Company Participants

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

Other Participants

- Andrew J. Ritchie, Analyst
- Andy D. Broadfield, Analyst
- Blair T. Stewart, Analyst
- Marc A. Thiele, Analyst
- Michael I. Huttner, Analyst
- Nick Holmes, Analyst
- Paul C. De'Ath, Analyst
- Peter D. Eliot, Analyst
- Thomas Seidl, Analyst
- Vinit Malhotra, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day, ladies and gentlemen, and welcome to the Allianz Conference Call and the Financial Results for the First Quarter 2014. For your information, today's conference is being recorded.

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

Oliver Schmidt {BIO 2473131 <GO>}

Thank you, Suzanne. Yeah, good afternoon from my side as well and welcome to our conference call about the results of the first quarter 2014. I think I can keep it brief. We have published key numbers already last week. You have seen our presentation this morning and all the details you will now get from Dieter.

Dieter Wemmer {BIO 4755450 <GO>}

Thank you much, Oliver, and then good afternoon or good morning for everybody on the phone. I will run you as usual through the presentation. And before I get into the numbers, let me start with the business highlights of the first quarter.

On the product level, we are continuing to upgrade and update our non-motor retail products in Italy and Germany here, as an example. Italy, we have now fully digitalized the sales process and the agency. And I did recently in Italy, with some investors actually meetings in a digital agency. If one of you would be interested, happy to organize that.

In Germany, our new non-motor retail product which is also modular and covering all lines – sub-lines of business is actually supporting our growing number of retail customers as we already talked about in Q4, and we increased here to 170,000 additional policies in Q1.

Life and Health, I will talk about it also when I come to the Life numbers. Our new fixed index annuity product in the U.S. which is selling really very well, it offers better upside for the customer and still a protected downside. And then we have launched our Allianz Global Benefits team which offers for multinational company, employee benefit solution out of one hand for the whole company and its international subsidiaries.

Perspektive. Perspektive is our German product which is a hybrid between guarantee and unit-linked. I think it's a product very well made for the Solvency II world and giving customer and shareholder the better end of both sides and it is selling really well.

In Asset Management, I think I mentioned it already in some of the meetings before PIMCO launched its largest private closed funds ever replacing the funds which expired a year ago, so $5.5 billion committed capital and it will focus on distressed banking assets. And Allianz Global Investors have seen very strong demand on its upgraded income and gross fund is €2.3 billion inflows in Q1.

On the Investment space, we could add to our portfolio two shopping centers in Germany and a large financing of a motorway in Belgium, reconfirming our chosen direction of investments, but still volumes could be bigger as we have more money to wait for investments.

Acquisition, I think you have all seen the deal we did with UnipolSai. If there is still a question open, happy to answer it. We signed the United Nations Principles for Sustainable Insurance in the first quarter, and we continued to invest in Bayern Munich to strengthen our international rent in particular.

So now let's move to the numbers. Actually, why are we calling the start into Q1 a strong result despite it is 2.6% down on face value compared to previous year? Because we feel that it clearly demonstrates how our three-segment business model works, fall in operating profit and asset management compensated by Life and in particular P&C, but also actually when you look at the one-offs we had last year – I think last year was already a strong result – when I take out all one-offs, then I would consider this year first quarter result even a notch stronger than last year in quality. And we have had €40 million or €46 million of impact of FX in the operating results this year compared to last year. So therefore, I think also in size, it is more or less unchanged.

The revenue story started very well into the year 6% up. Excluding foreign currency, it's actually 7.4% up mainly driven by Life revenues and it really shows that our new product generations which we are selling in the market are really matching customers' interest and it resulted in very high net inflows for the Life segment in the first quarter. Net income with unchanged deduction from the operating profit and tax rate is the same unchanged story.

So let's move to the capital ratios. Shareholders' equity up €3.5 billion, actually only two drivers that is higher and unrealized gains in the bond portfolio and retained earnings of the quarter. There is almost zero FX impact in the quarter. So the whole currency volatility took more place in 2013 and not yet observed in the first four months or three months of the year.

Conglomerate solvency, the old solvency, one calculation. Higher shareholders' equity compensated by higher revenues in particular on the Life section. Therefore, it is more or less the same number. Economic solvency; the 203% at March end is a very strong number because it includes already the reduced interest rates at quarter-end because the numbers we are presenting are always using the interest curves at the end of the period that might be different with some peer calculation and presentation.

Secondly, we have embedded all the changes we talked about at the year-end, so it is really a very strong ratio with 203%. And as we have included also the charge for the government bonds which makes about 15 points, 1-5, and here the discussion with the regulators is not yet over. I still believe it would be an unfair punishment for the Allianz Group as we are one of the few to bear this additional burden. S&P capital, we are still nicely ahead of the AA requirement, so in line with the other solvency numbers, strong development.

Let's move on to the P&C segment, internal growth, 1.9%. Actually the foreign currency impact is even more than 2%, but that added up in total to a flat nominal revenue development. Positive numbers seen in Germany than with a large corporate business, credit insurance developing on a nice track, and then Allianz Worldwide Partners adding real good growth.

On Turkey, unchanged good internal growth and also still helped by the first-time consolidation of now third quarter of Yapı Kredi, where the negative numbers we see lower premium in France, Italy, the U.S. part of our underwriting changes, and in Latin America, we are facing in Brazil a transition of IT platforms which created a shortfall of volume in the first few months that gap we assume will be closing over the rest of the year.

Let's look at the performance of P&C; strong jump in the underwriting profit to almost €1.5 billion, making a good half of the total operating profit. So what are the drivers? First, I would like to mention that we have reduced our expense ratio. So Germany, very much on track to achieve or actually have achieved the 26.0% expense ratio in Q1, and maybe there is more to come. And the loss ratio is a combination of really further improvement already on a very good attritional loss ratio, a benign cat situation in the first quarter, and also good results on large losses.

