Q2 2019 Earnings Call

Company Participants

- Giulio Terzariolq, Chief Financial Officer
- Oliver Bate, Chief Executive Officer
- Oliver Schmidt, Head of Investor Relations

Other Participants

- Andrew Ritchie, Analyst
- Farooq Hanif, Analyst
- James Shuck, Analyst
- Jon Hocking, Analyst
- Jonny Urwin, Analyst
- Michael Haid, Analyst
- Michael Huttner, Analyst
- Peter Eliot, Analyst
- Unidentified Participant
- Vinit Malhotra, Analyst
- William Hawkins, Analyst

Presentation

Operator

Ladies and gentlemen, welcome to the Allianz Conference Call on the Financial Results of the Second Quarter 2019. For your information, this conference call is being streamed live on allianz.com and YouTube. A recording will be made available shortly after the call.

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

Oliver Schmidt {BIO 2473131 <GO>}

Thank you, Christian. Yeah. Good afternoon from my side as well, and welcome to our conference call. Normally, our quarterly calls are conducted by the CFO and Investor Relations, but today, we have a treat for you. Our CEO, Oliver Bate has joined us as well. He won't be able to stay for the entire call and that is why we start directly with him.

Oliver Bate {BIO 19184930 <GO>}

Thank you, Oliver. Hello, everybody. Thank you for joining today on a day that is ugly in the market. Good news is, Allianz is keeping it up, at least for those that are invested in our stock. And I would congratulate those investors having -- had the right nose in this environment. Why I'm talking to you is, number one, I missed you through the inside series in Munich. I was in London at the time trying to understand what Brexit means. I'm still not much smarter, but will find out very soon. But what we are much smarter on is that on Renewal Agenda 2.0 that we have launched in last November, Allianz is fully on track. And I would like to have you look through the quarterly numbers and think about what we have said in the strategy session and how we are keeping to deliver on those and keep an eye on the delivery against this strategy.

What we told you is that, the environment is going to get very ugly; that the trade dispute is not going to go away; that will result in rates going further down. And now we have the bond even at 30 years being negative, and we are less than half of where we were a year ago. And because we knew that, we have started to tighten the ship early and make sure that we are prepared for the storms that are ensuing.

Now let me talk about that in a little bit, and then I hand over to Giulio. The first one is that, we have made sure we transform our Life business as we've done the last three years and keep on changing the business mix on the new business side and maintain discipline on capital deployment on the in-force. Giulio is going to talk about how we given a declining investment income are strengthening the earnings power of Allianz nevertheless, because we are growing market share not just in Germany and the United States, but also in Asia at very, very good levels of profitability despite the massive decline in interest rates.

And we're going to continue to pursue growth in other earnings sources than just investment income and making sure capital is being redeployed where it does meet our objective. As we stand today, we have very strong return on invested capital. As many of our competitors are fleeing the Life business, we are growing and we are improving profitability. That is not to be seen in many other places. The second one is the Asset Management business. After the turnaround of PIMCO numbers in the past, we are back to full strength. Many of you had questions about the fourth quarter of last year on some of the flows. I think PIMCO is demonstrating extremely strongly that we will strive in very difficult markets, different than other companies can do, and you see that in our earnings.

So the businesses that are most exposed to capital markets are showing enormous strengths. That then leads us to Property-Casualty where we have had very good result despite the ensuing headwinds in commercial lines. And I want to be very clear, the global market and commercial lines are not yet where they are, there are signs of rate hardening, but we need to look through short-term expectances, there is work ahead of us for all of us in the industry to make the profitability rise. Allianz is doing exceptionally well on retail, both in margin and in growth, and we have some further week -- work to do on commercial lines, which means there is significant performance uptick that we can gain for our shareholders in driving the commercial lines business forward. But that will take time and hard work, and we're on it.

In the meantime, Allianz is focusing on controlling the levers that do not depend on financial markets to go well; very importantly, trying to grow organically our business and being extremely disciplined on the productivity. So we have had yet another quarter we are delivering on productivity gains, and we are not letting it go. And we will deliver on that in an environment where that is one of the key levers, next to underwriting discipline and risk controls on the investment side to make sure that we stand when others will get weaker.

Now last comment I'll make sure in terms of transformation delivery, we are not just delivering extremely strong results in this really difficult environment, we're continuously working on transforming the business. And that then allows us to also grow inorganically. I would like to reiterate the point that we are not planning any large acquisitions anytime, we're sticking to bolt-on, very well priced acquisitions. In difference to many other people, we don't need -- see and feel the need to buy something large to camouflage problems that we may have strategically, and that will remain a discipline for the time to come.

Now we will guard your capital very carefully. So as we have said in the past, if we cannot reinvest the capital into our businesses for profitable growth, be it organic or inorganic, we will not sit on it. Now given that the times are getting tougher, we'll make a very careful trade-off between capital usage and how we invest it. I think it's time to invest it in the core business and not in overpriced assets.

And these are the message for today. Thank you for your trust. And with that, I hand over to Giulio.

Giulio Terzariolq

Thank you, Oliver. And I like now to go -- good morning and good afternoon to everybody. I like now to go into the results for the second quarter. But before we go into the results for the second quarter, I'm going to give you a view on the very good results, as Oliver was saying, for the six months.

So if you move to Page six -- page three of the presentation, you can see that we have been able to grow our revenue by 6%, and the growth in revenue was driven both by Property-Casualty and Life/Health. So again, in Property-Casualty we had a growth rate which is in excess of the 3% we were used to see a few years ago. The operating profit is also following a nice increase with 6% plus or EUR367 million of additional operating profit. All segments have contributed to the increase in operating profit. And then, when you look at the net income, it's up 7%. And if you do the calculation of the earnings per share, we are up double-digit compared to the six months of 2018. So a very strong story.

When we look at the KPIs, on the operational KPIs, you can see that our combined ratio is stable in 94%. And what is also very important, our productivity gains are coming through, and we were able to improve our expense ratio in the first six months of '19 versus the six months of '18. So that's an additional improvement. Then on the new business margin, you can see that we have been able to keep the new business margin stable, and this combined with an increase in production has lead to an increase in value of new business of 17%.

And then finally, on the asset investment side, you can see that the net inflows are very strong. Over the six months, we had about EUR40 billion of net inflows. This is mainly driven by PIMCO, but I think the number is very, very strong. So all in all, it doesn't matter whether you look at the revenue, whether you look at the operating profit or the net income or the operational KPIs, I think there is a very strong picture.

As we go to page five, you can see a similar kind of good picture also for the second quarter standalone. On the revenue side, again, we had a positive growth of 4%, also driven by Property-Casualty and Life/Health. When you look at the operating profit, you can see an increase over the level of 2018. Here, the increase is mostly driven by the Life business. I'm going to come back on this one. But when you look at the other segments on aggregate, we also see a lot of stability. And just to keep in mind, the level of EUR3 billion over 2018 was already a very good level. So again, a very good quarter.

And then on the shareholder net income, you can see that we have an increase in shareholder net income of 13%. This is a consequence of the increase in operating profit. Also, as you are going to see later, the nonoperating result was a little bit better compared to last year. And finally, the tax rate has been lower compared to the tax rate in 2018. So all in all, with EUR3.2 billion of operating profit and EUR2.1 billion net income, I think we have a very strong picture also for the second quarter standalone.

