seen actually in various private equity deals we did more on the investment portfolio but in the end they are following the same logic as M&A in the insurance industry. There we have seen that we could actually get to better outcomes and the competition was more rational than actually in the insurance space where the people are probably desperate because they don't find anything to acquire and you have really to watch out how you want to play it. In the end, it is about making money and returns and not just showing some tiny deals.

Q - Peter D. Eliot {BIO 7556214 <GO>}

Okay. Thank you very much.

Our next question comes from Jon Hocking of Morgan Stanley.

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

Hi there, afternoon. I've got three questions please. On Italy on the P&C side, it was a very strong combined ratio in the quarter but the rates movement looks quite weak, I just wondered what the outlook is there. Are you looking to taking down policy accounts and do you have sustainable (69:43) combined ratio number, that's the first question. Second question, I wondered whether you can comment on the press articles in the week talking about the Wells notice which PIMCO has received.

And then finally, just on point you're making, Dieter, about the very strong capitalization in German life business and policy – the tendency to feed through to the group ratio, given that there is no sort of real burn-through risk here, I just wondered if you could sort of comment on the – to what extent that's introduced the group policy that you received in the last few quarters and whether it might be useful breaking that out given it's actually something which is fairly ring-fenced, thank you.

A - Dieter Wemmer {BIO 4755450 <GO>}

Yeah John, that is a very good suggestion, I am also thinking about to break it out. I would suggest we wait now until we have finalized our IMAP approval process. One of our German competitors got already their approval but they have a much simpler supervisor, we call it, and not having sales supervisors debating the pros and cons of every feature of the model. So we probably still have to wait a number of months before we have everything.

And then we should certainly consider to break it out, because I am absolutely not nervous about the volatility of the term life business. And the burn rates, I – look, a reinvestment place of 0.8% is still enough so I'm not sure how negative the euro swap growth has to go before it really burns fully through, but we will work on it after we have the proposal and can really separate out all the numbers correctly.

Italy; in Italy policy count is still growing but only just slightly. The main growth is still in our direct business. We have also in premium plus 5% but the tariffs are down. The whole market is competing very strongly because all sitting on a positive combined ratio and that allows still the market to reduce rate which then translates into falling total premium for the Italian P&C market. In Q1, we were with our shrinking still growing market share since the market was 1 or 1.5 points more shrinking. For Q2 I have not yet seen market figures but when I just compare ourselves to one of the large Italian peers, it shows that our Italian volume is still holding up slightly better.

So, the Wells notice. Well, I think all the – so one of you who are familiar with the processes at SEC it is a recommendation of the working group to the commissioner level to follow up on it, so it is not yet an action against PIMCO. The Wells notice is referring to the smaller brother of the total return fund that is a listed ETF at the New York Stock Exchange, it has at the moment $2.5 billion money under management. And it is a discussion what got criticized is about the disclosures in a specific phase in 2012, I think it's referring to three or four reporting months. Actually no harm done to any customer, all customers got their full money and values. So therefore it looks to me from the current understanding a very formal discussion and we take it with respect because any dealing with the SEC we are very respectful what we are saying but it is not alarming from a content point of view.

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

Excellent. Thank you.

Our next question comes from William Elderkin of Goldman Sachs.

Q - William H. Elderkin {BIO 3349136 <GO>}

Hi, thank you for taking the questions. One on PIMCO and one on U.S. life. Did I hear you correctly in your speech that you said overall PIMCO outflows in July were €3 billion? And I'm just wondering if I heard you correctly, did that imply outflows on the portfolio excluding the total return fund which I think you've already given the figure for July with just €1 million – I may have – €1 billion rather. I may have misheard you but it seems to be a dramatic improvement on that situation over the last six months or so. And then second question was just on the U.S. Life, operating profit was €297 million in the quarter. I just wondered, are there any unusual features in that, is that number really sustainable?

A - Dieter Wemmer {BIO 4755450 <GO>}

I think that on one hand of course the dollar translation helps also with our U.S. life business. Then we have reserves – margin on reserves when compared to a year ago. So the whole balance sheet has a – has really had a nice growth so that is very sustainable movement and then we had some, I think, positive on hedging results on the VA book and maybe in the year before there some negative. So some part is also derivative to revenue but not a lot. So, the PIMCO number, the around €3 billion I was referring to, it's the total net outflow of the company. I did not highlight any specific funds, that is the total, and yet everybody always looks at this total return fund disclosure, I am not sure but I would remember that it was almost $3 billion standalone. So, that tells you that actually the non-core parts of PIMCO are really doing fine.