The run-off ratio is higher than a year ago. So it's 2.4%, but actually 2.4% is still below our long-term average for the years in particular when you compare it with the previous years. So I think it is really a great start of the underwriting result. And as the underlying loss ratios and expense ratios are moving in the right direction, it should also help us in the next quarters.

When we look at the operating profit of the various entities, it is not surprising when a €44 billion portfolio has a combined ratio below 93%. That's heavy weight. All must have good combined ratios. So Germany below 91%; France at 93%; Italy in the low-80%s; AGCS 92%; Credit Insurance below 80%; and the only outliers or you can also say, we could afford three areas above 100% combined ratio that is, at the moment, Central and Eastern Europe only driven by Russia. The Russian motor market with the changes in the claims practice, but still the old limitation on rates is really unprofitable, and we have to work our way through how we get it back on track.

Latin America, that is mainly an effect coming from Brazil. And the U.S. has two negative impacts, which move the combined ratio to 107%. There is on one hand, the long winter. Maybe some of you have observed in person in the U.S., so therefore we have really consumed our cat budget for the first quarter at least twice.

And additionally, we had additional negative development on last year's crop business. We had to book for the accident year 2013 in crop additional six points. I think, we all as also the other players in the crop market got surprised that the total yield for the harvest was lower than expected because prices were lower realized. So it was not only the yield of the harvest but also the rates. And therefore, it's actually good that our crop exposure has been substantially reduced compared to previous years.

Turkey, higher combined ratio than last year driven by two facts. Actually, it's a medical inflation which drives the combined ratio up. It has nothing to do with the split between Yapı Kredi and our own business. And on the other hand also, the profitability in the motor business is a bit reduced as the weaker currency in Turkey has, of course, a negative impact on the prices of spare parts, which is in the motor business an important part of the claims handling. And altogether 96% is still a number, which is ahead of our business plan we put together for Turkey. So operating profit is actually on a very nice level.

The P&C result got supported by a very stable current yield on debt securities overall. On a run rate, you would have expected a falling yield compared to last year and actually that has also happened. But in the beginning of 2013, we had a negative hiccup on some of the inflation-linked bonds, which we are keeping in France and Belgium to protect lines of business which are absolutely – where the claim is absolutely linked to inflation development, like a worker's accident in Belgium, for example.

So therefore, on a like-on-like comparison, I think it is a bit weaker this year. Actually, in the last quarter 2013, our average yield was 81 basis points. Now it's 77 basis points. So that is actually the normal path of development you should expect with a reinvestment yield of 2.6%, which is 60 basis points below the average yield, roughly.

So moving to the Life segment. As I already mentioned in my introduction, a strong growth up to €17 billion in revenues leading to about €5 billion net inflows in our balance sheet, which is a record number for a quarter. If you compare the two growth rates in revenues between the face value revenues and then the present value of new business premium, you'll see there is a huge difference in growth rate. And that tells very easily that we are growing faster in single premium than in periodic premium.

We see a shift here in Germany that our single premium products are selling better despite the sales successes on our new product, Perspektive, but just the level of guaranteed premium products is substantially down to historic levels. And maybe one single additional item, with the introduction of the unisex tariff January 1, 2013 in the EU, we had this last-minute fire sales in December 2012 where a lot of the policies were actually then administered in the beginning of the year instead of the end of the year. That is one of the drivers.

But let me talk about our new fixed-indexed annuity product in the U.S. It is a product which offers an uncapped participation in the performance of the index you invest in. And the downside protection is still as the same as in with all fixed-indexed annuity products, and we are using here a new Barclays Index, which is a combination of the Barclays aggregate so fixed income and the S&P 500. And this product, I would call it is maybe moving slightly away from a traditional fixed-indexed annuity, and it attracts also a lot of people, who would have invested otherwise into VA products and our sales organization which is the broker-dealer – sales channel is strongly used to VA and they really love our new fixed-indexed annuity product. Therefore, we have an increase in sales of this product of €1.2 billion, and we have seen a reduction in our VA sales of €160 million. I think that is overall for our balance sheet, a very good development. And also when we talk about the operating profit, you will see it's there as well.

Other strong contributors: Benelux, France, Italy. I think on the Life segment, we do in all areas, quite nicely. Also Asia-Pacific has actually good sales numbers. I should mention that even Korea is up in sales, and we have 11% growth, which shows that also the restructuring in Korea is actually on a good way.

Let's now move on to the operating profit. It is very much unchanged compared to Q1 2013. The little addition of €25 million can be completely attributed to the transfer of the pension fund companies from asset management. That is a €26 million transfer, so roughly the same. Although within the Life results, there is of course a lot of moving parts. So it is at face value, the same result as previous year but quite different combination. You'd see that that the expense load is substantially higher but just as the sales successes in the U.S. and compensated as we are almost taking 100% of the acquisition expenses in the U.S. by impact of change in DAC. So that is a profit-neutral number.

Our investment margin is slightly down, and that is all coming from Germany where we have a lower harvesting, so lower realized gains than before. We have this year only in basis points, two basis points compared to 12 basis points previous year. If we look then at more detail how it breaks down into the individual units, you actually see what I just said last reconfirm for Germany where the operating profit is 20% down. France is up. There's a bit more net realized gain as well as higher technical result. Italy is down as a consequence of our reduction of Italian government bonds in 2012 and 2013 where we just have a lower-yield income.

U.S. up driven by two factors. On one hand, the falling interest rates in Q1 have reduced the amortization of old DAC, and on the other hand we are earning more on the fixed index annuity business which is in total substantially up, I think that the biggest drivers in result. Benelux has some higher fee income, Netherlands improved health business. So there are some smaller changes, but all-in-all, I think that are the main drivers of the result.

