Q1 2017 Earnings Call

Company Participants

- Dieter F. Wemmer, CFO and Member of Management Board
- Oliver Schmidt, Head of IR

Other Participants

- Andrew James Ritchie, Partner, Insurance
- Arjan van Veen, Executive Director and Equity Research Analyst of Insurance
- Farooq Hanif, Head of Insurance Research in Europe
- Michael Hermann Haid, Analyst
- Michael Igor Huttner, Senior Analyst
- Nick Holmes, Equity Analyst
- Paul De'Ath, Analyst
- Peter Eliot, Head of Insurance Sector Research
- Thomas Seidl, Senior Analyst
- Vinit Malhotra, Banca di credito finanziario S.p.A., Research Division
- William Hawkins, MD, Head of European Insurance Research and Senior Analyst

Presentation

Operator

Ladies and gentlemen, welcome to the Allianz conference call on the financial results of First Quarter 2017. For your information, this conference is being recorded.

At this time, I would like to turn the conference over to your host for today, Mr. Oliver Schmidt, Head of Investor Relations. Please go ahead, sir.

Oliver Schmidt {BIO 2473131 <GO>}

Thank you, Ron. Yes. Good afternoon from my side as well. Welcome to our conference call about the results of the First Quarter 2017.

I think I can keep it brief. We have released our key numbers already last week. You have seen the analyst presentation this morning. And all the details, you will now get from Dieter.

Dieter F. Wemmer {BIO 4755450 <GO>}

So thanks so much, Oliver. And also. Good afternoon or good morning to everybody on the call. It's true, already old numbers, a week old. But maybe I have still a few interesting details for you. And I'm also looking forward to an engaging Q&A session.

Headlines. A clear EUR 2.9 billion operating profit, at a new record level. I think maybe at one point we will also have a EUR 3 billion operating profit line but not this quarter. Total revenues up 2.5%. Shareholders' net income is down. However, we had these extraordinary high results in last year on block trades, which we -- where we realized the substantial amount of gains.

Our EUR 1.8 billion for Q1, when you compare it with the full year result of '16, is more than 1/4. So we are well set for continuing our EPS growth even with the same number of shares outstanding, which is not happening, as you know.

So let's go into our solvency ratio because that was not announced last week. 212% is our regulatory reported solvency ratio for end of the quarter. The change to year-end is twofold. On one hand, we have fully deducted the full share buyback amount of EUR 3 billion. I think, as of yesterday, we have executed some EUR 1.2 billion and a little bit. So we are well on track. But our regulator recommended to us, "When you start executing, you should not deduct pro rata. You should take it all."

So 9 -- EUR 3 billion is 9 points in impact. That means without the share buyback, we would have ended up at 221%. That would be, for the first time, 1 point out of our capital management range from 180% to 220%. So really, a very strong solvency ratio. And I come to the details a little bit later.

Also, shareholders' equity, 0.9%, up to EUR 67.7 billion. And that is also, I think, a good start into the year. Some movement on the unrealized gains and losses, less gains on, in particular, the Mediterranean government bonds and more gains on equity.

When we -- I think the sensitivities, for your reading. And I'm sure ample part of the Q&A anyway.

So I shifted now. And let's look at our solvency generation. We had really good operating earnings. And the operating earnings are, by and large, close to our IFRS earnings. For the corporate segment and Asset Management, it's literally the same. For P&C, it is almost the same. You have only these little changes from reserve discounting. In and out the P&L, the effects are pretty small of this discounting. Then in Life, of course, all the DAC movements are out. But you have the new business value generation. And as new business value had a record quarter in Q1, also we have a record quarter in operating Solvency II earnings.

Market impact is what you expect. Capital management is very much the EUR 3 billion share buyback program and then the accrual for the 2017 dividend because we are following strictly the rule that we, every quarter, accrue pro rata our potential dividend. And that leads to a slight -- despite the high capital reduction, that leads to a slightly increased own fund calculation.

Risk capital is up to EUR 35.8 billion. The main driver is model changes. The model changes, well, that is a combination of both the regulator asked us to do and things we wanted to refine. Actually, in total, you can say, when you look, that the model change has created EUR 2.2 billion of additional own funds and EUR 1.1 billion of risk capital.

If you just divide the 2 figures, you are getting pretty much to our average solvency ratio. That means all the changes we do are refinements and, we believe, better matching our business logic. However, the regulator is watching out that numbers are not giving us any additional big benefits.

So now moving to Page nine and diving a little bit deeper into the P&C segment, with close to 3% revenue growth. I think we had a pretty good start into the year. We expect actually that it should, in some markets, even -- should go up even more. We had 2% organic growth and 1% from acquisitions from last year. That is a small Dutch commercial portfolio we acquired and then the Morocco business we invested in.

So most of the organic growth is actually price. Split is more than 1%. So 1.2% is price and 0.5% is volume increase. But it's very different by market, where Germany is really able to push through price very well and in Italy, obviously, the opposite. With still a very high profit margin, we still see an average reduction of motor premiums in the market. And at AGCS, it is a little bit weaker pricing. But mainly less writing because we really stick to our underwriting discipline. We have -- the very positive markets are Spain, Latin America, Australia and also, Allianz Worldwide partners, where we get both price and also volume running at a very good level. And also, Latin America, good mixture between price and volume.

Now turning to Page 11, the profit -- overall profitability of our P&C business. There is certainly, at first glance, less underwriting profits. And I come to this in a moment. But what is positive is actually that the investment result is keeping up very nicely.

So let's now look at our combined ratio, 2.3percentage points worsening is, from my perspective, actually hiding a 40 basis point improvement on the underlying. So how do I look at this? Well on one hand, yes, there was a bit more NatCat in Q1, as being explained here in this little bubble. Then, we had more large losses. Large losses, our long-term average is actually 3.1%. And we had 4.2% in Q1.

Then there is the famous Ogden case. I think you have, in the meantime, seen this with all of our peers and particularly, U.K.'s market leaders. In our case, Ogden cost us, in the run-off ratio, 0.8%. That means when you take out Ogden in Q1, our run-off results would be at 3.6%. So a very average run-off result for our group.