At page seven, we are showing the shareholder equity and the Solvency II capitalization. I'm going to focus on the Solvency II capitalization, because that's the most relevant metric. As you see, our Solvency II declined from 218% to 213% in the second quarter. The main driver for the decline is the change in interest rates. Also, I would say that the credit spread movement, there is some basis risk on the credit spread movement, has also caused a little bit of a reduction in our solvency ratio. What is important, however, the organic capital generation is at 3%, which is a very good number because this is eventually the number which is going to stay and support the capital generation moving forward.

One comment on the sensitivity. As you see the sensitivity in the downward direction had been pretty stable compared to the sensitivities that we had in Q1. The only sensitivity which is now stronger is the sensitivity up to interest rates where we have now a plus 6 percentage points. The point is, as we go down the curve, the interest rate convexity, if you want, is changing. So this to a certain degree also kind of normal, but we need just to be prepared, this sensitivity can change over time as we are moving up and down the curve.

At page nine, I know you're always very interested in the topic of the Solvency II generation. I can be a little bit more specific. As you see on pretax and pre-dividend basis, the organic generation was plus 7%. If you take out the dividend and the taxes, we are back at 3%, which is pretty much in line with our expectation. On the market, you can see, on a pretax basis a minus 8 percentage point of movement. After tax is minus 7 percentage point.

And here, again, I want to stress the following. First of all, we have a movement of the interest rates for the quarter, which was between 30 and 40 basis points. So there was a strong movement of the interest rates. The second point, our -- when we show the equity sensitivity, we are showing the equity sensitivity assuming that the nonpublic equity are going to move to the same level as the public equity. This is not necessarily the case, so eventually, our sensitivity then can -- actually, we can see a different results depending on the movements of the nonpublic equity.

And then also something to consider is, our portfolio has higher quality, if you want, from a bond point of view. We are more focused into, let's say, bonds compared to BTP compared to TEME [ph] the EIOPA portfolio. So for example, we saw a widening of the volatility that narrowed when the volatility adjusted. But when you look at what happened to the spreads, you can see that in the case of the bonds, there was a widening of the spreads. In the case of the BTP, on the long duration, there was a narrowing. When you look at the short duration of the BTP, there was indeed also sort of widening. So there is some basis risk there that can also cost a little bit of solvency.

The final point is, we have repurchased one subordinated loan in Q3, and the impact of the purchase of the subordinated loan was about 1%. So all in all, a 5% decline. But I will say, under the market condition, totally explainable and we are very comfortable with the level of Solvency II that we have now, and this is by no means any sort of restriction to our capital flexibility.

Moving to page 11. We come here to the segments, and we start, as usual, with the growth rates for our P&C entity. As I said before, a good growth rate of 4.3%. When we look by the way, the growth rate for the six months, 50% of the growth is coming from price and 50% is coming from volume. If you then look in isolation to the second quarter, you can see there is even an acceleration or the improvement coming from price, and that's especially because of the development in the industrial lines.

When you look at the change on renewal, we are pretty stable positive. Especially in the case of AGCS, we see a strengthening of rates. We saw this to a certain degree already in Q1. But definitely, we see more momentum in Q2, and we expect this momentum to continue also in the second part of the year.

When you look then in the single entity, I would say, we had a very good dynamic of growth in Germany, in Italy, and generally you see plus signs. The only exception is Spain, but in Spain, we are very focused on the profitability. Especially in the new business, we are kind of cautious. But in general, again, I would say, a good picture on the growth side, and this is now the first quarter that we have good numbers on the top line.

Coming now to page 13. We show here the operating profit, which has decreased by 5% compared to the prior period. This is driven by the investment income. When you look at the combined ratio, the combined ratio is more or less stable compared to the prior level.

What we see here is a higher load from natural catastrophe of about 60 basis points. Also, we see there is a lower runoff of 90 basis points. But offsetting these two developments, we see a more benign impact from the weather-related losses.

Also, we see some improvement in the pure attritional loss ratio. And then, more important, we see a further improvement in the expense ratio. So all in all, I would say, a good picture for the second quarter with an improvement of the attritional basis -- the attritional loss ratio and also a slight improvement in the expense ratio.

In this case, I would like also to spend a second on page 14, because I believe that when we see the numbers, sometimes it's better to view -- to look at the numbers on the six months basis. That can be more telling. And when we look at the development of the combined ratio for the six months, you can see an improvement of 2 basis points.

And here, we see that the net cash has been positive compared to the development of last year. On the other side, the runoff is 50 basis points lower. So the two things offset each other. On the attritional loss ratio, we are pretty much flat and then we see an improvement also for the six months on the expense ratio. So again, a sign that also in the six months picture, we are making progress on our priority to bring the cost ratio down.

With that, let's move to page 15. And here, we show the operating profit and the combined ratio for the selected entities. I will say, we had good results -- very good results indeed in Allianz Germany. This might look counterintuitive because you see 95.6%, but you have to consider that we had a 7.7% load from natural catastrophe. Indeed, I will say that almost -- the only real natural catastrophe that happened in the second quarter, more or less, happened here in Germany. So if you adjust the numbers for the extra load on natural catastrophe, I will say the performance in Germany is very good.

In the case of France and Australia, you see a movement compared to the prior period. This is more a result of normalization compared to either high level of last year or extremely low level of last year. And then, as you go into -- down the list, you can see in Spain, we have a significant deterioration of the combined ratio. Important here to note is the accident year combined ratio is stable and is stable at a good level of 93%. What we see here, however, is a swing from a positive runoff in 2018 to a negative runoff in 2019. But the underlying, actually, CR performance is pretty stable at 93%.

And then clearly, AGCS, it's combined ratio of 101% is a business that has a few challenges at the moment. But we also see there is a correction coming in the rates, so there is definitely a strong hardening. So we think that moving into 2020, 2021, we should see better results.

And then I'd like to highlight also the outstanding performance of Euler Hermes, where we see good growth rates and also, we see a very good combined ratio at about 80%. And also the way these guys are managing the business in an environment which is not necessarily easy, in my opinion, is best class. So all in all, I would say, a good picture in our underwriting results.

And with that, we move to page 17 where we show the investment results. You can see a decline by about EUR50 million on the investment results. I would say the main -- there are two factors. One is there is some kind of volatility that we might see on the net harvesting, and in this case, it's primarily driven by FX effect. And the other effect that you see on the interest and similar income, we got this year less dividend, especially on private equity, compared to what we had last year. But this is more a normalization because, last year the dividends were a little bit higher.

So I will say, all in all, in reality, stable or resilient results. And I would also point out to the current yield, which is pretty much stable compared to the level of last year. So from a bond point of view, from the income of the bond portfolio, we didn't see any substantial change in the second quarter.

With that, I'd like to come to page 19 where we are discussing the Life business. As you know, in the Life business, we had at the end of the day three goals. One is to keep new business margin of 3%. The other one is, we want to have at least 80% of our production in capital-light products, and I believe this strategy is extremly important in this kind of environment. And then also, we want to have a growth in the VNB. Since, fundamentally, the margin is now going to go so much higher compared to where we are now, at the end of the day, the growth in VNB has to come from growth in production.

And what we are showing in this slide is that, we have been able to meet in the quarter our objectives. When you look at the growth in production, that has been 8.5%, mostly driven by Germany Life and by the U.S.A. In a few countries like Italy and France, we had a reduction in the production because of the unit-linked business. But fundamentally, when you look at the total portfolio, we were able to grow our production almost on a double-digit level.

On the preferred product, we have -- more than 80% of our production are preferred products. And as you see, we have been able also to grow our margin by 10 basis points, and this despite the environment being kind of challenging already in Q2.