And the Health check on page 23, how did investment margin develop? Almost no movement. In total, net-net we had 21 basis points in Q1 2013. Now it's 19 basis points in Q1 2014. So still the level for the total of about 75 basis points for the year that is very much what we expect. When you look at the last line of the page, you see that the book value of our assets and also aggregate policy reserves are nicely up, and that is driven by the good inflows we have seen already in Q4 and continued in Q1 2014. The unrealized gains year-over-year, there is probably not too much change. There was a lot of change in the last quarter but over the 12 months, it is probably pretty unchanged, but...

So now Asset Management sector. First, our third-party assets under management compared to year-end are slightly up, so all the constant news flow about PIMCO got clearly compensated by market impact. So therefore in total, we are at €1.342 trillion of assets under management. Allianz Global Investors had €2 billion inflows in the quarter, PIMCO had €21 billion outflows in the quarter. That is roughly half of what we have seen in the fourth quarter, and it is half – the €21 million or €22 billion can be split half-half between what we have called core or non-core products, so between the products which are like the total return fund and the other.

So overall, actually an expected outcome for the quarter, expected and baked in in our outlook for the year. So we think that things are on track. And we have now to see that the turnaround at PIMCO continues over the next quarter, but let's look at the revenues and then its consequences for the operating profit.

On face value, 19% down quarter-over-quarter, and there is – besides some FX impact, which makes about 2%, I think, there is in particular the one-off performance fees from last year and the total volume of performance fees dropped from €274 million to €19 million which gives actually most of the difference.

The other, so the regular fees, if you want to call it like this, have dropped from €1,585 million to €1,497 million. And of this 2%, 3% are actually explained by FX. The rest is falling AUM. So the margins on the business actually, if you look at PIMCO, 14.8 bps (sic) [40.8 bps] to 41 bps, almost unchanged; Allianz Global Investors from 61.6 bps to 58.8 bps, only a small reduction and hence, our cost-income ratio stayed very stable as you can see on the next page.

Our cost-income ratio for the whole moved from 48.4% for PIMCO to 52.2%. But now, how does it compare when we exclude performance fees? PIMCO's baseline cost-income ratio was 52.0% in Q1 2013 and it is 52.4% in the first quarter 2014. And for Allianz Global Investors, it moved from 75.7% down to 73.6%. And the total calculation as the rating between Allianz Global Investors and PIMCO is slightly changed, there are the currency impacts as well as Allianz Global Investors some small growth in AUM; PIMCO, some reduction in AUM. So therefore, in the total the average moved to one point up.

So when we look now on the drivers of the operating profit, last year €877 million. And I think we were always saying that this is probably a peak number because we can't repeat the one-off performance fees so quickly. And also the dollar-euro exchange rate is hard to control for us. So therefore, €646 million operating profit for the quarter is a very decent result which we can really live with and have a good outlook for the rest of the year. We should really look at the underlying performance and the cost-income ratio, which really gives a very strong number.

Let's now close the discussion with a short look on the Corporate segment. Not really exciting although the two movements look big. We had last year a one-off coupon payment from the silent participation from Commerzbank which was paid back and resulted into €68 million one-off coupon for the Holding & Treasury segment, and then we have this year also some less investment income in general.

Last year, we have closed the German retail bank, Allianz Bank, that cost us €88 million restructuring charge. Our small banks actually, in general, did a little bit better in the beginning of 2014. So we are producing a small operating profit. So therefore, the swing is €101 million positive and giving in total an operating loss in the Corporate segment of €222 million.

Now, adding up all the numbers and translate it into shareholders' net income, that is done very quickly. We have, in total, the same non-operating items as a year ago, but there are two special effects. The realized gains are more than €100 million down compared to last year, but we have a one-off positive compensating for this lacking realized gains of €116 million which comes of a change of the German accounting rules for pension liabilities which changes actually the discount rate gap between IFRS 19 and the German calculation.

And that is actually – when you look at the net income numbers of our segment, creates a little bit of a mess between the segment numbers because we keep, as the holding company, all pension liabilities for all existing and former employees of Allianz Group in Germany.

Therefore, the change in the German GAAP law had to be paid in cash from the subsidiaries to the holding companies. Therefore, it is an expense item on the local legal entity levels and it is all consolidated out on the group level. And this creates then these deteriorations and distorting effect in the net income numbers of the segment in particular visible when you compare the net income of the P&C segment and the net income of the Corporate segment. So it's a bit complex. Therefore, just focus on the total numbers here as one-off. That is the best explanation I can give.

So tax rates, unexciting, unchanged at 33% as last year ending with a good net income of €1.64 billion for the quarter. Therefore, let me summarize. €34 billion of revenues, a record quarter in revenues for the group; operating profit at €2.7 billion, ahead of our quarterly €2.5 billion of the outlook, the same shareholders' net income, strong start into the year; capital position and balance sheet maybe even a notch stronger at the year-end, and I think also the composition of our operating profit is really a very good one.

And with this is one I would finish here, and we start the question-and-answer session.

Q&A

Operator

Thank you. Our first question will now come from Peter Eliot of Berenberg. Please go ahead, sir.

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

Thanks very much. First question I had was just on PIMCO. I was wondering if you could comment on how the flows developed across the quarter, i.e., perhaps how March looked relative to January and February. And I don't know whether you're able to comment at all on how you're feeling about events after the end of Q1?

And then perhaps just two non-Life questions on a couple of ratios that didn't quite live up to the very strong group combined ratio. In the U.S., I mean I appreciate you're always hostage to weather and that was a big headwind in Q1. But just looking at the underlying rate, it maybe looks like 100% combined ratio is now a bit of a stretch for the full year without any further improvements. I was just wondering whether you do still see improvements coming through or whether that was the case.