And the Ogden is also affecting slightly the current accident year. So in Q1, it has actually cost us 20 basis points in our segment number. And it's not only our U.K. business which is paying the Ogden bill. It is also our third-party reinsurance business, which has -- via excess of loss contracts in the motor line. But also, in other casualty lines has some Ogden impact. Then not to forget also, Ireland is following the Ogden rule and has also some small impact also; that is for our segment, of course, negligible.

Going to Page 13, the operating profit and combined ratio by country. The biggest cat events were on, one hand, France had a couple of these midsized storms; and then Australia, with the storm, Debbie. I think everybody has it on his or her radar is what the biggest cat event of the quarter, turning our Australian operating profit into the negative, the same as Mr. Ogden turned our U.K. profit into the negative.

What is working well is the continued turnaround in Latin America, first positive operating profits since quite some time and showing that our work starts to show, to bring fruits to what we were waiting for such a long time. I think else, besides this weather and cat volatility and some large loss volatility, mainly AGCS. But also Germany had some more large losses than in previous year; and also France a little bit; Italy, very shining result with the low-80s credit insurance as well; Spain continued to show a great story of growth and high profitability, pretty much unchanged quarter-over-quarter; and Allianz Worldwide Partners had, in the international health business as well as in the travel insurance programs, good progress on re-underwriting some of the key relationships.

So I think, overall, our combined ratio and the volume development is very much on track with the expectation. And when we look on Page 15, the investment income actually over-delivering in Q1. So that we have actually no concerns about making our outlook number or even a little bit more in the P&C segment this year. Of course, the caveat is always the large catastrophes.

So from this, I will directly dive into the Life segment. New business volume, nicely up. Our present value of new business premium, 3% up. And together with the new business margins, the first time above our target of 3% to 3.1% creating, in total, a really new high for new business value for our group.

And when you look at the mix of the business, clearly, our capital-efficient products stay at a good 1/3 of it. And we see a growing portion of unit-linked without guarantees, protection and health, slightly up. So all 3 together further shrinking the traditional guaranteed savings and annuity business. So very much all pointing towards the right direction.

And with this one, I move to Page 19 and a little bit looking at operating profit. EUR 1.155 billion is a very high number for the operating profit, which then immediately creates the question, "How sustainable is it? Is the investment margin driven by additional harvesting?" It is not. We have, certainly, as one of the changes is a EUR 95 million swing in the basis risk gain in our U.S. VA business. But the EUR 95 million consists of a EUR 56 million loss in previous year and then a good EUR 30 million plus this year. So actually, when you want to neutralize for it, you would deduct EUR 30 million.

And I think there are -- we have a one-off catch-up in DAC adjustments also coming from our U.S. business of around EUR 50 million. So if you want to be very conservative, I would maybe subtract EUR 100 million from the profit in the Life segment.

When you compare it to a year ago, I think actually what I told you before was the current new business value and where we are standing, we are on a stable 3% to 4% profit growth, together also with the underlying balance sheet growth in Life. So that is very much confirmed. I would say we have roughly EUR 50 million, more sustainable profit this year than we had a year ago, ignoring Korea completely. That would come as an additional base effect. So that our numbers in Life are really going into the direction we would like to see it. And they are really confirming quarter-over-quarter.

Well who are the main success stories? Well I think that is, on one hand, Germany continues to grow new business volume. You have seen, on Page 19, it's a double-digit growth in new business in Germany. New business value is nicely up. Italy shows a growing new business value. And that is all driven by unit-linked. And clearly, our Asia Pacific region is really doing very well. And we are producing a very good growth. But also, our smaller countries are doing very nicely in this area.

Volume-wise, the U.S. had a weak start into the year. New business volume was clearly down. But we have corrected the new business margin. And with 3.9%, we have achieved a really excellent new business margin in the First Quarter. In April and May, sales start to pick up. And we are pretty sure that we can, over the whole 12 months, just continue the success story of previous years.

Operating profit in the U.S. is shining. That is a base risk swing, plus the EUR 50 million DAC correction. And also -- and that is not a positive one-off. But a year ago, we had, in the U.S., an additional reserving in the long-term care business, which we did not repeat. So therefore, the operating profit in the U.S. was EUR 325 million, is a very good start into the year, which allows me actually to go to our investment margin.

We have delivered 25 basis points for the First Quarter. Our guidance for the whole year is 95 basis points. That means we have 70 basis points to go for the rest of the year, though, actually, the 25 is maybe 2, 2.5 basis points above what you would expect anyway to achieve 95 for the full year. And there is the base risk effect from the U.S.. And the rest is pretty normal.

I think our net harvesting has a little bit less realized gains than last year. But it has also substantially less impairments than last year, which explains more the net improvement. So it is very much, I think, a very stable situation.

And our unrealized gains, in particular in our equity portfolio and also real estate portfolio, have grown in this year and also in the last three months substantially further. So we are far away from harvesting the pro rata share of the growth in unrealized gains.

Asset Management. So I think we have, this time, the right order of our segments because we have really kept the best for last. Asset Management segment is benefiting from, on one hand, a good financial market. So we have, in total, more than EUR 40 billion more assets under management, of which half comes from markets. And the other half are inflows at PIMCO. Close to EUR 21 billion of net inflows at PIMCO is really a very strong continuation of what was already looking pretty good in Q4 and Q3 last year. So the trend just continues. And I'm also optimistic for the next quarter to go.

And on Page 27, you can actually see that PIMCO keeps its profit margin pretty unchanged. And hence, the whole result has been a good increase of revenues of 12% and Allianz Global Investors also benefiting from equity market development. Of course, it's showing a double-digit increase in revenues, which gives us, for the whole segment, an increase in revenues of 12%.

And that allows us then, on Page 29, to turn this into more profits. And our operating profit in Asset Management has a 24% jump in Q1 '17, which is, I think, a great recovery of our Asset Management sector and shows that, in some areas, active asset management can still compete very well into our today's world.