At page 21, we are showing the operating profit. And as you see, the operating profit is up about EUR 150 million compared to the level of Q2. Now here, we have a special effect coming from Allianz Leben where we changed the duration for the amortization of the debt. We had a duration up to 20 years, and now we are extending the duration to 25 years. To calculate the EGP, the amortization of the acquisition cost, so by definition, when you're extending the duration, you're going to add more profit into your model, and this is going to lead to a different DAC depreciation. So this is a special effect that we had in Allianz Life to recognize the longer duration of the products.

If you adjust the numbers for the one-off, we go back more or less to the -- exactly, I would say, to the level of the operating profit of last year. So the operating profit will be EUR1.075 billion. If you take our outlook for the year of EUR4.2 billion divided by four, that will be EUR1.05 billion. So I would say, even adjusted for the one-off, we are well on track to achieve our outlook and the second quarter has been a confirmation of this.

And with that, we can move to page 23. Here, we are showing, as usual, the value of new business, new business margin and operating profit for the different entities. On the value of new business, I'd like to highlight that we achieved double-digit growth in the value of new business mainly because of the increase in production.

But as I was pointing out before, we were able to increase also the new business margin. The reason why we have been increasing the new business margin is mostly due to mix. And then if you go back a couple of page, you're going to see that we have a higher mix in capital-efficient products, and the capital-efficient products had a higher new business margin compared to the products in other -- at least in the savings or unit-linked.

On the operating profit side, clearly, you see a nice growth at Life U.S.A. This is mostly driven by the impact of the change in DAC. You see also nice growth in Asia Pacific where we don't have the drag from the legacy book in Taiwan anymore. And then you might see a couple of minor signs, but these are related mostly to lower realized gains in the second quarter compared to the realization in the second quarter 2018. So all in all, again, a strong operating profit for the second quarter.

And then at page 25, the gross investment margin is stable, but the policyholder participation, the profit sharing is up. So this leads to an investment margin which is 3 basis points lower compared to the level of last year but is flat compared to the level that we had in Q1. So what is important here is that the gross investment margin, which is the difference between the current yield and the technical guarantee, this margin is stable. So as the current yield are coming down, also the guarantee are coming down. And then clearly, we can credit more or less to the policyholder, and this can lead to a higher or lower investment margin.

I want to point out that we had changed for 2019 the guidance from 80 to 85 basis points of investment margin to 75 to 80 basis points just to recognize that, in this moment, we have a higher credit into the policyholder, especially in Allianz Life. But this is not a change to the guidance of our operating profit, so we stick clearly to our outlook for 2019 and also, clearly, we stick to our outlook for the future.

And the reason is that we have also other profit sources, which are clearly getting more and more important. And also, I will say we see also a little bit of a higher growth in the amount of business, so this is also creating additional profit. So change in the guidance on the margin doesn't mean that we are changing the guidance on our expectation for the profitability of the business.

And with that, I'd like to go into Asset Management where we have also a very good story. As you see at page 27, we have about EUR1.6 trillion of assets under management. I'm referring here only to the third-party assets. You can see also nice dynamic on net flows. Especially at PIMCO, you can see EUR23 billion of flows in the second quarter. We had also substantial inflows in the first quarter. So I will say the flows dynamic at PIMCO is very good. In the case of GI, we see some outflows, but I will say they are kind of moderate. And when you put PIMCO and GI together, the flow situation in Asset Management is very healthy.

Also, we had benefited from the change in the market value of the assets because interest rates have gone down. So as we always think about the impact of interest rates and we think about the negative impact that lower interest rates might have in, for example, the Life side, on the other side, we need to recognize that, that can also create additional value in Asset Management because we have a higher asset value. So all in all, I will say, good flows, favorable market condition from an Asset Management point of view, leading to record third-party assets under management, which is also something which can help as we go into the second part of 2019.

At page 29, the revenue, broadly flat compared to the level of last year. Indeed, if you exclude the performance fees, a little bit higher compared to last year. Once you include the performance fees, which went down a little bit, then the revenue is slightly negative. But overall, I will say, a good result on the revenue side, too.

And when we look at the margin, you can see that the margin at PIMCO is 0.7 basis points lower. This is driven by the acquisition of Gurtin, and also, there was a slight change in business mix between retail and institutional. But fundamentally, we are speaking of small movements, and in the case of AGI, you see even an improvement compared to the level of the second quarter of 2018. So I will say, fundamentally, also from a margin point of view, we see rather stability. We don't see any significant change compared to the prior period.

At page 31, the operating profit is flat if you adjust for the FX effects. Here, we need to consider, however, that it's flat despite lower performance fees. So the performance fees are, by nature, a little bit volatile. The point is with an operating profit of about EUR700 million for the quarter, I think the line of business has performed very, very nicely.

And in general, you can also see that the cost to income ratio is going down. This is mostly driven by AGI, but also the cost to income ratio of PIMCO is very good with 57.5%. So I will say, good flows, stable margin and also a nice operating profit of about EUR700 million.

With that, to page 33. Our corporate segment is also improving, and here, you see an improvement of the operating profit of about EUR60 million. Half of the improvement is driven by better results at our IT company, providing internal services for our operation. The name is Allianz Technology. So we have better results there. And also, we have better result on the investment income because we -- differently from the situation in Property-Casualty, we got here more dividends compared to last year. So all in all, a good development also on the -- in the corporate segment.

At page 35, just a few comments on the nonoperating items. As you see, they are better compared to last year by about EUR90 million. If you look at the numbers, the realized gains net of impairment are below last year. But on the other side, last year, we had a negative impact due to the transaction in Taiwan, and also, the restructuring expenses are a little bit lower this quarter compared to what we had in the second quarter 2018. So all in all, I will say, a little bit of an improvement, especially driven by the fact that we didn't have the impact like in last year from the Taiwanese transaction.

On the tax rate, we see an improvement of 3 percentage points. And here, we have a couple of effects. First, we have an increase in deferred taxes. And the second point is also, we have a release of reserve for tax uncertainty. So when you adjust the effective tax rate for these two impacts, then we will be at 25%, which is at the lower end of our range. But all in all, good operating profit, better nonoperating items and lower tax rates are leading, as I was saying before, toward 13% increase in our net income.

And with that, I come to the last slide. Again, strong results for the quarter and, I will say, strong results for the six months. In Property-Casualty, we are making progress on improving the expense ratio. In Life/Health, we saw, again, double-digit in VNB. In Asset Management, we are seeing positive net flows for the first quarter, for the second quarter and also, in reality, for -- the July month has been positive. And so all in all, we have a strong position at the half of the year. So at this point in time, we are clearly confirming our outlook for the remainder of the year.

And with that, I would like to welcome your questions.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Peter Eliot from Kepler Cheuvreux. Please go ahead, your line is open.

Q - Peter Eliot {BIO 7556214 <GO>}

Thank you very much. I'll try and limit myself to three questions. First one was on the expense ratio. I mean the obvious question is whether that's fully sustainable. It's obviously a very strong number. But I guess, I mean, even stronger -- on an absolute basis, I mean, on a relative basis, it's perhaps even stronger given that a lot of your peers are sort of seeing expenses creep up, largely through the acquisition expenses. I know you can't comment on those, but -- as well as the absolute ratio, I'm just wondering whether -- if you can say whether you're sort of immune from those industry trends?

Secondly, on the Life investment margin, I take all your comments, Giulio, and I discussed it with IR this morning as well. But I guess there's a bit of a change in message between Q1 and Q2. And I'm just wondering, is there anything in particular that's happened that sort of caused a slightly higher policyholder participation and forced you to change that guidance? And I'm hoping you can add maybe some comments about where we should expect it to go beyond 2019?