Q - William H. Elderkin {BIO 3349136 <GO>}

That's why I asked the question because I mean it seems to be close to neutral on by far the largest part I guess of sort of the management...

A - Dieter Wemmer {BIO 4755450 <GO>}

I can also tell you that out of the 22 trading days in July, 10 were positive.

Q - William H. Elderkin {BIO 3349136 <GO>}

And just in terms of...

A - Dieter Wemmer {BIO 4755450 <GO>}

Already going into the right direction.

Q - William H. Elderkin {BIO 3349136 <GO>}

I mean yeah, I appreciate it's only one month but is there anything structural change in terms of having had very significant institutional outflows working their way through, is the future sort of a little bit more positive in that respect for example?

A - Dieter Wemmer {BIO 4755450 <GO>}

I think overall a very good performance, look the Eaton's vastly criticized total return fund got back its five-star Morningstar ratings just this week. The year-to-date performance of the total return fund is at the 96 percentile or something like this. So the team is really doing an outstanding job because a fund which has so large outflows and still showing performance, really a very strong performance compared to most stable funds, that is a fantastic investment performance of the team. I really like what they are doing and we should not forget this.

Q - William H. Elderkin {BIO 3349136 <GO>}

Excellent. Thank you very much.

And our next question comes from Nick Holmes of Société Générale.

Q - Nick Holmes {BIO 3387435 <GO>}

Hello, hi guys. Thank you very much. I had just a couple of follow-ups on life. Coming back to German life I fully understand what you're saying about the strength of the business, the value of the RFP but I just wanted to come back on John's question about the quantification of the sensitivity within the solvency, the group solvency to ratio. I mean can you for example tell us what proportion of your 8 to 9 percentage point movement I think for 50 basis points approximately in the group ratio, are you saying, Dieter, that the German Life business does not contribute to that at all or are you saying that there is some contribution that is actually pretty small, that's the first question.

And the second question is just coming back on Korean life. I know that you've got a history of strengthening reserves there and I wondered, could you just tell us a little bit more about your methodology and your reserve strength? I mean you're signaling that it is not the end of the story in Korea dependent on what interest rates et cetera do, I mean can you give us any kind of guidance on what we might expect because it was a pretty big charge, wasn't it, in Q2 and in 2014, you also had a pretty big charge for Korea? Thank you very much.

A - Dieter Wemmer {BIO 4755450 <GO>}

Yeah, Nick, thank you for asking. No, with the German life business, I wanted to express more the opposite of the sensitivity. The German life business has an over-proportional impact on our input rate sensitivity but as it's encapsulated, it is anyway actually not creating any capital action for the group. Therefore, maybe our total sensitivity appears bigger, then it is really an impact and from the 9% sensitivity, I would say probably slightly more than half is the German life business. But it doesn't matter as it fluctuates in itself and we will not inject capital, we will not take out capital, we just take the dividend and we close the business.

So that is – therefore actually that is from my perspective too much focused on the sensitivity, but we are not standing still. We will also in the future reduce the sensitivity further. There are two elements which will mid-term reduce the sensitivity in our German life business. That is on one hand our new business mix. But that is a slow process as you actually need to add a couple of years of new business mix before you really have the overwhelming effect of the business (81:25) under control.

And the second thing is an activity of the German regulator, which is called ZZR, that is building up this additional reserves to reduce the average guarantee risk and the ZZR will be from next year on below – or let's say the required interest rate till next year lower than at the moment our average guarantee. That means that it will help accelerating to get the average guarantee down and that will take interest rate sensitivity further out.

If you project the whole thing 10 years forward, and we have recently done it and have said look, what would happen when we have a Japanese scenario, we have used the April 1 interest rate and said, let's continue with this for 10 years. Then our solvency ratio will actually grow over time, which is maybe counterintuitive for most of you but it is happening because it is a new business mix and it's a ZZR effect. So therefore we are very reluctant about the sustainability of our German life balance sheet. And it's really important information; therefore, I am spending so much time on it because I have read so many disoriented analysis over the last weeks and months that I am really fighting back now much stronger.

So, Korean life...