And then on the CEE, your comments implied a little bit that there was little you could do there. I was just wondering whether that was the case or whether there are things you can do; and if not, what your view on Russia would be going forward? Thank you very much.

A - Dieter Wemmer {BIO 4755450 <GO>}

Peter, very happy to answer the question. PIMCO, I think that it's a very flat development month-over-month, and actually before somebody is asking it, also April is pretty much unchanged compared to January, February and March. I think what I did not say before but actually, you see in the whole industry outflows out of actively-managed fixed income. You can look at BlackRock, Legg Mason, Vanguard.

The inflows at the moment in the fixed income sector are more going to the passive funds than to the active managed. But I think that is, at the moment, a seasonal topic, and I think the performance of the active managed will, in the end, I think, attract the customers which are at the moment probably trusting more into the passive funds.

The P&C result, I think you asked – you are spot-on. The underlying with having this additional booking for the Corporate in the last year was really an ugly first quarter. And actually also April in the U.S., I think that was almost immediate transition from winter storms to tornadoes. It's certainly also not supporting a strong improvement of the combined ratio. So the 100% combined ratio at year-end is probably a stretch and our dream of the double-digit is probably postponed for a quarter or two.

The CEE Russia, what can do we do? Yes. And when you'll play in the market and in the provinces which have the highest litigation frequency, you have just to pay the losses. So what you can do is change the composition of the portfolio, get down to zero in the provinces where you have the high litigation because the litigation frequency is not the same in every part of the country, and it is a very large country. And that mix change is the only thing what you can do.

And you can, of course, rework your pricing on MOD and see that you get a higher share of MOD compared to motor liability. And you can be really very strong and very hard on your expenses. And that are the three things, the three levers you have available. The rest is as long as the Russian parliament is not voting in favor of a change of MTPL pricing. And it seems at the moment Russia has other priorities than dealing with motor insurance.

So with this one, next question.

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

Thank you.

Operator

Our next question comes from Paul De'Ath of RBC. Please go ahead.

Q - Paul C. De'Ath

Yeah. Hi and good afternoon. A couple of questions from me. Firstly on the Asset Management business. You mentioned this €5.5 billion private fund launch which replaces one of the previous private funds. And would you be able to comment on the structure of that private fund? Essentially, does it have similar performance fee arrangements to the private funds that brought the large performance fees through in the past?

And the second question was on the Life business, particularly the U.S. So you've obviously had a lot of success in the fixed-indexed annuities market. What do you see is the outlook for this business? And essentially, how unique is your new product in that market? Is this going to be a sustainable competitive advantage for the foreseeable future? Thanks.

A - Dieter Wemmer {BIO 4755450 <GO>}

Yeah. Let me start with the Life question. Well, actually I am convinced that insurance industry never lives on innovation and intellectual property-wise a long time. Usually, you have an advantage of up to 90 days and then somebody else will also bring a similar product. So therefore, I would assume that we will not see the same growth rates continued over the next quarters. However, I believe that in particular, as we have some proprietary channels that they really like the product, and also we'll continue to sell well. That this really give us a level of new business volume that we also have not the risk of expense overrun on the sales channels, which is very good.

On the Asset Management side, yes, I can understand that you try to estimate the future inflows coming from performance fees. I think we, of course, are not disclosing all contractual details for private fund because it is a closed fund. And therefore, if you have invested early enough, you would get a copy of the rules. But I can also maybe add that we have still some private funds, which are at work, which should be scheduled for repayment to investors in 2016 and 2017.

And that would be then, for me, the first year where we would see additional one-off performance fees. And this one here is, I think it's actually called Basel II, will come in a few years later. But in the next three years, there is certainly some money, which could come but you are also aware that actually the revenue recognition rules are only allowing us to show it and book it when the money is being paid back to the investor. And actually that is a good rule. It's a bit conservative, but the right way to do it.

Q - Paul C. De'Ath

Great. Thanks.

Operator

Our next question comes from Andrew Ritchie of Autonomous.

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

Hi there. Two quick questions. First of all, just looking at the underlying loss ratio movement year-on-year, I notice in the appendix at the back of the presentation that we don't have any effect this year from frequency/severity. That's been running at a minus 2% year-on-year impact for the last five quarters and it's zero now. Can you just comment on – and I appreciate there's some probably large loss noise in there, et cetera. And I guess some of the crop noise. Can you just give us a sense, Dieter, as to what's happening in frequency trends, and whether there's a slowdown in the benefit from what has been a run of pretty benign frequency trends?

The second question just on PIMCO. I'm a – just wanted to clarify what your comments meant. You were talking about you were much more confident for the rest of the year and that outflows Q1 were in line with expectations. Is your expectation that that rate of outflow is continued over the year, or are you expecting net inflows at some point this year? Maybe just give us a color. I'm not quite sure what you meant when you were referring to the outlook. Or are you just referring to the fact that there's been good operating efficiency despite the outflows? Thanks.

A - Dieter Wemmer {BIO 4755450 <GO>}

Andrew, let me start with the last question. I think we discussed this question. Actually that was beginning of March in our small group in London. And I think the answer is still the same. And I was only reconfirming what we already said three months ago that we did not expect that the outflows would go completely to zero in the first half of the year, but that it would get smaller over time. And I think as Q1 was at half of the level of Q4, I think that is pretty much what we indicated already in this discussion.

And yeah, I think PIMCO has certainly to prove that it stops at some point and then after bringing it to zero, the next step would bring it to a positive number that is probably everybody's expectation. And also, I think when you know the people working at PIMCO that is also exactly their ambition level. And that is very, very normal development.

But I think they did really a great job to work on the variable expenses and really kept the profit margin at the same level. So it is a very active management process and shows you also that actually the whole organization is really working in the same direction, which is for us internally very important, although there is always an external assumption that this is not the case.

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

And sorry, just on the.