I think I will then just go to the summary. Corporate segment, nothing exciting. A little bit more profits in the banking segment. We have less provisioning for -- less loan provisioning than a year ago. And in holding and treasury, we show a little bit lower temporal expenses and also some better hedging results in FX. I think the year ago, we had some more losses there. So that is, in the end, small movement in the overall scheme, which then is bringing me to the last page, Page 33 of the numbers.

Nice growth in operating profit by EUR 250 million. But realized gains are EUR 400 million down. And hence, we have actually a lower income before tax. And as the realized gains from last year were completely tax exempt, you have actually also not this great effect on the tax rate. And with 29%, we still show a very low tax rate, below our 30% target level because we have still some tax-exempt income. And resulting then in a EUR 1.8 billion shareholders' net income, which is a very good start into the year.

And let me then summarize where we stand with respect to our 2018 targets on Page 35. Okay. EPS growth is the rolling 4 quarters, 4.8%. Plus its continued effect, you will get out of the share buyback. So I will -- I think we are very much on track for this year to repeat a good EPS growth.

Return on equity of the group is, at the moment, standing at 12.5% (sic) (12.4%). Certainly, still a bit limited by our very strong capital base. But, as you all know, that is more of a luxury problem than anything else.

P&C combined ratio, yes, with 95.6%, clearly above our target. But I think the underlying improvement shows in the right direction. So I think we are still on track to make our 94% by 2018.

10% ROE for all Life businesses. We show in Q1 61%. But Italy and France are both close to the 10%. When I just add the 2 countries, we are at 85-plus % already of the whole segment. And both have actually too much capital in their balance sheet. So also easy to correct by just upstreaming the money via dividends.

New business margin at target level.

And also, on the qualitative targets, we are moving forward, although the qualitative targets are not all being measured on a quarterly basis. So some of them are older information.

So the Net Promoter Score, we are not update -- we have not updated in Q1. So therefore, that is not new news.

The interest rate sensitivity is a little bit higher than at year-end. That is a consequence of the model changes. And I'm waiting for the question to dive there into the details.

PIMCO's cost/income ratio, very much at the target.

Internal employee satisfaction and Work Well index, close to where we want to be.

And I think we made a good jump in digitizing our new products and of the ones got launched this year, half of them are already satisfying our full digital product definition.

And with this one, I guess, actually, speaking back to Oliver to manage through the Q&A now.

Oliver Schmidt {BIO 2473131 <GO>}

Yes. Thank you, Dieter. And we are now ready to take your questions, if any.

Questions And Answers

Operator

(Operator Instructions) We will now take our first question from Peter Eliot of Kepler Cheuvreux.

Q - Peter Eliot {BIO 7556214 <GO>}

Dieter, I'd better not disappoint you. So I'll start off with the question you were expecting which I was going to ask anyway actually. But yes, no, I was intrigued by the solvency sensitivity and how the upside, the symmetry has been restored by modeling changes and especially, I guess, given that you've effectively closed the duration gap in the Life business this quarter as well. So yes, I mean, if you could explain what's happened there, then that would be great. Second question on the Asset Management. I mean, great news on both earnings and flows. In the same way that you very kindly gave us guidance in the Life division, I was wondering if you could sort of give us a bit of guidance on whether -- to what extent you think there are any one-offs in that result? I mean, I guess, in particular, I note the footnote on Slide 27 regarding the EUR 46 million of other revenues. And looking at the financial statement supplements, it looks like those have sort of flowed through largely to the bottom line. And if I can slip in one third one perhaps. You mentioned the business evolution weighing ever less on the SCR development. And obviously, 0 this quarter. Just wondering if you think -- is that sustainable going forwards? And if so, I'm just wondering whether the guidance you've given for the run rate of underlying capital generation is even a little bit light, especially the benefit you're getting on the numerator from new business. And I guess, a fair amount of that, as you said, is coming from Germany, where you must now have about 40% of the market, I would guess. And I'm just wondering how sustainable both numerator and denominator are.

A - Dieter F. Wemmer {BIO 4755450 <GO>}

Okay. So then let me try to explain the change in interest rate sensitivity. Actually, when one of you could give me a whiteboard and some pens, I could easier explain it. But let's try to put it in words. Yes. We are -- in duration, which is actually more on the own funds side, we are neutral. And we have closed, at first glance, the gap there. So the increased sensitivity is all coming from the SCR or actually, the next derivative. And how should I put it? We have changed the whole modeling of our German cash flows that we did already use for the new business margin and value calculation in Q3 last year. But we couldn't use it yet for the Solvency II calculation because the approval by the regulator has (a stem) January 1. So therefore, it is a beginning-of-the-year change and not a year-end change. That has to be included. So this change is modeling all the cash flows and also from all the new products much better. And overall, the sensitivity of the interest rate increased on both, on the up as well as on the down. However, the downside is more protected by the additional funds our Allianz Leben subsidiary has, which are under transferability restrictions. That means in the -- when you transfer the solvency ratio and also the sensitivity from the Life subsidiary in Germany to the group, the upside goes fully through. The downside is being dampened by the amount which got haircut by transferability restriction. So it is a very complex story. And now you know why I would have preferred to present it on a board in a room and not over the phone. It's really difficult. But I think we do much better. And actually, also personally, my gut feeling always was that our upside was understated. So I like the new sensitivity numbers more because I can now sleep better. In Asset Management, yes, we are showing in the footnote one-off. That was a catch-up booking on foreign currency exchange translation, mainly U.S. dollar to British pounds. It is actually also going through the profit sharing at PIMCO. So therefore, the operating profit impact is 70% of the number. And in Q2, we will not have the costs for the incentive scheme anymore because Q1 '17 is the last booking. So you can also see that this expense was, in Q1, the last one-off of this number. So I think we are on good track in Asset Management. Guidance on Solvency II and the quarterly production. I think with our operating earnings guidance unchanged and strong new business values produced every quarter. So we should see a similar positive development there. Of course, there are always some secondary effects, which are hard to anticipate. Will we also not consume more capital? I think that is much more difficult because the diversification shifts every quarter a little bit on market parameters. And the market parameters we all look at, like interest rates, equity markets, were obviously positive. But you should also not forget that, I think, mid of April or the end of March, (RICs) was at a record low. Interest rate volatility came in lower. So there is also a number of the secondary parameters which supported our development in Q1. And that number still will go around. Certainly, what I would expect on Solvency II is that with financial markets as of today, solvency ratio would be looking better. Credit spreads, after the French election, on French government bonds came in -- I think, actually, that French government bonds show, at the moment, a 0 spread compared to swap. So that is certainly pretty positive for our numbers. Interest rates are slightly higher. Equity markets are further up in the Second Quarter. And volatility still very low. So anybody who was (inaudible) on that RICs would come back quickly. I think that people are all not earning a lot of money or have lost their shirts already. So I hope that answered all your questions, Peter.