Q - Nick Holmes {BIO 3387435 <GO>}

Sorry, Dieter can I just very quickly follow up because it's obviously a very complicated area. So, the first point you are making is that you don't see any possibility for German Life to be ring-fence separated out from the group solvency ratio – I'm sorry before you answer that question, can I just ask coming back really to Farooq's questions on transitionals, if that's the case if German life cannot segregated out, why is that you are not interested in transitional arrangements? I mean it's something that the UK insurers are doing for their troublesome annuity books. Surely transitionals would be quite an effective method of just ring-fencing your German life business?

A - Dieter Wemmer {BIO 4755450 <GO>}

Yeah, well, I think the decision on transitionals is the question. How many digits does your sovereignty ratio have? Well, you have a 30% sovereignty ratio then I would go for transitional; if it's above 300% – and we have not disclosed the absolute number we are only indicating it's bigger than 300%, I wouldn't see the reason for transitional. And why should we take any risk that we have to agree on a recapitalization plan with the regulator because that is what transitional says. Transitional says file the plan with the regulator how you recapitalize your business till the end of the transition period. That is very simple, this meaning of the word transitional. So at 300% what plan should we file? Saying we have too much capital and we will dividend it out?

Q - Nick Holmes {BIO 3387435 <GO>}

Yeah. No, that's very clear.

A - Dieter Wemmer {BIO 4755450 <GO>}

So the Korean life is indeed a prescribed methodology. That it's a – the lost – the loss adequacy test under U.S. GAAP rules that is very formulaic process without any leeway to interpret it left or right. You just apply the formula and you look what is the outcome of the formula and then you book the difference or not, and that is just a test which is projecting the current investment income with future reinvestment rates, it is an averaging of the interest rates over 16 quarters of rolling averaging, and then you compare it with the discount rate you have in your reserve and that is more or less the test. And therefore, I think we will see more additions in Korea, it depends a bit on the market development, and that is very sensitive, whether markets are 50 basis points up or lower. But I would also expect that we would see some more reserving in the future, it is not something which I think will damage our overall grade profitability of the life segment.

Q - Nick Holmes {BIO 3387435 <GO>}

Okay.

A - Dieter Wemmer {BIO 4755450 <GO>}

And Nick I have some additional information for you. The court in the U.S. dismissed our last open class action in Minneapolis, you are always asking about the status of our class action, so the last month got dismissed by the court without payment by us.

Q - Nick Holmes {BIO 3387435 <GO>}

Well, congratulations. Thank you for that. Just a very quick follow-up Dieter on the Korean life. Is there not a temptation to make an additional prudential reserve though for Korea so that it stops appearing constantly in each quarter at all or every few quarters?

A - Dieter Wemmer {BIO 4755450 <GO>}

Look, my natural instincts would fully agree with you and I would like to do this, but somebody needs to rewrite the formulas for U.S. GAAP. And either we stick to what we disclose as our accounting principle or not. We cannot have it both ways.

Q - Nick Holmes {BIO 3387435 <GO>}

Okay.

A - Dieter Wemmer {BIO 4755450 <GO>}

Either you are – we are not on French GAAP; there, you have more flexibility.

Q - Nick Holmes {BIO 3387435 <GO>}

All right. Okay. Thank you very much indeed.

Our next question comes from Andrew Ritchie of Autonomous.

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

Hi I just have one question really, Dieter. In the comments in the slides you refer to looking at the attritional loss ratio to the ex-cap loss ratio. You refer to lower large losses but on the other hand some higher frequency effects. Could you quantify those numbers and maybe just on frequency, there is a specific reference to higher frequency in NTPL in Italy; are you seeing any frequency upticks in any other markets? Thanks.

A - Dieter Wemmer {BIO 4755450 <GO>}

It's Italy and then probably a little bit UK where we have a small portfolio. I think also Australia we have seen a slightly higher frequency. Overall, the attritional loss ratio is very close to last year's number because the NatCat effect I would take out. We are also still I think in a very good development year. So for the one who had already seen it peaking some quarters ago, we are very stable; the same our reserving process is also in a very stable situation where 2Q actually got hit by Fireman's Fund again but that is not the first time. So that is the other Korea, at the west coast, yeah.

I assume that we are in Fireman's Fund are more getting to a closure of this evergreen episode and the running is actually our attritional loss ratio. It's in the right direction. We are still, I think, are not improving fast enough in Brazil, so that is also included, I think, in the uptick of frequency in the motor business. So that is still where we have to work on getting the stuff (1:30:11).