And then final one is on Allianz Technology. I guess we had very good results last quarter, and I came away from the Inside Allianz Series thinking that, that was maybe a little bit of a one-off. But you've delivered again, and the investment result is also looking quite sustainable. So I'm sure you're expecting the question, but is it time to revisit the outlook for the corporate segment going forward? Or are these genuine sort of one-off results? Thanks a lot.

A - Giulio Terzariolq

Okay. Thank you for your questions, Peter. Maybe I'll start from technology. It's not a one-off, so we expect technology to run better this year compared to what we saw in the past. So I will say the performance we are seeing at technology is also more or less in line with our expectations. In the sense of changing the outlook for the corporate segment, I will say, I don't do that, but if -- you are free to do that, if you want. But for the time being, I will keep the outlook at the same level. This shouldn't be a huge surprise if we are going to be better than our outlook of EUR900 million at the end of the year. Now for the time being, I'd like just to keep the numbers stable, but definitely, the trend that we see in the corporate segment is going the right direction.

On the investment margin, yes, it's a little bit of a change in what we said before, but I will say we had already kind of anticipated that's the measure that we need to always take a look. I will say what has changed. One could just say that we had 19 basis points in Q1 and we see 19 basis points again in Q2. So when you see that we are sticking to the 19 basis point, then there is a point where you're going to say this is not going to necessarily revert. And I tell you, even more, it's not even needed, a reversion, because we are anyway confident we can get to our operating profit also with this kind of investment margin.

What is happening anyway, especially in the U.S., we see a lower investment margin compared to what we had before, and this is a combination of two things. First of all, because of the tax reform, we can do lower spreads and still get to the same kind of IRR after tax. And clearly, how much of this, let's say, tax reform benefit are we keeping for us and how much are we giving to the policyholder, this is something that we can somehow adjust also based on market condition. But there is a little bit of that point that with a lower margin, we can still get to the same kind of returns that we expect to have on an after-tax basis in the United States.

The second point is also as rates are going down, there is always a little bit of a catch-up effect. You need to change your products, your crediting ratio, you are always catching up a little bit. So this is also something that can, in the short run, cost some basis point in investment margin. But all in all, I will say we are feeling pretty confident about the level of profitability that we have in our Life segment right now.

The last point was on the expense ratio. I will look at the six months because every time you look at a quarter, I would say it's a little bit too limiting. When you look at the six months, we are at 27.6%. And we said that we want to be below 28%, so I will say that it's very likely that we are going to be below the 28% threshold by the end of the year. And your question about sustainability, absolutely, this is supposed to be sustainable. In reality, our intention is to bring down this expense ratio over time. So that is actually the point. It's not the idea to decrease the expense ratio one year and then to -- maybe to have a huge decrease in expense ratio one year and then maybe to go back up. I -- our idea is to bring it consistently down over time in a steady fashion.

And you were referring to competitors or industry trend. On the expense side, I will say it's not so much about industry trends. It's not something like frequency or severity of claim losses. This is really a matter of how much emphasis you put on productivity, and I can assure to you that in the last 24 months, we have become obsessed with the idea to reduce the expense ratio. So I would say it's a matter of attitude. So we are totally committed to bring this expense ratio down. And it looks like it's working, and I'm pretty confident that in the future we are going to see a further reduction of the expense ratio compared to the level that we had last year or the 28% minus that we want to have this year.

Q - Peter Eliot {BIO 7556214 <GO>}

Right. Well, thank you very much.

Operator

Thank you. Our next question comes from Michael Huttner from JPMorgan. Please go ahead, your line is open.

Q - Michael Huttner {BIO 1556863 <GO>}

I think you've covered most of your points in your introduction which is so detailed, so thank you, Giulio. But on AGCS, low reserve release, and why -- what does the unchanged outlook kind of imply? AGCS, I'm seriously worried because my colleague who sits next to me covers Swiss Re, which is CorSo. CorSo, of course, has your ex-manager now running it. And they've had a big adjustment. So whenever I hear the word adjustment refer to something in commercial and I think, oh my gosh. I heard this is not going to be the same scale. And I wonder if -- how you can reassure us here. And maybe you can give us something a little bit more specific, there's a CVA thing in the U.S.?

The second point is on the low reserve release. Here, I'm guessing because I didn't do all the math, I'm sorry, but Spain cost you EUR50 million in the quarter. So that's half of the EUR100 million, the 80 bps lower reserve amount in the quarter. I just wondered what other moving parts are there or what can we take away here? Is this something that's -- because the underlying combined ratio is fantastic, but you worry about every moving part.

And then in terms of operating profit, if you've done EUR6.1 billion the half year, you leave a guidance -- and here, I'm by taking the midpoint of EUR11.5 billion. It kind of implies EUR5.7 billion for the second half, which kind of -- sorry, yes. Anyway, it kind of implies a run rate of about 12%, something like that, lower in the second half. And here, I'm wondering, is there stuff that you're seeing particularly on the investment income side that we should think about? Thank you.

A - Giulio Terzariolq

Perfect. Okay. Let's start with AGCS. I'm not so sure what kind of country manager you were referring to, but -- okay. So talking about AGCS. In our case, I will say, first of all, clearly, the 101% combined ratio for the quarter is not the level that we'd like to see. So we can start from there. Also, considering, to be perfectly honest, that we didn't have significant natural catastrophe in Q1 of -- in the second quarter 2019. So the starting point clearly is not the starting point we'd like to see. But the good news in the case of AGCS is that we see a hardening of the market. And also, clearly, we are taking a stronger -- we are reviewing in what kind of lines of business we want to be. So we are not just thinking about price strengthening. We also think about potentially the underwriting lines of business and making choices about the portfolio. So from that point of view, I will say there is work to do. But a good part of the story is that, at least now, the rate changes are going in our favor. We don't need to fight against the tides anymore. This can help definitely a lot.

I think your other question, if I understood you right, on the child abuse. We didn't -- based on what happened in New York, right now, we didn't see the necessity to do any change in our reserving. Clearly, as the New York position might extend to our state, this might lead to a different conclusion. But I will say that in our case, the exposure should be -- considering the diversification of our business, should be always relatively modest. But I can just tell you that based on the information we have now, we didn't see the reason why we should increase the reserve, but clearly, this assessment might change in the future.

Then your other question on the Spain situation, the runoff. I can give you the number there. If you look at the swing in runoff as -- in the combined ratio of Allianz Spain, I was mentioning this is all driven by the runoff. So if you take the 7 percentage point and you run the math based on the NPE, net premium side of the company, you have an impact for the group of about 20 basis points. So I will say that when you look at the runoff for the six months and you run the math, you can see that you have about 20 basis points lower runoff at the group level because of the development in Spain. I think this issue is going to go away next year. So we are not necessarily going to revert to positive runoff in Spain in 2020, but I'm pretty confident that in 2020, we are not going to see a negative runoff in Spain.

And then your last question was on the outlook for the operating profit and why we are not changing the -- our outlook. I will say when I look at the outlook, I'll always look at the EUR11.5 billion, plus minus EUR400 million. And I will say as long as it's not completely unreasonable, then we're going to stay within this range and don't change the outlook. So when you have a EUR6.2 billion of operating profits for the first six -- EUR6.1 billion operating profit for the first six months, I wouldn't say that it's unreasonable to expect that we could be below the EUR12 billion threshold. That's a little bit the philosophy that we are using here.

I answer your question in AGCS because I could not really understand...