A - Dieter Wemmer {BIO 4755450 <GO>}

Yeah.

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

I think in March, you said that your position with consultants on the institutional side, they had been broadly welcoming I think of the changes. I mean has there been any change? Have we been put on watch by more consultants, or is there any major changes in your perception there?

A - Dieter Wemmer {BIO 4755450 <GO>}

No. There is no change in the perception and you – well, you know the asset management industry probably better than I do. The consultants who advise institutional investors are all doing due diligence locally before they recommend an asset manager. Therefore, almost all the consultants we are working with have all personally visited for one or more days the PIMCO office in Newport Beach in the past. They are fully aware of the business culture and the capabilities of the organization. And that is a personal judgment each consultant is doing.

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

Okay.

A - Dieter Wemmer {BIO 4755450 <GO>}

Now, coming back to your loss ratio question. Well, I think there is – let me break down your question because the whole frequency debate was very much a question of motor frequency in Southern Europe. And did we see a change? Well, actually not. If I just pick the Italian example, our frequency in Q1 was even slightly lower than before and that has nothing to do with the economic circumstances. I think that is also consequent of the continued risk selection process, which has obviously also an impact on frequency.

However, for the total portfolio, we are moving in total our growth much stronger to short-tail portfolios. AWP is our strongest growing line. They have high number of tiny claims. So therefore, frequency is certainly up coming from these lines of business. And what this appendix number is showing you is that on a portfolio in total, it is unchanged. But yeah, it's probably difficult to interpret how this one number is really driving €44 billion of P&C portfolio. So therefore you can only take it as it is shown here. The impact in the overall loss ratio of frequency and severity is very much flat. We see a positive impact coming from price, and we have less nat cat. So underlying loss ratio, yeah, I think we are in maybe 30 basis points, 40 basis points better than a year ago. And I think we are moving overall on a very good level, and we are not nervous about the rest of the year.

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

Okay. Thank you.

Operator

Our next question comes from Thomas Seidl of Bernstein. Please go ahead.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah. Thank you. Good afternoon. Three questions, please. Number one, on PIMCO again. I think as you stated, the outflows were pretty much in line with expectation. However, I do note a drop in the fee margin. €43.9 million is 1.6 basis points lower than in Q4. You mentioned in the notes that this is driven by the lower number of trading days, but I also note that the retail share of assets has gone down in Q1. Is this a main driver, and should we hence expect the fee margin at best to stay at this level for the remainder of the year?

Second question on P&C. Here we note that the price trend is further down, 1.4% in the quarter is lower than the previous quarters. Given that the investment income is further coming down, reinvestment is coming down, shouldn't we expect more and stronger price actions of Allianz in these markets?

And finally on page eight, you note that the accrued dividend is at 40%. How should we read that assuming that it's meant for 2014?

A - Dieter Wemmer {BIO 4755450 <GO>}

So let me start with the dividend. Actually, when I did read yesterday evening one last time the analyst presentation and the comments, I made a mental note to myself that this question would immediately come. And thank you, Thomas, for confirming it. We said we will talk about the dividend and the way forward at year-end. We will certainly not implement a new dividend policy by a hidden footnote that we have changed the accrual for the dividend. So really sorry. In the end, that is the status quo and the update comes when it comes.

Q - Thomas Seidl {BIO 17755912 <GO>}

Okay.

A - Dieter Wemmer {BIO 4755450 <GO>}

So PIMCO, yeah, I think the margin is indeed unchanged and it is probably more fair to compare Q1 over Q1. Although the way how the number is calculated, the trading days of the quarter have an important impact that as it is calculated on a daily basis. So therefore, I think the margin is indeed on a good level but I would not assume that it is a growing number. And I would say, well, it is pretty much stable. And the margin includes already the retail institutional split. Therefore, when we say stable, it includes already both.

Q - Thomas Seidl {BIO 17755912 <GO>}

Okay. And the retail's fall, do you think it's linked to the discussion about PIMCO, the negative headline news?

A - Dieter Wemmer {BIO 4755450 <GO>}

Well, I think that it's also because people are nervous about what is happening to the interest rate. And certainly, I think sales people who live on upfront commission payments certainly will not miss opportunities. Also for switches, I think that is certainly a very normal routine thing. And the Asset Management sector, although I think it is from this perspective still very small, and I would not see this as a big trend.

Q - Thomas Seidl {BIO 17755912 <GO>}

And then on the P&C pricing trend?

A - Dieter Wemmer {BIO 4755450 <GO>}

P&C pricing trend, sorry. The P&C pricing trend, it is slightly down. When we just look at the big flagships, so our large OEs, we had a year ago still 2%. Maybe now we are down to 1.4%. Is this a big change? Well, in the end, the inflation is probably even more benign than before. So what argument do you have to increase rates? And when you actually look at the trend of our loss ratios, I think we are very comfortable where we are standing. To push through another 2%, 3% of rate increases, probably you can do. You end up with a lower volume. In total, you'll end up with even better combined ratio. And in the end, we have to produce and deliver operating profit which is a product of volume and profit margin, and we feel that our current strategy is trying to optimize exactly this challenge.

Q - Thomas Seidl {BIO 17755912 <GO>}

All right. Thanks, Dieter. Very helpful.

Operator

Our next question is from Marc Thiele of Mediobanca.

Q - Marc A. Thiele {BIO 3503774 <GO>}

Yeah. Hi. Good afternoon. My first question is on economic solvency. The full-year number has been restated as previously indicated, and the slide mentions model changes with a €10 billion boost to own funds and almost €9 billion to the requirements. This seems to have contributed the nine percentage points' increase in the first quarter. Is this right? And can you detail the impact of the declining bond yields in percentage points? Or even better, maybe you can reconcile the main components of the movements.