Operator

We will now take our next question from Nick Holmes of Societe Generale.

Q - Nick Holmes {BIO 3387435 <GO>}

A couple of questions. First one is, Dieter, what do you think we ought to do with the solvency and financial condition reports? I mean, what do you recommend we focus on? If you could give us any guidance there, that would be great. And the second question is looking at Italian motor. There's lots of mixed views about what's going on in the market. Wondered if you could tell us your experience. I think you said pricing is still under pressure. But are you seeing some signs of stabilization?

A - Dieter F. Wemmer {BIO 4755450 <GO>}

Yes. Thank you, Nick, for the 2 questions. Well with these results, there are 2 recommendations. When you print it, you can burn it. When it's digital, you can delete it. So that -- I must say, yes, there is probably a lot of additional detailed information. And if you want to find certain points -- and I'm sure that you and your colleagues will put a lot of focus transitionals. In none of the Allianz entities you will find any balance sheet transitionals. But I think and what I hope is actually that it gives a more comparison across the whole industry. And what, I think, is probably another focus area, where are the disclosed solvency ratios are actually fully aligned with the regulatory filed numbers? I think we are really trying to be very precise and really only put in our analyst presentation what is also being filed with the regulator. And so far, we have not found any deviation. We have done the following. We have, in total, produced 61 reports, 60 legal entities in the EU and 1 group report. Out of the 60, of course, there is a lot of very small entities. Therefore, we have put on our website, here in the IR section, 10 or 12 of the individual legal entity reports. And when there is any missing company you want to know, Bulgaria or whatever, we will certainly also be able to provide the link. But then you have to call the Investor Relations department to get this. We will, in our Inside Allianz Series, do a special section. And also, I think Tom Wilson got a job to run you more details through these reports and how to read the various chapters, what is in it and whatnot. And I think our Chief Actuary, Oskar Buchauer, is also there. So you have all our technical expertise who then, after you have some time to read the reports and if there is a special area of interest, then we are very happy to explain it. So Italian...

Q - Nick Holmes {BIO 3387435 <GO>}

Sorry, Dieter, could I just quickly follow up? Am I correct in thinking that you won't give us the group ratio until the Investor Day in June? And I just wondered, if that is correct, why do you want to do it way? Because, I mean, we will all be sort of involved in a guessing game for the group ratio. I just wondered what your thinking is.

A - Dieter F. Wemmer {BIO 4755450 <GO>}

I don't understand what you mean with group ratio.

Q - Nick Holmes {BIO 3387435 <GO>}

The group Solvency II ratio, the volatility adjuster and items like that. Is it correct that, that won't be...

A - Dieter F. Wemmer {BIO 4755450 <GO>}

Okay. You mean the impact of the various components?

Q - Nick Holmes {BIO 3387435 <GO>}

Yes, yes, exactly.

A - Dieter F. Wemmer {BIO 4755450 <GO>}

I think that is on -- that is ready on May 24. We have also to go through our various internal checking and approval process. Therefore, I don't have it yet fully at hand. But I -- therefore, I said, there is no balance sheet transitional. The only -- what we use is the VA. And that has some impact on our Life businesses. For the rest, it is really not important. And for the group, the impact is also minor. But I don't have the number now at hand. And I think both from a sign-off procedure, you have to understand that I'm not disclosing it before I went through all formalities here. That would really be not correct, yes. And well, the total number is the 212% we just gave you. And also, please keep in mind, this financial condition reports are based on year-end. This is an annual report so it doesn't link back to the Q1 number. Then you have to wait another year. So that is -- I'm more in favor of the quarterly numbers. And yes, the year-end, therefore, I'm not so excited. But maybe, if there is some practice in the industry on a peer average, which could be improved by the whole industry, then I'm sure you and your colleagues will spot it and the industry will do better after.

Q - Nick Holmes {BIO 3387435 <GO>}

We will try.

A - Dieter F. Wemmer {BIO 4755450 <GO>}

Yes. Italian motor, yes, actually, our accident year loss ratio is slightly better than a year ago. That tells you that all the rate decreases we were suffering and complaining about during last year did not reduce profitability. So that is the good news. The consequence of this is that the market might slow down a little bit in the rate decrease. But it will not stop it.

Q - Nick Holmes {BIO 3387435 <GO>}

And just a quick follow-up. Do you see any sign that the bottom might be reached in the next 12 months?

A - Dieter F. Wemmer {BIO 4755450 <GO>}

Yes. We are very hopeful that the answer to your question is yes.

Operator

Our next question comes from Thomas Seidl of Bernstein.

Q - Thomas Seidl {BIO 17755912 <GO>}

Three questions. First, on the regular investment income in P&C, you normally show like a model, like behavior in drop in ROI. But not this quarter. It's pretty stable. You quote dividends. And I wonder, is this just a 1 quarter respite? Or is this also what you expect for the year, pretty flattish regular ROI in P&C? First question. Second, on Life realized gains, I heard your comment, obviously, Dieter. But I still think that a 30 bps quarterly run rate on harvesting, which benefited, obviously, from low impairment, is pretty high also compared to history. Again, I wonder, is this what you expect for the full year? And was it, like last year, mainly driven by these pulls on bonds, which was the main thing last year? Third and last question on Asset Management. Another drop in the revenue margin, 0.8 basis points, mainly driven by Allianz Global Investors, whereas PIMCO is now stable. My question is how high is your conviction that this is now the bottom? And how does the journey develop from here? Will it stay at the current revenue margin level? Or is there some or even strong optimism that it will recover again?