Q - Michael Huttner {BIO 1556863 <GO>}

Yeah. No, sorry. AGCS, this is kind of -- it's a deeper worry simply because Swiss Re has had such challenges on its industrial lines unit, which is just called corporate solutions. And so I was worrying if there's something like that within AGCS. If you start reunderwriting, do you have to take big reserve adjustments or anything like that? That's really the background.

A - Giulio Terzariolq

Okay. I wouldn't expect that we should have big reserve adjustment. I could not disclose that we might have some minor reserve adjustment, but I will be -- I will never say never because in life, you should never say never. But I will be surprised if we won't have significant reserve adjustment in AGCS.

Q - Michael Huttner {BIO 1556863 <GO>}

Thank you so much. Thank you.

Operator

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

Q - Jon Hocking {BIO 2163183 <GO>}

Thank you. Good afternoon, everybody. I've got three questions, please. Firstly, on France, I wonder whether you're happy with your P&C combined ratio in France? You've got quite a big gap to see some of your peers now. So wonder if you talk a little bit about what's happening in the French P&C business?

Secondly, just to come back on AGCS. Can you give us some color, please, in terms of what you are seeing there in terms of rate momentum on different lines since the turn of the year? Or whether that's changed your appetite for any particular part of that business?

And then just finally, on the LV business. Could you give us some idea of what the appetite is when you (inaudible)? And what your philosophy is going to be there in terms of market share versus profitability? Thank you.

A - Giulio Terzariolq

Okay. I start from France. I will say that the 97.9% combined ratio that you see for the second quarter is clearly not the level of combined ratio we'd like to see. This said, in France, we see large losses. So that's the driver for that performance that we are seeing right now. And this has been, by the way, a topic also for a few quarters. So we are taking a look into that, and especially we see a large loss in our property portfolio. So we are a taking a look at that.

But fundamentally, I will say, we think we can definitely put action in place to bring this combined ratio to a better place because 97.9% is definitely not the level of expectation that we have for France. But the main reason for the numbers you are seeing is the amount of large losses. And clearly, as usual, you need to determine how much of these large losses is because of volatility and how much might be that we need to refine the underwriting. There was something that Oliver mentioned before. We know also that we have some work to do in the commercial lines, and that's definitely one of the topics that Oliver was mentioning. This will be definitely the case also for France. So I will say this is something that we need to tackle.

I'd like also to make a comment. These are also all opportunities because as you see, we have a very strong combined ratio. And that's good sometimes to have also some area where we have some room for improvement because these allow us also then to improve in totality our combined ratio.

On the AGCS side, I will say we see rate increases more or less across-the-board. I would say the only exception will be in the liability business. We see lesser rate increases. Otherwise, you see significant rate increases. When we put all the math together, we are at about 6 percentage points of rate increases. And the point is how long we are going to see these rate increases. That's, for me, the most critical factor.

And then also the second question would be are we going to see inflation in the loss trend or not. My expectation is that rate increases are going to go for a while. So I believe this is the beginning of a hardening, not necessarily the end. Otherwise, the process of the hardening will be too quick. So in general, we see a different momentum right now, and that's definitely going from a correction. That's the way I define what was happening in the industrial business at the beginning of the year. Now I will say we are going to a year of hardening from my point of view.

And then the last question was on the LV business. I will say definitely, we are going to look for profitability, especially in a situation where you are bringing two companies together. It's not about chasing market growth or market share. That's more about consolidating the business in a way that you create a very good franchise. And in general, I will say we are not a strong believer that you should go for market share, market growth. I strongly believe that if you go for market share and market growth by pricing differently, this is a recipe for disaster. So market growth, you get there because you have better customer service or these kind of things. And in my opinion, this happens, right? It's not something -- so you work hard to get to a better customer service to do all the right things, and eventually, this is going to translate into a higher market share. But that's more the results of hard work, and this is something that is not even easy to plan, if you ask me.

Q - Jon Hocking {BIO 2163183 <GO>}

Okay. Thank you. Very clear.

Operator

Thank you. Our next question comes from William Hawkins from KBW. Please go ahead. Your line...

Q - William Hawkins {BIO 1822411 <GO>}

Hi. Thank you very much. Giulio, can you hear me?

A - Giulio Terzariolq

Yeah.

Q - William Hawkins {BIO 1822411 <GO>}

Yeah. Good. First of all, can you just summarize -- you talked about some of the key points, but the 1 percentage point improvement in your combined ratio that you still need to achieve to get to your business plan, can you just help me understand the balance now of where that that's coming from, expenses versus claims? You just said that your expense ratio could have further to improve. You are already, in the first half, close to the 27.5% that was part of your target already. So either you're going to carry on blowing through your target or that figure is going to be normalizing? And can we get some further improvement on the loss ratio side? So if you could just summarize for me the walk from 94% to 93% from here, that will be helpful.

And then secondly, within the combined ratio, I'm sorry to come back to Spain. I know you talked about this in the first quarter, but I'm still a little bit confused about what exactly has gone wrong. You talked about whether from last year deteriorating, you talked about the motor book. So I understand sort of the facts, but I don't really understand the why it's gone wrong in Spain. And I guess the reason I'd like to just get a bit more color on it is so far, Allianz has been using Spain as a test case for excellence that the rest of the group needs to learn from. And now all of a sudden, there seems to be some reserving volatility that implicitly could point to some pricing uncertainty or whatever. So I'm just not sure the extent to which I should be worried that the shine is coming off Spain, if you like.

And then lastly, just briefly, forgive me if I misheard you. In terms of the investment margin, to Peter's question, you talked about what's happening in the U.S. But I thought during your prepared remarks, you talked about increasing allocation to German Life policyholders in the investment margin. And I wondered if you could just give a bit more detail on that because the general trend I've heard in the low-yield environment is decreasing what you're allocating to policyholders. So how come your German Life policyholders are earning up so lucky? Thank you.

A - Giulio Terzariolq

Okay. Maybe I start with the expense ratio. And -- or from the improvement of the combined ratio, mostly come from the expense ratio, mostly come from the loss ratio? So what we said is when you start from 2018 as a reference point, our combined ratio was 94%. Somehow in that combined ratio, we had a 4 percentage point of runoff. We always said the runoff is going to go down to 3%. So at the end of the day, we need to improve the underlying by 2 percentage points. And the idea here is that 1 percentage point should come from the loss ratio, 1 percentage point should come from the expense ratio. I will say as we go through the quarters and so on, you can see some movement in the expense ratio/loss ratio. But fundamentally, I will say this is still the kind of guidance that we have. So at the end of the day, we would expect that we're going to have an expense ratio which is approaching the 27%. In reality, even better compared to the 27.5% that we discussed in the Capital Market Day. So that's something that clearly we are striving to achieve. And the rest of the improvement should come from the loss ratio. So I would say start almost from a 95% because you want to adjust for the 1 percentage point less runoff and then assume that 1% is coming from expense ratio and the other half is coming from the loss ratio. Is this clear? Does that answer your question?

Q - William Hawkins {BIO 1822411 <GO>}

Crystal clear as always. Thank you.

A - Giulio Terzariolq

Perfect. And then, on Spain, I will say what went wrong. As I tell you, sometimes it's overconfidence I will saw. So at the end of Q4, by the way there were weather-related claims in Spain affecting the numbers. And somehow we didn't recognize the impact of these weather related claims. Also, we have been a little bit too aggressive in the estimation of the loss ratio for model. So these two things have led that we have been too confident on our numbers for 2018. And now, clearly, we need to catch up on that. But as I was saying before, the combined ratio, the accident here is 93.