And then the second question is on the P&C reinvestment yields. They have increased to 2.6% in the first quarter from 2.5% for full year. And I guess the reason is we're looking at averages, or is Allianz taking more investment risk? Do you have a quarter-end number or a current rate that we can use as good guidance for projecting investment results?

A - Dieter Wemmer {BIO 4755450 <GO>}

Well, I think we - as we - let's start with the investment results. Our usual guidance is that we see in P&C still a reduction of 15 base points to 20 base points, but we are not giving further guidance than the one we have disclosed. But you can make a very simple calculation. On average, we have to reinvest 5% of our P&C investment portfolio every quarter. So when your average yield is 3.2% and your reinvestment yield is 2.6%, then the 5% dilution every quarter is a very simple rule of thumb calculation.

And on the Life side, you can do the same. Only the turnover of the investment portfolio is of course lower there. It is probably more between 2% and 3% which we reinvest every quarter and hence, the dilution effect of the current market environment is smaller. What you cannot anticipate is when we do large deals with attractive yields in the infrastructure sector of real estate, that are the positive one-offs which help supporting our old yield levels.

So on economic solvency, that is a longer story. I hope you all have nothing else this afternoon. Let's first look what we did at year-end. We have included the sovereign credit risk, including the credit, the spread charges. We have updated all our correlation because they are based on a model how the correlation factors are being calculated. We have added a charge for our internal pension. We have implemented of the impact of the volatility adjuster on the spread risk. We have some scope changes which actually have also reduced our solvency ratio. And also, we have a capital add-on for some best-estimate outcomes. So there is – in case where buffers are used more than once, we have taken a general haircut.

So for example, we have reduced transferability restrictions, but we still have kept some. And the positive developments during the first quarter, that is the net income, the plus, in particular non-Life. And when you look at our MCEV development, I have moved the MCEV slide into the back because it seems that nobody wants to hear anything about MCEV anymore, but we had a very strong organic earnings in the MCEV, so that added to the available funds. Then we issued in the first quarter a small hybrid, and we have some market effect in non-Life. What has consumed more is increasing equity market and then the decreasing yield, obviously interest rates and peripheral spreads who came down which has a reduction of credit charges on one hand, on the other hand, of course, even smaller yield. So...

Q - Marc A. Thiele {BIO 3503774 <GO>}

Do you have like a number for the interest rates, just to give a feel for how significant that was because I would presume looking at the embedded value disclosure, we are moving slowly back to the record lows that we've seen, I think it was a year ago.

A - Dieter Wemmer {BIO 4755450 <GO>}

Well, the effects are a bit more – well, first of all, we have in the appendix various interest rates sensitivities. However, on the MCEV, actually it is a bit complex because you have in the end to compare how the swap rates moved. And I think we have seen more reduction in Italian and Southern European spreads than in the swap curve. Therefore, I think overall, the impact of the interest rate in our MCEV is actually pretty small in total.

Q - Marc A. Thiele {BIO 3503774 <GO>}

Got it. Thanks. Thank you very much.

A - Dieter Wemmer {BIO 4755450 <GO>}

Yeah. Sorry. €580 million was a change in the German markets and the Southern Europe was even positive. So we have in total €0.5 billion coming from the interest rates in the MCEV. So not in the risk model.

Q - Marc A. Thiele {BIO 3503774 <GO>}

Super. Thank you.

Operator

Our next question comes from Michael Huttner of JPMorgan. Please go ahead.

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

Fantastic. Thank you so much. Just three questions. The real estate, I was surprised to see, was still at 2%. I keep reading in the paper and you keep highlighting that you're making all these real estate investments, but it doesn't seem - you're actually not paying any money for it. It seems weird. On Russia, given that it's clearly not getting better for the time being, what's the risk of an impairment? And I know you say the impairment is set for the whole CEE, but now the whole of CEE is actually negative. So I was just wondering if you can give a figure for that.

On Italy, can you give us a feel for what the underlying is? I know it's a bit of a silly question because we keep getting positive surprises on the reserve releases so that it seems to be that the negative inflation is working through. But maybe any indication would be really helpful.

And then a little bit follow-on from Marc Thiele's question. The €8.3 billion uplift of IFRS versus - sorry, of MCEV versus IFRS was not in the balance sheet. It was €9 billion at the year-end. Can you give us a little bit of a feel if we were to think about even lower interest rates, or just a feel for how robust? What I'm trying to see is how robust that 203% figure is. What could drive it back to the 190% level which is where we all a little bit surprised at the full year? Thank you.

A - Dieter Wemmer {BIO 4755450 <GO>}

Michael, you lost me a bit on the MCEV question, so...

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

Okay. Just, very simply, what could drive the 203% back to the 190%? What kind of scenario do we need to think about to get to - it's not a scary number, but a number where one feels a bit less comfortable about what you might say at the end of the year?

A - Dieter Wemmer {BIO 4755450 <GO>}

Look if - you can look at our disclosures on page 42. I think that we have actually done all the tests of the various calculations. And that is what moved the number. But I think for the time being, I think we are really keeping the risk very much under control and managing the ratio very well.

The real estate question, sure. It is only a small number. But also you have to remember that in our balance sheets different than many others, our real estate is on an amortized cost basis. We are not giving the full market value. Therefore, there is a natural amortization. And therefore, a reduction of the booked real estate number year-after-year, that is one of the conservatism of the Allianz balance sheet, also one of the reasons why our capital strength is high. But you are also right. We are really looking for quality investments also in the real estate sector which is satisfying our ambition and our returns. And therefore, the progress is slower than we would like to do but better good deals than speedy deals.

Italy, we have good 4% one-off result in Q1 2014, and the year before was no one-off result in Q1. And that gives you, I think, a good indication of the development of the underlying. Russia, we have to watch the development. We have to look what management comes up with this operating plans. And then we have to look what impact it has on the accounting numbers and also on the balance sheet. That is a standard process which we are very systematically working through.