A - Dieter F. Wemmer {BIO 4755450 <GO>}

Okay, Thomas, thank you. Let me start with the P&C investment income. It -- we have guided beginning of the year to a reduction of the annual investment income of some EUR 200 million. And I think with where we stand today, I would say that this number was too conservative. Would I say that we are sticking at absolutely the same level every quarter, well, that is at the moment still a bit difficult to say. There were 1 small positive one-offs in Q1. And then Q1, Q2 are always a bit, in total, distorted because also the dividend income from equity investments is included there, which is, of course, in Q3 and Q4 nothing. But I would say somewhere that we probably end up in the middle, between flat and the EUR 200 million reduction. That means EUR 100 million less than last year is probably a reasonable assumption.

Q - Thomas Seidl {BIO 17755912 <GO>}

Then why is this slowing down? Looking at your economic reinvestment yield, nothing has really changed here.

A - Dieter F. Wemmer {BIO 4755450 <GO>}

It is a bit currency mix. And now coming to your Life question. Actually, when I look at the net harvesting. And correct for the swing in U.S. base risk, the swing is $95, last year it was a minus, this year it is a small plus, then, actually, it's net actually down and not up. So that means our ongoing realization activity is pretty much unchanged. And it is true, there is harvesting also coming from the bonds as we are always using the bond portfolio also to lengthen and to give fresh duration. And we are not waiting, obviously, until maturity. We harvest earlier because the last two years, from a market point of view, these bonds are heavily in the negative yield. So why would you put your hold to a bond which only produces on mark-to-market negative yields for the last two years? Then you start to turn it around. And we have really a very systematic approach also to use this constantly to create a new duration. What you could see on the Life side is actually that our reinvestment yield is slightly down quarter-over-quarter, which is coming from the fact that we took a little bit less credit risk in First Quarter '17. That means we are -- we became a bit more conservative on running credit risk. So your last question was on Asset Management and the drop in margin. Well the year-over-year comparisons, the big drop came in Q2 from the Rogge acquisition, that it's an averaging effect. Rogge is institutional bond mandates; that means it is a very small fee margin. So that has created -- for our total segment, the Rogge acquisition has cost us 60 basis points on average in the fee margin. And that is, I think, explaining most of the drop. But certainly, there is also -- well, then I should not forget a very interesting observation. Our Korean asset manager, which we tried to sell together with our Life company, the transaction has not yet closed. It is still with us where the Life company is sold, that means that, actually, our former in-house business turns now into third-party business. And that actually reduces for the third-party business the average fee by another 20 basis points. So that is actually already explaining most of it and the rest is ups and down. But also I don't want to hide that at Allianz Global Investors also, the ongoing business sees some fee margin pressure.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yes. But overall, would you say there's a bottoming out from here? Is this your base case? Do you stay at this level?

A - Dieter F. Wemmer {BIO 4755450 <GO>}

Small movements still ahead. But not this big jump Q1 over Q -- yes, well, now you have then to compare the ongoing quarters and not do the 4 quarter, otherwise you have always the Rogge acquisition in between the next 2 quarters. So...

Operator

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

Q - Paul De'Ath

A couple of questions, please. Firstly, on the Life business, obviously very strong result in terms of new business value and you very helpfully made a number of comments at the full year around what level of future earnings you expect from the new business value that came in at the full year. I mean, if we use the same sort of multiples on that, would that be reasonable? So sort of over EUR 1.5 billion of future earnings has been added on in Q1. And I guess, as an add-on to that, are you making any progress on your potential enhanced disclosures around the new business value? And -- that'd be question one. Then the second point was just on the P&C business in the U.K. Can you just remind me of your strategy of the exit direct? Kind of going forward, what's the strategy there? Sky News are currently reporting that you might be in discussions with LV. Would you see the U.K. as a more or less attractive proposition post-Ogden?

A - Dieter F. Wemmer {BIO 4755450 <GO>}

Paul, thank you very much. I think the new business value, what we showed last year was that we are producing out of last year's operating profit around EUR 5 billion. But I think it is -- if you just want to be not this precise, just to use round numbers, if you multiply the value of new business with 3 or maybe it's a little bit more than 3, you have a good grasp on what operating profit is being added quarter-by-quarter. So we are fully sticking to this calculation, sure. You need -- you would need to refine it every quarter also what asset mix are we doing with the selected money and how the credit spreads are moving. But then you get into a full modeling. Therefore, I think the factor 3 is probably a pretty good and easy formula. U.K. P&C, we have exited the Life business, we still like the Motor business. The Life business, we never (entered) it, actually that was 1 of the best strategic decisions. I think we have a reasonable business in homeowners, we have a reasonable business also in motor fleets as well as broker and we have this fantastic pet business in retail, plus a very strong commercial position. We are working on our expense base in the U.K.. And I think we are on very good track to get back. At the moment, of course, after the Ogden decision, the challenge is are you getting enough rate to make up for the Ogden impact. And as a reminder, that is yes, it is mainly Motor. But every other line of business which includes bodily injuries, whether it's employers' liability or also a third-party liability cases or whatever, they are all impacted by Ogden. That means you have now really to go through every product and say, Ogden impact, yes, no; how much is it; how much rates do I need to make up for it? Then we have to see in which line of business is the market positively reacting to it and where is fierce competition actually stopping it. So that is, besides simplifying our internal organization, probably our main effort at the moment what we do in the U.K.

Operator

We will now take our next question on Farooq Hanif of Credit Suisse.