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

And in Germany and France, there's no real frequency trends changing? Is it falling still or...

A - Dieter Wemmer {BIO 4755450 <GO>}

No, Germany is slightly, it's down. In particular we see it on the larger claims. We still see a trend to let larger claims in the motor business.

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

Okay. But the other question I had actually, your colleague (90:41) has laid out some of his new strategy this morning. And he is talking about – we will learn more about those initiatives at the end of November. I mean do you anticipate any major restructuring costs in the second half of the year, or is all of what he's letting out very much sort of business as usual?

A - Dieter Wemmer {BIO 4755450 <GO>}

Well, we did not answer this question this morning, and thus the answer should not depend on the audience of the call.

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

Sure, I didn't know it was asked. Sorry.

A - Dieter Wemmer {BIO 4755450 <GO>}

Therefore, we are not answering it, but fairly to also give you the rationale. It is much too early to do so and it is more important that we get now the strategy worked out and it's very much about a cultural shift program and really getting the insurance industry much deeper into digitalized processes. That does not mean that we are all becoming fancy but I think all the normal processes can be very much digitalized, and we have so great tools.

We have, as we put on the first page, this new tool in Germany where automated camera system actually calculates hail damage. We have this – another claims solution provider developed an app where you can actually – a little damage in your car you can take a photo and it calculates the claims amount and we can settle immediately without human interaction. That would be the mid-term solution after a testing period.

So there are so many things where our industry can really enhance base services or that our international health business allows you to take a photo of your smartphone integrated in the app, and then the billing and settlement process of the health bills is automated.

So that are all the little improvements where we have kept more in the 21st century, and I believe that our industry is still a bit reluctant to go with this full step and that is the shift we are really pushing forward. There will some investments but there will be also savings. When I still look at our annual bills for printing and mailing, that is a substantial amount. I think we are printing in Germany hundreds of million pieces a year. That is a real forest that we're seeing running through the printers.

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

Okay, great thanks.

Our next question comes from Frank Kopfinger of Commerzbank.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Yes, good afternoon, everybody. I have two questions. My first question is on your life reinvestment yields. You show a significant increase to 2.8% in Q2 from 2.2% in Q1. What were the drivers behind this, simply the rise in interest rates? Because you don't see or you don't show that the same extent on the P&C side, and certainly this is also on the lower duration but I was wondering what the drivers were on the 2.8%. Then on German Life with your 300% Solvency II ratio, there you clearly show a strong situation but I'm wondering how you see the whole sector because this is certainly not representative for the entire sector and certainly not for the average local peer, I would say. So how do you see the sector and how do you see – or whether you fear a negative spillover effect for your group?

A - Dieter Wemmer {BIO 4755450 <GO>}

Two very good questions. The life reinvestment yields, as we are investing really long in the life segment and when you see that the 20-year-euro swap curve moved 92 base points up, plus we have seen additionally actually a lift in credit spreads slightly in the second quarter, so the 60 base points up is actually not a surprising number. You could almost say it is a lower increase than you would have expected from the market data. But that is always a bit the mix.

And I think we had in the second quarter also more investments, U.S. investments; therefore, that is also an important driver. And the 2.8%, as I mentioned already in my explanation, that is also a share of emerging market bonds, where we hedged and the currency is depending on the risk capacity.

Yes, I agree that our results for the solvency ratio in the German market is not reflective of the average, and actually I hope so that it is substantially better than the average. Would I therefore conclude that I am in panic over the German market? No, because we are not the only well-managed company, but we are clearly the market leader which has also a clear scale advantage, because our cost advantage allows us actually a much cheaper refinancing of the guarantees than the rest, because the other companies need more investment return to pay for their expense levels. And that is, I think, the advantage, and therefore what we want to offer the customer: more investments in real assets.

And maybe the one of you who has followed the press, we have done a large investment in all the fuel stations and restaurants at the German motorways because that is one large umbrella company running the 300 places; and we have participated in a group here who has acquired 100% of it.

We have done other investments in the UK: there is a new wastewater tunnel under the Thames, which is a large public-private enterprise investment. So I think that allows us to really to drive better than the rest of the industry but we are also not concerned that we have to bail out too many competitors, if this was the question. I think the bailing out in Germany is a well-organized process which makes it also, even for the rest of the industry, very absorbable and I'm not expecting that we have to bail out over the next years many companies.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Okay, thank you.