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

How significant is that risk? When we asked at full-year, the ceiling was not heavy. Now from your answer, I'll say we're in the kind of 30% area. I don't know. Is that fair?

A - Dieter Wemmer {BIO 4755450 <GO>}

I think the risk is certainly higher than it was at year-end.

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

Okay.

A - Dieter Wemmer {BIO 4755450 <GO>}

But it is not high enough that we would book it. So therefore, it is on the watch list.

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

Excellent. And the amount it relates to, I can't remember but is it somewhere around €800 million?

A - Dieter Wemmer {BIO 4755450 <GO>}

No. €800 million, that's for Russia. No that's – I think it is – well, it is embedded in the overall CEE goodwill. But you – I think it is somewhere between €300 million and €400 million.

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

Okay, brilliant. Lovely. That's really helpful. Thank you.

Operator

Thank you. Our next question comes from Blair Stewart of Bank of America. Please go ahead.

Q - Blair T. Stewart {BIO 4191309 <GO>}

Thanks very much. Good afternoon. Three quick questions. Firstly, with the drop in U.S. bond yields, any comments you can possibly make on the performance of PIMCO in terms of fund performance with a view to perhaps slowing down the outflows?

Secondly, on the Life business, the fee-based revenues were a bit better than expected. Is that a good base to forecast for the rest of the year?

And thirdly, maybe just a few comments on this new U.S. product that you've been so successful with. What's the expected duration of that? And anything to worry about from a risk management perspective on the product? Thank you.

A - Dieter Wemmer {BIO 4755450 <GO>}

Blair, I think – I'm not sure that I can link the movement of U.S. bond yields with the fund performance, because they are completely different funds with different strategies. And therefore, I think things are quite specific for each fund. Income funds, very high performance. I think our one-year performance was below historical average. Our three-year performance is hence down to 88% outperformance which is still a market-leading number. And I think we have a good recovery story on global unconstrained. And the total return fund, I think, you are all reading probably every week on your Bloomberg screen. So I don't need to explain this.

In Life, the fee-based revenues, I think I'm not aware that there was anything special in Q1. As I would anyway say, the Life results in Q1 might not be a predictor of what we will have every quarter as an operating profit. But I can also not say that there was any special one-off in the numbers, which I could isolate and know. So there will be some volatility in the number. In particular, I think the DAC write-downs are more volatile. That is the U.S. GAAP logic and the old VA book which creates this. But that is probably a volatility, which exists. The new U.S. product, I don't think that it has any special additional risk features. So I think from a risk management point of view, it is well designed product.

Q - Blair T. Stewart {BIO 4191309 <GO>}

And the expected duration of it?

A - Dieter Wemmer {BIO 4755450 <GO>}

The index we are using, it is – when you want to look it up, it's called BUDBI. So that is – it stands for Barclays US Dynamic Bond (sic) [Balance] Index, terrible acronym. And it has an embedded balance between bond and equity components. And the index manager is also doing a reallocation between the two classes depending on the market development. So I think it is also a self-regulating index and that actually supports our risk management efforts a lot. Therefore, I think it is really a very, very good and interesting solution.

To some extent, we have outsourced the rebalancing between the fixed income portion and the S&P 500 component to this index, and therefore we have internally to spend less money on the hedging.

Q - Blair T. Stewart {BIO 4191309 <GO>}

Okay. And the duration of the product expected?

A - Dieter Wemmer {BIO 4755450 <GO>}

Duration, I think it's a normal five years, seven years or eight years.

Q - Blair T. Stewart {BIO 4191309 <GO>}

Okay. Super. Thank you.

A - Dieter Wemmer {BIO 4755450 <GO>}

So.

Operator

Thank you. Our next question comes from Nick Holmes of SocGen. Please go ahead.

Q - Nick Holmes {BIO 3387435 <GO>}

Hi there. Thank you very much for taking my questions. Just two of them. The first is coming back on PIMCO. Wanted to ask with the outlook for performance fees – I know this is incredibly difficult for you to comment on. But I think you've said in the past, three percentage points to four percentage points of revenues is the sort of level that you would expect. Now, I wondered whether you can comment on that in the light of Q1. And also, really same question with the cost-income ratio, which has risen from 53% to 57%, and it's really the same question isn't it, whether you expect the level of performance fees to cause that ratio to remain higher?

And then, second question is coming back on the solvency ratio, the new definition. Just wondered if you could explain exactly what it is that you mean when you say you've reduced transferability restrictions? Thank you very much.

A - Dieter Wemmer {BIO 4755450 <GO>}

Okay. I think for PIMCO, we reconfirm what we said before, and I think that was also the answer I gave to Andrew, I think. And on the performance fee, the first quarter is seasonally weak because it is not the closing quarter for the funds, which have usually always a four-quarter calculation as you probably know also from SocGen's asset management activities. So that – and Q1 is a very low quarter where this calculations and billing is being done.

The transferability restriction is very simple, an internal process that we have taken out conservatism as we had it in the past because we have also replaced top-down estimates on the market consistent balance sheet by a proper bottom-up process and our market-consistent balance sheet is now being produced by the same SAP system as our IFRS results. And that is the same consolidation process that therefore you can also say that our current numbers are more precise and more detailed than this. And therefore, we have also removed some conservatism we had before as reserves of fund for sale, so to speak.

Q - Nick Holmes {BIO 3387435 <GO>}

Okay. Dieter, can I come back just on the transferability, and in particular, with the question of the RfB? How do you treat that in terms of transferability? I know that under the conglomerates ratio, you actually have a lot of it available at group level. Is this something that you're also doing with the economic ratio?