Q - Farooq Hanif {BIO 4780978 <GO>}

A quick question on Life and then on Asset Management. In the Life business, your change to fair-value accounting for the VA business, I wanted to understand what impact that had when you talk about the swing in basis risk in Q1. You mentioned roughly EUR 150 million. Have you gone from negative basis to neutral or from neutral to positive? And going forward, would you -- would we be expecting, in the current quarter, the environment, some future base of profit? It'd be nice just to understand the volatility of that line going forward. Second question on Asset Management. What do you think is going to happen to the cost/income ratio now of PIMCO? Now that it's reached its target and incentive plans are coming to an end, what do you think we should take into account?

A - Dieter F. Wemmer {BIO 4755450 <GO>}

Farooq, thank you very much. I think I'm looking forward that we can see a small improvement in the cost/income ratio but also, we will not stick only to the current business. We also want to expand into new strategic areas. Therefore, we are not planning that the cost/income ratio is now the big driver of a higher profit margin. It's more important that we continue to grow revenues and enjoy the current profit level. I should have mentioned maybe in the beginning of the presentation the accounting change we did. We have only changed a very small part. So the variable annuity business and the hedging of the equity guarantees you have implicitly in the product, that part has not changed at all. So we still have the same base risk as before. Because there, also accounting never helps you because the base risk is just the difference that you allow your customers to invest in actively managed funds and your equity hedges are naturally linked to an index. And the base risk is the difference between active managed and the passive index fund. Sometimes positive, sometimes negative. What we have hedged is actually for the minimum retirement benefit. We had the interest rate risk open and not hedged. The local statutory accounting in the U.S. as well as the capital formulas under local stat, changed already in end of '15 or something. So already more than a year ago. So that means the 2 changes in the U.S. allowed us, under local stat, to do already the interest rate hedging without creating the volatility in the accounting numbers. Only we did not do the hedging because the IFRS numbers were -- would have then just shown the movement of the interest rate hedges. So now with the change to fair value, we have implemented a hedging on Jan 1, that means now we have closed this risk position. Is this creating additional operating profit? Yes. In the long run, maybe some small positive because you don't have the losses from the interest rate exposure. Of course, you could argue when now the Fed is rising rates every three months, we have missed an opportunity to gain something, which we have now locked out with locking in the current position. So it's -- I see it from an operating profit, if you want to be conservative, it's a very small positive, I see it as a really de minimis change.

Q - Farooq Hanif {BIO 4780978 <GO>}

May I quickly ask what the size of that portfolio is in euros or dollars, just the one that's been moved to the fair value basis?

A - Dieter F. Wemmer {BIO 4755450 <GO>}

It's a EUR 7 billion retirement benefit portfolio. So that is not anymore the active equity part.

Operator

We will now take our next question from Arjan van Veen of UBS.

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

Dieter, if I may ask a question on the improvement in the attritional loss ratio. Could you call out if there's any particular countries where that -- the contribution is coming from? And could you also maybe make any commentary around where potentially you're seeing some claims inflation coming in that you hadn't seen last year? The second question I have is around PIMCO. I saw a headline today that you said that the trends have continued positively into Second Quarter '17. So if you can confirm that. Then finally, your very strong growth in EBITDA value in Asia-Pacific, could you also highlight specifically if this is coming from certain countries rather than others?

A - Dieter F. Wemmer {BIO 4755450 <GO>}

Okay, very interesting questions. Attritional loss ratio, that is a very mixed picture. I think the largest positive contributor, it starts actually with Italy, what I have mentioned before. Then even France is a small positive. Our Allianz Worldwide Partners is a small positive.

Latin America is a small positive. And I think a little bit negative is -- or more neutral is Germany. So overall, I think it is a very broad base. Worsening, we have seen slightly I think in AGCS and the U.K.. But it's the Ogden impact mainly. Australia is on a slight recovery. But needs to do more. So it's -- and the EUR 15 billion portfolio, that is one of the questions where it is hard to give this one answer who explains it all. The main drivers for our growth business, growth in Southeast Asia or in Asia in general, is China and Taiwan. And that is all bank distribution which delivers this business to us. Then you had -- yes, yes, PIMCO, yes, I think we are doing pretty fine in the Second Quarter.

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

The second part of the -- sorry, the second part of the question was just whether you're seeing any adverse inflation trends anywhere (inaudible) last year?

A - Dieter F. Wemmer {BIO 4755450 <GO>}

(inaudible) inflation in -- well, when I said...

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

It's just the countries you mentioned before is it?

A - Dieter F. Wemmer {BIO 4755450 <GO>}

Yes. Well I said U.K. is going in the wrong direction and Germany see some increased in claims -- well, claims inflation or claim incidence, I -- we had this discussion this morning in our press conference that actually, bodily injury in Germany continues slightly to pick up. And that -- yes. And I heard this morning the comments that the big debate in the U.S. about the distracted driving, whether this debate should not soon also come to Continental Europe. And we should have the same discussion.

Operator

We will now take our next question from Michael Huttner of JP Morgan.

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

On the buyback. So EUR 1.2 billion in, I guess, just over -- around three months. So we've got -- my question is could you actually do another -- second buyback on top of the EUR 3 billion this year? Is there any reason which would stop you doing so, whether regulatory or I don't know? And the other one in terms of the profit targets, the EUR 10.8 billion. And I was listening, maybe half listening, you confirmed the EUR 5.3 billion in non-Life, which seems to be coming a bit more from investment income. You kind of indicated what I understood that Life would be better than your target because the run rate is incredible and you're not going to lose the money, which you -- the extra money which you made in Q2, Q1. Asset Management, it sounds like you're on track to beat by EUR 200 million, there's still a lot of performance fees to come. So it all adds up to about EUR 11 billion, EUR 11 billion and a bit. And I just wondered at which -- at what stage would you feel confident enough to kind of review your profit target? That's my main. And on the corporate bonds, I must just say, you had some positive sensitivity to corporate bonds, I just wondered. But if it's maybe too many questions.