So I will tell you the following. I believe next year we're going to see what the numbers of Spain are. And if I'm right and Spain is going to be back to the 93 combined ratio that we see and there will be no negative runoff. I can tell you, there will be a great story, because at the end of day we are a company that is performing very nicely for many years.

Somehow sometimes, you can also get something out right. And if we had the ability, that I believe we have, to go back to 93, in my opinion the story of Spain is even stronger than before. So I will not throw the baby with the bathwater here and then start assuming that because of what happened in 2018, now all the good things of Spain are not valid. This is a company running at an expense ratio of below 20%. So this is something clearly that is telling you about the quality of the company, and now we just need to fix a little bit this issue coming from last year. And then let's wait for 2020. And I really hope I'm right because there will be really a good story to tell in just a few months.

And then your other question on the investment margin on the policyholder. I -- Because I need to look at (inaudible). I think I would always distinguish anyway between the IFRS logic compared to the HGB logic. So I will say the two things are not necessarily the same also because, for example, the investment income recognition can be read differently between the German GAAP and IFRS accounting. So from that point of view, you shouldn't draw conclusion from HGB that you transfer into IFRS. When I look at the investment margin of Allianz Leben in the IFRS view for the quarter, that margin was pretty stable.

Q - William Hawkins {BIO 1822411 <GO>}

That's great. Thank you.

A - Giulio Terzariolq

You're welcome.

Operator

Thank you. Our next call -- question comes from Jonny Urwin from UBS. Please go ahead, your line is open.

Q - Jonny Urwin {BIO 17445508 <GO>}

Hi, there. Thanks. Just two for me, please, both on P&C. So AGCS, I mean, I guess there's some concern today around performance given we're seeing two companies over the last five years just consistently underperform in this line with commentary from management that there's going to be a gradual correction. It never really worked until there was a sort of big, big remedial actions taken across that book. So I guess why -- similar to Michael's question, why is it different for you guys? How can you give a some reassurance, I guess, that the pricing environment is better at the moment?

And then secondly, a very quick one. Where is claims inflation running at the moment across the book versus your price increases of 2.4%? Thank you.

A - Giulio Terzariolq

Yeah. So -- and as you said, that I would like to say that we have a combined ratio 101%, so depends how you define success, but we wouldn't define this as being successful. So to a certain degree, I will say we are sharing the pain that you see in the market at a different level. We have been seeing that, in general, over -- in the last years, we have been able to outperform our competition. But clearly, somehow we are exposed to the same dynamic. And I will tell you even more that sometimes you get comfortable because you are outperforming the competition. But eventually, your combined ratio is also above 100%. So I don't think that we are seeing anything differently from what our competitors are seeing. We just see this at a lower level because up to now, we've been able to outperform what our competition has done. Then we have a couple of things. In our case, you need to consider that we had a drag out of the old FFIC business where we are now somehow transferring -- we are doing a migration from the old system to the new system. So this is about 1 percentage points for the combined ratio of the company. It's about 1 percentage point. So this is going to go away anyway by 2021, latest 2022. So we should see a little bit of an improvement coming from there.

And then clearly, there is some hardening going on right now, and that's also not to be underestimated because continuous hardening in a couple of years can lead to very different results. And then as I was saying before, we have put a lot of emphasis also on looking at the portfolio, what kind of portfolio we want to keep, what kind of portfolio we think is not structurally profitable for us. And we are going to take a clear look, especially the United States. But again, we are somehow exposed to the same dynamic. We are just running at a better level.

On -- then you had a question, I believe, on claims inflation. And I think you are referring to claims inflation in General. I would say that what we see in Continental Europe in -- I will say we see this in a few markets. We see that severity model is going up a little bit, and that's because the cost of the spare parts is going up. So we see this in Germany. We see this also in Italy. On the other side, there are other parameters which are moving in the opposite direction. So we don't necessarily see an increase in frequency.

So when you look at the totality, I will say there might be some pressure here and there. But I will say, in general, the price increases should be definitely able to compensate for this kind of pressure but maybe just a little bit more an uptake in severity this year compared to what we saw 12 months ago. But again, in general, I will say the situation is pretty much under control.

Q - Jonny Urwin {BIO 17445508 <GO>}

Okay. Thank you.

Operator

Thank you. We will now take our next question from James Shuck from Citi. Please go ahead. Your line is open.

Q - James Shuck {BIO 3680082 <GO>}

Hi, good afternoon, everybody. Three questions from me, please. Firstly, Giulio, the liability duration on the Life side, it increased by frankly a whole year actually in the quarter year-on-year. Can you just explain a little bit about what's happening there that -- to lengthen that?

Second question, interested by the opening remarks from Oliver re talking about commercial lines and the need to do more on that side of the business. Are you able to sort of split the P&C business into how you would see it between kind of retail, maybe SME and larger lines of business, and perhaps give some insight into the combined ratios on those basis, please?

And then final question, again, returning to France but more on the Life side, really. Operating profit in Life was down 18%. You talked about a lower Protection and Health results, in particular. So just keen to know what the moving parts were within that, please? Thank you.

A - Giulio Terzariolq

Yeah. So on the liability ratio, yes. If you look, it went up. And also, now we are longer on the liability compared to the duration we have on the asset side. Here, I will say, just the fact of rates going down and the complexity of the liability is stronger compared to the complexity of the assets. So we are catching up. At the end of the day, we don't want necessarily to be short duration. That's not the position we like to have. But here, we are constantly catching up because the interest rates are constantly going down. You need also to consider it's not so easy to move the duration one-to-one right away. So -- but fundamentally, this is just a consequence of rates going constantly down and our ability to adjust the duration accordingly. There is always sort of a time lag.

On the commercial lines, I'll tell you something. So I was looking at the commercial line profitability in the different country. And I will say when you look at commercial lines, in general, and you look at our retail business, I could tell you it's not everyday that the commercial lines are so much worse when you look in totality. It's maybe, I will say, a couple of percentage points worse compared to retail, in general, the combined ratio in commercial lines. And here, we are not speaking about AGCS. I'm speaking of France, Italy, Germany. The point is within the commercial lines books, you might have really interesting portfolios. And we have portfolio where, honestly speaking, the combined ratio can be even 110%. So that's the issue. And if you were to be very -- to go very granular, and then you're going to see that somehow, we are definitely losing some profitability because of some businesses which are -- portfolio which are severely underperforming. When you look at the commercial book, in general, if you don't go granular, you're not going to see all this kind of disparity between retail and commercial lines.

And the last question was about the protection. The protection side...

Q - James Shuck {BIO 3680082 <GO>}

Yeah. Sorry. And, no -- yeah, we see a reduction in the operating profit in the Life side in France, which was driven by a lower technical result from Protection and Health?

A - Giulio Terzariolq

Yeah. There's -- it's a deterioration of the loss ratio in Protection and Health. Just to give you an idea, if you have a 2 percentage points, deterioration is about EUR800 million of premium. In the quarter, this is already making EUR16 million of our operating profit. So there is a little bit of a deterioration. I wouldn't call it a trend. It's just some volatility in the quarter.

To be more specific, anyway in -- just to give you an idea about the French book, we are very happy with the performance, in general, in individual health. And I will say on the corporate health, that's a book which is a little bit more challenged. But the deviation you see here in the quarter, I will say, this is more kind of volatility -- quarterly volatility.

Q - James Shuck {BIO 3680082 <GO>}

Okay. Thank you very much.

A - Giulio Terzariolq

You're welcome.