A - Dieter Wemmer {BIO 4755450 <GO>}

The RfB is, of course, not transferrable. I think that the BaFin would really be upset. And also how would you argue that something, which belongs to the German policyholder can be transferrable. That would be a very difficult argument to make. But maybe we can learn from some of our peers.

Q - Nick Holmes {BIO 3387435 <GO>}

But do you not do that with the conglomerate ratio? You have over €5 billion of free RfB which is available. Is it not in the conglomerate ratio?

A - Dieter Wemmer {BIO 4755450 <GO>}

Yeah. But that is the shareholder share in it and not the policyholder. And it is a completely different calculation because that is, in the end, the share in the unrealized gains of the bond portfolio which – when they are being realized, they are split according to the normal formula between both sides, between policyholder and shareholder. Therefore, that is a different calculation. And we have certainly retained in our German Life business whatever is needed for running off the portfolio for all guarantees and also the announced profit sharing.

Q - Nick Holmes {BIO 3387435 <GO>}

Yes. I mean, I'm sorry. I was really referring to the free RfB whether that is the subject of a change in your transferability restrictions.

A - Dieter Wemmer {BIO 4755450 <GO>}

No.

Q - Nick Holmes {BIO 3387435 <GO>}

Whether you've – no. No. So no change there? Okay. Thank you very much.

A - Dieter Wemmer {BIO 4755450 <GO>}

Absolutely correct.

Q - Nick Holmes {BIO 3387435 <GO>}

Great. Thank you.

Operator

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

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

Hi there. Just one question left, actually. It's a follow-up on the fixed-index annuity to Blair's question really. You mentioned that the consumer now got more of the upside but kept the downside. I think any product that sells so well, where that seems to be the shifting dynamic, raises an eyebrow. Can you say – no particular concerns around the risk management, I don't know whether it's possible in this call to just give us a little bit more detail around those features that you haven't already given because I'm not sure I fully understand what the additional benefit is and why there isn't an additional risk to shareholders for that.

A - Dieter Wemmer {BIO 4755450 <GO>}

No. Well, I think in the end we have the same dynamic hedging on the product with the other products. The only question is whether you are – what costs are you consuming for the various hedges. And I think the construction we have chosen here also with this very specific index, we are hedging the downside. But when the index runs positively, we can share the profit with the customer. The product itself has the same adjustment clause on the expense charges as the previous products, that means in case that hedging costs go substantially up, then yes, that might create a shortfall and between collected expenses from the customer and the hedging cost in a month. But then due to the changed clause in the contract, we can then catch up in the following quarters. And that is the way how it works in all the fixed-index annuity products.

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

So is this effectively that you're saying you've got a more efficient hedging partly because the index that you use (01:19:26)...

A - Dieter Wemmer {BIO 4755450 <GO>}

Yeah. And also, this index itself as it is recalibrated between equity market and fixed income market is of course – has therefore, a lower volatility than when you do a plain S&P 500. So therefore, the hedging costs, to start with, are lower than with other funds and that allows the asymmetric treatment.

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

Okay. That sounds like I want to look into that a bit more. But that said that's helpful. Thank you, Dieter.

Operator

Our next question comes from Vinit Maltora of Goldman Sachs.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Hi. Good afternoon. Just two things just to clarify, please, Dieter. When you said that the PIMCO flows, outflows were in line with expectations, were the expectations also met for the core and non-core lines? I just wanted to quick check on that, a quick clarification on that.

And then just one thing, I'm very curious. On these Solvency II sovereign credit charges, after you had announced that famous slide, we didn't really hear this from the other insurance companies, and I'm just wondering why was it that Allianz was sort of picked up for having to include these charges? Is it linked to the SIFI debate? Is it something else? It's just not very obvious. Thank you.

A - Dieter Wemmer {BIO 4755450 <GO>}

Well, I think it is very obvious, Vinit, because the German regulator said they want to see it for internal models and the two large and prominent user of internal models in Germany are Munich Re and us. And I think it is probably well-known that Munich Re has also a charge for government bond risk in their model. So therefore, it should be, from this perspective not surprising. But having said that, we will certainly not accept as we are being disadvantaged against other European players, and in particular on local market comparisons whether it's in Spain, Italy or any other market, I think that would be an unacceptable disadvantage.

We have now put it into our model also to demonstrate that our solvency ratio is still at a very comfortable and excellent level even when we produce here a worst-case scenario. And actually, it is also the process we have told of you that we will reflect in our quarterly model update, the current status of our discussion with our regulator. And as BaFin is the owner of the approval process for our group model, that is the current view. So from this perspective, there might be more chances for upside into the calculation than for downside. And I think usually you guys are always using for the downside in everything. So this time, you can search for the upside.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Thanks.

A - Oliver Schmidt {BIO 2473131 <GO>}

Okay. We have time to take one more question, please.

A - Dieter Wemmer {BIO 4755450 <GO>}

Sorry, Vinit. I forgot the PIMCO question. I got too excited about Solvency II. So we have not refined our expectation between core and non-core. I think that that would be too much of a forecasting process. And I think the overall number is what we felt is to be expected.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay. All right. Thank you, Dieter.

A - Oliver Schmidt {BIO 2473131 <GO>}

Okay. This one did obviously not call but now we have time for one last question, please.

Operator

Thank you. As there are no further questions in the queue, I will now hand you back to your host for any additional or closing remarks.

A - Oliver Schmidt {BIO 2473131 <GO>}

Well, perfect. It was perfect timing. Thanks, everybody, for having joined the call. We say goodbye to you and wish you a very pleasant remaining afternoon.

A - Dieter Wemmer {BIO 4755450 <GO>}

Yeah. Also, from my side, thank you much for the call. And let's continue the dialogue. I always enjoy it, as you know. Have a good afternoon.

Operator

Thank you. Ladies and gentlemen, that will conclude today's conference call. Thank you for your participation and you may now disconnect.