A - Dieter F. Wemmer {BIO 4755450 <GO>}

Yes, Michael, thank you very much. I was already concerned you were not on the phone because usually, you are the first to ask. So then welcome to the call and thank you for dialing in. The share buyback, I think we are executing really at maximum speed. We had -- only before our shareholder meeting, there is a legal break period, which we have to comply with. Therefore, we only restarted after the shareholder meeting. Look, the decision to do another share buyback as an overall strategic consideration, therefore, you have to understand that I cannot answer this question. But certainly, I can confirm that the solvency position and the liquidity would not stand in the way. So therefore, we have really a lot of flexibility whatever we do strategically. The outlook is -- actually, as you know Allianz much longer than I do, you know very well that we like to show a good performance against our outlook. And we never change our outlook in Q1. Whatever happens to the number, whether it's a weak start into the year or a strong start into the year, Q1 is too early to settle for the year. And I think you have much more opportunity to draw all your conclusions and I will then answer it with the half-year results.

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

And on the -- maybe the bond sensitivity, the corporate bonds?

A - Dieter F. Wemmer {BIO 4755450 <GO>}

Corporate bond sensitivity.

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

It's positive.

A - Dieter F. Wemmer {BIO 4755450 <GO>}

Yes. Well certainly on the government bonds, I think our largest investment are French govies. Of course, when you want to look which asset had the best performance in Q2, then it is definitely the French government bonds. We have some EUR 40 billion market value of it. And if I'm not mistaken, the average maturity of it is above 12 years. So that is a high leverage. When, I think, in Q2, French govies, that came in 23 or 24 basis points, multiply this with 12 years. So we probably made on this investment only 2.5%-plus in market value. So that is a pretty decent number. But, of course, as we do this mainly for hedging in our Life books, the higher market value is not creating now the tremendous additional shareholder funds. But it is clearly reducing credit spread risk as such.

Operator

We will now take our next question from William Hawkins of KBW.

Q - William Hawkins {BIO 1822411 <GO>}

Slightly following up on Michael's question, Dieter, you just gave a very clear answer around the operating earnings, thank you. But I am just intrigued on the Life side because you are making it quite clear that there's not much we should strip out to normalize that result. And after, at least my math, adjusting for what you've said, it points to you being above the top end of the target range that you mentioned just a couple of months ago. So I just want to be clear. Has something changed that you weren't expecting three months ago that makes this result so high and so sustainable? Or should we maybe be tempering our enthusiasm that whilst there's nothing specific you can point to, this maybe has been a surprisingly high quarter? I'm just a bit confused on that. Then secondly, hope these are quick, Slide 7, my normal question about the Life operating capital generation. Are there any variances there that you could mention to us or if we just take the total, the minus new business value, the enforced run-off is sustainable? Then lastly, I hope this is quick, restructuring charges. They were very high this quarter because of AGCS. I think in the past, you've been doing about EUR 200 million a year. Are we still happy with that level coming below the line or is the First Quarter a sign that restructuring charges could be structurally higher?

A - Dieter F. Wemmer {BIO 4755450 <GO>}

No. I think good questions. No. I cannot add anything to the Life operating profit story. I think the EUR 100 million to get down to sustainable number, that is still correct. But also, the volatilities we have, they are not every quarter positive. Therefore, you know that we are tremendously careful people before we hype a result. Yes. We all believe at the moment that financial markets are in a dream position. Every asset class is peaking and that can, of course, change. And then I have to do a lot of explanation why the variance goes in the other direction. So I think we are pretty happy to keep the overall outlook number at the moment to where it is. And you can make your causes where you see at the moment the pluses and the minuses. Probably you would find more pluses than minuses and I would not reject your conclusion. The formula, how to see the Solvency II operating earnings development, I think what you have said, I can only confirm; that's absolutely fine. On the restructuring charges, the reason why we moved it from operating to nonoperating profit, that was not to spoil your strategies. That was really to create more flexibility and faster reaction in the group as a lot of our managers are being incentivized on operating profit. Before they use the excuse that they have to wait until next year with the restructuring because it has to be put into the plans, we have really opened up this line and say, "If you see an opportunity where you can restructure the business to create economic value, start Monday and don't wait until next year." That is very simple, the internal message to restructuring. The big project that was Allianz Global Investors last year; (inaudible) has had already a big restructuring; AGCS did a lot of the announcements year-end. And we are now in full execution mode and we booked the agreed things then, well, selling of Korea is, of course, the ultimate restructuring you can do. And we will also see some other cases where we need to drive the organization. And that, we will certainly do this year. And I think we have the financial resources as well as the energy to drive more change through the organization. And we will see many local projects doing so.

Operator

We will now take our next question from Michael Haid of Commerzbank.

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

Three questions. First question on third-party asset management, obviously, PIMCO performs very well. On the other hand, Allianz Global Investors has net outflows in the First Quarter and I wonder how you see that, especially after we have seen already net outflows last year in total of EUR 2.8 billion at Allianz Global Investors, what are the drivers of this? Second question, the new business margin in Life and Health, 3.1%. This stands against your target of -- from the Renewal Agenda to achieve 3.0% by 2018. Should we expect an increase of this target? Or do you think the 3.1% is somewhat exceptional at this stage? And last question on the value of new business. As you said, you provided an interesting insight into the value of new business, how it translates into operating profit. Obviously, I also do not expect you to give an update every quarter. But just for my understanding, the more you move from traditional Life products to capital-light products, the lower this multiplier, which you just mentioned should be 3x, the lower it should become because the cost of capital are included in the value of new business but it's not -- it's excluded in the operating profit. Is this effect material, say, from one year to the other, say, from 2017 versus 2016?