Operator

Thank you. Our next question comes from Farooq Hanif from Credit Suisse. Please go ahead. Your line is open.

Q - Farooq Hanif {BIO 4780978 <GO>}

First question on AGCS. We have seen others talking about not only pricing but pricing in different lines and areas where they want to bounce off and areas where they want to grow. So for example, marine and aviation has been an area that a few of your competitors have talked about falling out of. I was wondering if you could talk about mix? And also excluding the Fireman's Fund portfolio, when do you see a return to profitability?

The second question is to what extent do you think you can offset some of the yield pressure with your liquid investment strategy? And third question is just a confirmation on the Ogden rate. When you made the comment that it doesn't affect Allianz, does it affect LV? Thank you.

A - Giulio Terzariolq

Let's start with the last one. The Ogden rates, it doesn't affect Allianz, including LV. We are also considering for LV. They have -- I'm not going to speak about LV. But in general, when we put together our books and the effect on the LV side, we get to a very immaterial amount. And by the way, the amount is slightly positive, not even negative. But I'm clearly considering also for the effects coming from the -- at-equity consolidation of LV into our numbers. So that's on the Ogden rate.

Then on AGCS, I'll just tell you. So as I was saying before, we see fundamentally a hardening across-the-board when you are asking when we are going to be at profitability. If you define profitability as being below 100% combined ratio, I really hope that we're going to be below 100% next year. So that would be definitely the idea. And personally, I'm not giving up on the idea that we try to get to 96% by 2021. So I'm not -- I don't say we are going to be able to get there. But personally, I'm not giving up on that idea, at least I'm not giving up on that right now.

The drag from the U.S., I think it's pretty significant, especially MidCorp in the U.S. We are running with a combined ratio which is well above 100%. And so this is also something that we need to consider, to what extent this is a business where we want to do a stronger pruning, let's put it this way. And the issue we have in the U.S. is also an expense ratio issue. So we are running at a very expense ratio also because of the double cost of integration but also because the skill we have there is limited. So I will say this is definitely an area of focus. In reality, if you run the numbers of AGCS without our U.S. business, you get already now to a combined ratio below 100%. So that's the situation. And now by adjusting AGCS with the U.S. business, we are below 100%.

Otherwise, from a line of business point of view, you were mentioning marine. In marine, in this, the line of business has been performing at about 100% combined ratio for the last years. But now we see rate increases that should bring this performance more in line with our target. In reality, marine, we are exactly getting the rate increases that we need to get to get to a profitable place.

And then you had a third question that I'm not sure I captured. Can you repeat, please? You have...

Q - Farooq Hanif {BIO 4780978 <GO>}

(inaudible)

Q - Unidentified Participant

I think, we're done, right?

A - Giulio Terzariolq

I thought you had another question, sorry.

Q - Farooq Hanif {BIO 4780978 <GO>}

Yeah. The Illiquid (inaudible) material -- can you materially kind of change the decline in yield through investment strategy?

A - Giulio Terzariolq

I would say there is a point where I believe you can always do something on the investment income to try to cushion the decline in yield. But as only we were saying before, sometimes you need to open other fronts in a sort of awards or you are going to work a lot on technical excellence, on the productivity. So I think the idea that we are going to fight a low interest rate environment with an extremely low interest just by changing our strategic asset allocation and getting more illiquid and getting more risk, that would be a bad idea. There is definitely something we can do there, but I believe we need to work on really even hard on the fundamental of the business. The good thing is it's not new. So honestly speaking, interest rates have come down for years now. And now we were thinking maybe they are going to stop to go down. It looks they're going down further, but the recipe is always the same. So working on the combined ratio, working on the right results in P&C. On the Life side, making sure that our liability matching is there, which has been the case in -- for our in-force, making sure that we are constantly adjusting the products to the environment, that we are constantly adjusting the crediting rates to what we see in the market. So the recipe is always the same. So I think we have been training over the last four or five years, and now we will continue to deploy our skill set in this area.

Q - Farooq Hanif {BIO 4780978 <GO>}

Thank you very much.

Operator

Thank you. Our next question comes from Vinit Malhotra from Mediobanca. Please go ahead. Your line is open.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes. Good afternoon, everybody. Giulio, just one. So even in your Bloomberg interview and in your opening remarks as well, you were talking about -- and even just now actually, you were talking about how the low interest rates, you're -- you want to work more on the Life new production, for example, and how to change it. But when I look at the VNB, for instance, I mean, even in Germany, it's up 24% in Q2. In the group, it's 11% up, 2Q. But -- and even over a longer term, it's up substantially, maybe even doubling in the last 8 to 10 years. I mean, how -- is there more room left to change these products' mix? And I'm conscious that the early answer (inaudible). But is there room left? And the second topic related to this is that is there -- I mean ultimately, the VNB will translate into profits in future, but it's based on a series of redemptions. And do you think that any of the low interest rate or lower for longer interest rate concepts are going to challenge some of your assumptions in new business value? But just basically focusing on that area. Thank you very much.

A - Giulio Terzariolq

Yeah. I will say the following, so clearly as you see the new business merge is holding. I would also say that when we look at the -- when we calculate the new business margin, for a European country, we'd always calculate the new business margin with a quarter lag. So this quarter, we are going to use the assumption as of end of Q2. And you're going to see that there will be -- or we expect some decline in the new business margin. We are still going to be above 3%. But then you need to think, Okay. So maybe we're going to have a bonds, or right now we have a bond at minus 50 [ph]. So it's considered that there was a bond at minus 33 [ph] at the end of Q2. So you need to prepare that this situation can get even worse.

And for me, it's also, I will say, regardless of what the model is going to tell you, there is also a common sense kind of view. And when you see that the bond is at a level that we have right now, I think you always want to take action to create some room before the yield you can get and the guarantees you are giving to the policyholders. So from my point of view when we see this kind of trajectory, it's always very prudent to look. First, we need to take a look at the products. And if we see that somehow the economics are different, then we need to clearly adjust the feature. So I don't -- I didn't mean today that we had to change the product. I meant today that we need to take a close look. And potentially, we need to be prepared to change the products, which I believe personally wouldn't be a problem because I -- depending on the market, you might get a different answer. But I believe that we can still offer competitive or interesting features and still change a little bit the level of guarantees that we are giving. So I think there is definitely room for maneuver, and I think it's prudent clearly to take a look at the situation considering that the rate environment is substantially different compared to the beginning of the year.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Can I just ask one second one on asset risk? So the -- on the -- I appreciate the liquid -- illiquid asset answer. But is there -- do you think that there is more room for credit risk in Allianz Group to offset some interest rate yield pressure? It's not your focus, I know, but is there room, do you think?

A - Giulio Terzariolq

I will say that on the margin, there might be always room. But our strategy will really more always look into the liquidity or illiquidity spectrum as opposed to looking to additional kind of credits, yes, getting the credit premium. I believe that again, the answer is not going to be so much on the investment side. Again, we can use something but I believe the answer is to be on the technical part of the equation.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Sure. Thank you very much.

A - Giulio Terzariolq

You're welcome.

Operator

Our next question comes from Andrew Ritchie from Autonomous. Please go ahead. Your line is open.

Q - Andrew Ritchie {BIO 18731996 <GO>}

I'll do some just short ones, I think. I think Oliver was -- in his opening remarks, besides positioning the group medium-term for low rates, reiterating that you could hit your EPS target and near-term target despite low rates. I think just on that, I just want to judge how much harder you have to work in the near term. What is the maturity? How much of your non-Life bond portfolio matures in the next couple of years? Is there a skew to that? I'm just trying to work out the degree of headwinds specifically in Non-Life from low reinvestment rates.