A - Dieter Wemmer {BIO 4755450 <GO>}

That was the core of the question.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Okay, this was the question. Thank you.

A - Oliver Schmidt {BIO 2473131 <GO>}

We have time to take one or two last questions if there are any. We want to close the call at a quarter to, thank you.

We will just take our next question from Vinit Malhotra of Mediobanca.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yeah, hi, Dieter, hi. Just one sort of philosophical question based on the page 25, since German life is so strong and we also agree with you – since German Life is so strong, why not push into the classical traditional products if they are giving you already 20%-plus ROE. In the sense that's where the real competitive advantage lies, don't you think, because otherwise everybody wants to sell non-traditional? Or – yes, I admit, it's a bit off-the-hook question but it's been a question I have been thinking of many – for quite some time and I'm wondering if you could shed some light on that.

Also in Germany combined ratio, there is a comment that the accident year loss ratio ex NatCat is still stable but they – I am assuming it's YoY. But there has been price increases, is it just the severity you mentioned which is eating up some of that price increase?

And lastly, just want to quick clarification, Brazil, the presentation mentioned temporary headwinds in the economy, but you sounded a bit more cautious in terms of these pricing cycle in the industrial and motor, you mentioned. Which one's the case? Is it – are you worried about turnaround or are you just looking at sort of a temporary slowdown in the turnaround in Brazil? Thank you.

A - Dieter Wemmer {BIO 4755450 <GO>}

Vinit, hi, now thank you for the questions. I think the combined ratio in Germany is probably on a view like-to-like comparisons, slightly improving over the years, but it's always tough to measure the last couple of basis points, so therefore I would still keep it roughly at sustained average at last year and if we get some positive surprises out of it it's also not bad.

In the life business in Germany, yes, indeed you are right, we could continue the guarantee business without going into a better situation, but then we cannot put so much risk capital behind our investment strategy.

And in the end for mismatch risk you are not making any returns. You are investing capital in something which is not bearing any interest and we don't need to do it to gain market share. Our products – and in the end you have also, in the long run, to offer, our customers returns. When you invest in classical and you have to go for low-risk investments then it is easy to calculate what will be your long-term investment yields, then it will be below 2% in today's environment, and who wants to buy this product?

I think it is really important that we are also leading the shift to other products in the German market and I think it is for the whole market – I think for the customers and industry it is a better version when we could help to transition the German life insurance market to a different product mix and we don't want to stick to the old rules. And in Germany we are in a very comfortable position, that transition to different products that is also needed in other markets. And I think we are running here also a good strategy and do you think our other markets would follow it when we would say Germany doesn't need to change, that would be a very strange decision for a group to manage something. Because it is again a cultural shift.

Q - Vinit Malhotra {BIO 16184491 <GO>}

But the RORAC would be lower than this 21% then right?

A - Dieter Wemmer {BIO 4755450 <GO>}

The ballpark of the new product is substantially better than of the old products.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Fair enough.

A - Dieter Wemmer {BIO 4755450 <GO>}

It is still even in its – well, also when you have a strong balance sheet, the RORAC is not benefiting from a – on the balance sheet when you consume a lot of capital for a product. Therefore you would see in a – with the classical product you are low double-digit, with an adjusted product or new product generation you are 20% plus. So that also, in translation when you would stick to the classical product and we go through the Japanese interest rate scenario you cannot keep the high ROE forever.

Q - Vinit Malhotra {BIO 16184491 <GO>}

All right. Thanks Dieter.

A - Dieter Wemmer {BIO 4755450 <GO>}

So for Brazil yes it was not a statement that we will see a delayed recovery because growth is lower. That means expense is actually faster up. We have a high inflation so that it – and pushing through price increases is slower than expected because customers are not in the economic position to follow the price increases, they are then looking to the cheaper solution.

Q - Vinit Malhotra {BIO 16184491 <GO>}

But the health portfolio is in control. This is the Moto that we're talking about?

A - Dieter Wemmer {BIO 4755450 <GO>}

It is in general in control but also a bit suffering from higher expense level.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay, thanks, all right, thank you. Thank you, Dieter.

A - Dieter Wemmer {BIO 4755450 <GO>}

Thank you Vinit.

A - Oliver Schmidt {BIO 2473131 <GO>}

All right. So we have to close the call and well, so thank you to everybody. Thanks for your attention. We wish you a very pleasant weekend and hopefully a nice summer break. Good bye.

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