A - Dieter F. Wemmer {BIO 4755450 <GO>}

All questions are very good. And actually, the last question, a question, I have not thought about but I -- when you give me 10 seconds, I hope to find an answer for you. So let's start with the Allianz Global Investors. The net outflows are mainly in pure active equity and the inflows is in our multi-asset product. I think we're doing a very strong job in selling our capabilities in multi-asset, it's a very successful product. The active equity, I think Q1 was an exceptionally high quarter. And I think we are looking for a more balanced result in the next quarters. It's also more U.S.-driven than Europe. And U.S., we are actually -- we have not such a huge portfolio. The new business margin, no, we are sticking to the 3% and we clearly want to grow the business and prefer volume growth over driving additional new business margin. Of course, there can be -- always be quarters where we are a little bit below or even a bit higher up. When we are able to increase our biometric risk business and our Health business, there certainly is still room there for -- even for better new business margin. But the strategic target, we'll stick at 3%. The new business value and how it translates into operating profit. Yes. You are right; unit-linked doesn't have the risk margin or cost of capital charges. However, you have, in traditional business, also the cost of options and guarantees, which are not translating into operating profit at all. So I still -- I have not done the calculation, whether the factor of 3 to 3.5 is for unit-linked higher than for the rest. But maybe, actually, unit-linked is probably a bit lower. However, our capital-light products are still in the general account. And that is our main gross line. We will have more calculations. And when we meet next time, then I think I know probably all variations of your questions.

Operator

We will now take our next question from Andrew Ritchie of Autonomous.

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

First question, ACGS. I see you've flagged the restructuring. I'm more interested in -- there was quite a big shrinkage in premium, I think it was down 7% on an internal basis. Is there a sort of more significant repositioning taking place in ACGS? Has there been a further assessment of the tough pricing conditions in commercial lines? It looks -- because you'd expect it to be flat or even growing slightly there and then suddenly you're shrinking. So what -- where are you shrinking? What parts of the business? Is it U.S. or outside the U.S? Second question on PIMCO. A lot of the flows have been concentrated in one fund, the very successful income fund. And that appears to be the case looking at data into April as well. That fund has been rated highly because it's been nimble in the past and it's been quite concentrated in illiquid securities, nonagency mortgages, commercial MBS. How scalable is it? Can it really continue to grow and see the level of inflows that you've been seeing and maintain performance? Or are you going to have start more radically diversifying or hoping to launch a new range of products?

A - Dieter F. Wemmer {BIO 4755450 <GO>}

Okay. Thanks so much. I think actually in the premium income AGCS, there is the chunky volatility from our ART product, our alternative risk transfer is always doing large premium deals. And that is the main driver for the big move in premium. Otherwise, it would be closer to 0 or slightly down. But we do also a substantial reunderwriting program in Marine and also in our U.S. mid-corp business. So there, we would see a small decline in volume. I think all what we are doing there is clearly helping to restore the attritional loss ratio profitability. Yes, PIMCO, you can -- it's nice that you still called the income fund as a very nimble and actual fund. It is -- it gains the title of the world's largest actively managed bond fund. So it is not this small anymore. The AUM are at $80 billion. The performance, I think we are also indicating it in our explanation, of all PIMCO products is still high at 92%. And also, the income fund is part of the strong outperformance, which, of course, is attracting more money. And we are doing very nicely there. And as I've said before, April and May are not showing any changes.

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

There's no concern about the concentration of the flows into that one strategy? That's what that data still shows, the Morningstar data for example.

A - Dieter F. Wemmer {BIO 4755450 <GO>}

Yes. That is on one hand, true. On the other hand, when you look over the last 24 months, the inflow and outflows at PIMCO, the increase in inflows is actually not so big. The bigger shift is in reduced outflows. So the inflow levels were actually always very stable and that was also the reason why I am very early for saying I am very confident that we will see a turnaround at PIMCO's net flow numbers from the negative to stable and then to positive. That we would go so quickly to Q1 levels that is, of course, above expectations. But I think that explains mainly why we are seeing here. And we have quite a number of also other fund strategies which have positive flows. Yes. The lion's share is this income fund. But we are working to broaden it. And I think we will continue to see it. In particular, the income fund has shown very stable flows also in December, January, when the whole world was talking in the U.S. about fast-growing interest rates. In the meantime, we are lower than we were, actually, end of November. So I think that fund product offers also a stable situation in a more volatile interest rate market.

Operator

Our last question is from Vinit Malhotra of the Mediobanca.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Just -- so very quick ones, hopefully. The -- in the capital-efficient products, the operating profit was, I notice, affected by some lower realized gains and less favorable hedging result, as on Slide 20. I mean, this number was below the recent run rate as well. Given the emphasis in the group on capital-efficient products, does it not concern you that realized gains have caused sort of a lower profit? Any comment would be useful. And second one is a quick follow-up, just to clarify my understanding. This GMIB restatement, was it -- just to understand, this was negligible in 1Q and also is not material from your guidance perspective? Just want to confirm just what I seem to understand but I wasn't sure.

A - Dieter F. Wemmer {BIO 4755450 <GO>}

Thank you, Vinit. So that, I must say I have, obviously, done a very bad job to explain the GMIB product. Because we started the whole hedging in Jan 1, the profit impact of this product -- or of the changed accounting is indeed de minimis. The (inaudible), -- yes, well, the (inaudible) is, by and large, 2 products; that is our fixed index annuity business in the U.S. and then the German variation of fixed index annuity, which we sell under different brand names, in Germany, Perspektiva and Index Select. And so on. The operating profit also of the fixed index annuity business had some realized gains last year which did not repeat this year. But more important is, as we are building up the portfolio in Germany so fast, there are -- the acquisition losses on day 1 are still overshadowing the profitability of the business. When you look at the new business margin in Germany and, actually, of this product is at a very healthy level, you can be reassured that the profitability of this line is not reduced, it is only deferred. Actually, I should add that their product in Germany reached a 0 operating profit level for the first time. If I remember correctly, in Fourth Quarter '16, it was still minus EUR 22 million operating profit because -- I remember this very well because I think I had a long discussion about it with Andrew Ritchie in February.

Okay. Then thank you very much. So hope to talk to all of you either over the roadshow or then in three months. And in the meantime, enjoy reading our financial condition report. Thank you. And have a good weekend.

A - Oliver Schmidt {BIO 2473131 <GO>}

Just wanted to say goodbye as well. Thanks for your time and your interest. Have a nice day and a nice weekend. Bye.

Operator

Thank you. This does conclude the Allianz Conference Call on the Financial Results of the First Quarter 2017. Thank you for your participation. You may now disconnect.