The second question, mutual -- your net inflows were very concentrated into mutual funds, judging from the new disclosure you've provided. Is that retail mutual funds? Presumably, they are -- that's a fairly high-margin net flow then. Maybe just clarify that.

And finally, it's a very simple one. I should probably know the answer to this. When the AGCS reports rate increases in its reported accounts, which they publish, they say plus 6.3%. But your slides say plus 4.8%. What's the difference? Thanks.

A - Giulio Terzariolq

Yeah. Okay. Starting from the Non-Life, on the Non-Life side, we are reinvesting per annum about EUR20 billion of assets. So if you think of a 10 basis point decline in the investment income, there will be about EUR20 million. So from that point of view -- then clearly, this is going to roll over the period. But let's put this way. On the P&C side, if you ask me, I will say it's manageable. So it's definitely a headwind. But I will say is that headwind can be manageable, considering that to offset a EUR50 million, let's say, lower investment income, you need to have an improvement in the expense ratio, let's put it this way, or 10 basis points. So that's the number. So from that point of view, I will say on the P&C side, it's definitely manageable.

On the Asset Management side, by the way, the short term can even be an advantage. So from that point of view, even if you get some drag on the P&C side at the beginning, that would be compensated by better results potentially on the Asset Management side. And in the Life side, clearly, it's a different kind of game. In that case, you need to lower the credit generation. You need clearly to manage the book over time. So I will say it's definitely, if you ask me, a headwind, but I will say it's a headwind that we have been having to a certain degree over the last three, four years. And from that point of view, I believe we have the skill set to manage this kind of a headwind. That's also the reason why we are still sticking to our kind of expectation for the future. And then clearly, as we go through this time, we are going to reevaluate this situation. But fundamentally, you should have the confidence that we can manage this kind of situation.

Then you had a question on the mutual funds. Yes, they are mostly retail mutual funds. So from that point of view, usually, the margin we get on that business are higher compared to the margin that we get in institutional account, that you always have to look whether it's equity versus fixed income because in equity, you're going to get higher margin compared to fixed income. So there are a lot of things going into that. But fundamentally, in the retail space, we have a different kind of margin. I tell you also more that the difference in margin between mutual funds or institutional kind of mandates can be different in Europe versus the United States. So you see more of a gap sometimes in Europe compared to the gap you might see in the United States.

And then your other question on the difference between the four point -- the numbers that we have in the renewal versus another number that you saw. The 4.8% is more coming almost from our accounting kind of system where the other number is more, I will say, the real number that can be used for the rearview coming from the underwriting about the price strength. So that's the difference between the two.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Okay, great. Thank you.

A - Giulio Terzariolq

Okay, before we continue we have time for one last question if there's any.

Operator

Thank you. We will now take our last question from Michael Haid from Commerzbank. Please go ahead. Your line is open.

Q - Michael Haid {BIO 1971310 <GO>}

Two questions. First on the Life and Health new business margin, 3.6%. You mentioned that if you had applied the yields -- the yield environment at the end of the second quarter, then it could still be above 3%. Can you provide a breakdown of what happened -- what would happen to the new business margins to -- of your various types of products on page 19, so Protection and Health, unit-linked and so on, the -- especially the guaranteed savings and annuities, 2.3%? Where would that be in this current interest rate environment?

Second question on the low interest rate environment. I assume many fixed income securities you have in your portfolio currently trade at a negative yield. Probably it makes sense to sell them before they mature. So what should we think of realizing capital gains from this -- in this year? Should we expect some more to come? And how would that affect your net profit? Should we think about some compensating items? These are my two questions.

A - Giulio Terzariolq

Yeah. So on your first question about the new business margin, how to split it in the different buckets, I -- we did a good -- so I didn't look at assets in this way. But I can tell you eventually, the drop is coming both from the guaranteed savings and annuity and from the capital-efficient product because I wouldn't see the unit-linked moving much because in reality, you get a lower -- if you want a lower projected run rate, to say. However, the discount is also going down. So I would expect that on the guaranteed savings and annuity, you see it at now 2.3%. The number could go below 2%. And in the case of the capital-efficient product, I would expect that we are going anywhere to be above 3%, but that might be the moment more or less consistent with the 3.6% becoming 3.2%. So we expect potential rate to be stable. I would expect even to go up potentially because you have lower interest rates. Unit-linked with guarantees also to be fairly stable in capital-efficient product, I would say we are going to get below the 3.5% I would expect. And in the case of the guaranteed savings and annuity, I would expect that we are going potentially to be below 2%. So that will be my...

A - Oliver Bate {BIO 19184930 <GO>}

Yeah. Below 2%.

Q - Michael Haid {BIO 1971310 <GO>}

Yeah. Below 2%. The guaranteed savings and annuity, does that basically look like Germany or what is it?

A - Giulio Terzariolq

It's mostly Germany where we have also -- it's not necessarily group Life, but it's mostly Germany. Then we have also something in France, and then we have more blocs here and there. But it's basically Germany, definitely a big chunk, and then we have also France.

Q - Michael Haid {BIO 1971310 <GO>}

Okay.

A - Giulio Terzariolq

Then the other question about selling bonds. I'm not the Chief Investment Officer here, so I would say I leave this to the Chief Investment Officer. As a CFO, I will say we are matching our liability. If you start selling the bonds, yes, you create realized gains, but then you have a lower income going forward. So from that point of view, I would say that selling bonds, at least for an insurance company, might not be the best action. If you're clearly a trader, you have a different -- you have a view that interest rates can just go up from here. Then you might decide to sell bonds. But in our case, I think we need to stick to our asset-liability kind of matching. In reality, this makes the difference. The fact that we have been buying the bonds, and these bonds are there producing a nice current income to match our liability, this makes a difference compared to somebody who's going to sell -- I don't know, whatever you do, you go short, you go wrong. And then you end up maybe making the wrong bet, and then you have a problem down the road. So I think we stick to our approach, which is asset-liability management. And we are not going to speculate on the direction of interest rates.

Q - Michael Haid {BIO 1971310 <GO>}

Can you say how much of your -- how many of your bonds currently trade at negative yield?

A - Giulio Terzariolq

I don't know, but I would expect that the entire German bonds -- okay, we have all the bonds. It's going to be below. And I will say -- if you give me a second, I can even tell you how much bond we had. Yes, we had around -- at the end of the year, for example, we had about EUR30 billion of bonds. That's on sovereign. So this is below, for sure, because everything is below. I will say French bonds, we had about EUR40 billion. That's almost also below. Slowly, slowly, I would say, Italy is the only one that's still positive. Slowly, slowly, it's going to be a risk-weight, too. So I would say there are a significant number now that they are trading below the negative yield, definitely. So at the corporate bonds, I think they are still at positive yield. But on the government side, you see easily EUR70 billion, EUR80 billion of bonds below the yield -- at negative yield.

Q - Michael Haid {BIO 1971310 <GO>}

Okay. Thank you very much.

A - Giulio Terzariolq

Okay. All right.

Operator

Okay. At this time, I would like to hand the call back over to you, Mr. Schmidt, for any additional or closing remarks.

A - Oliver Schmidt {BIO 2473131 <GO>}

Thank you. Yes, this concludes our call for today. Thanks to all of those who have joined us today. We wish you a very nice weekend and for some perhaps even a long and peaceful vacation. Thanks and goodbye.

Operator

This concludes today's conference call Thank you all for your participation. You may now disconnect.
