S&P Capital IQ

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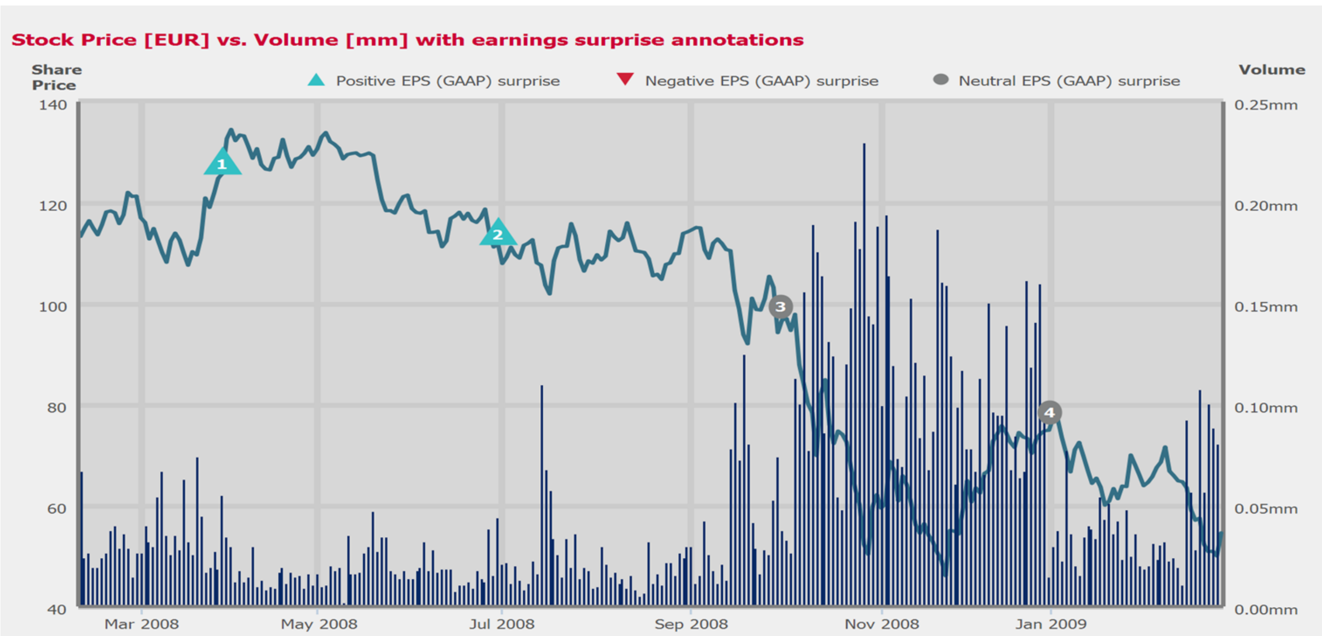
FQ1 2009 Earnings Call Transcripts

Wednesday, May 13, 2009 12:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2009-			-FQ2 2009-	-FY 2009-	-FY 2010-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS (GAAP)	0.47	0.04	(91.49 %)	2.32	8.68	11.54
Revenue (mm)	21185.60	27725.00	26.39	14977.00	86401.52	88776.82

Currency: EUR
Consensus as of May-13-2009 10:31 AM GMT



- EPS (GAAP) -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2008	2.37	2.48	4.64 %
FQ2 2008	3.09	3.39	9.71 %
FQ3 2008	(8.56)	(4.48)	NM
FQ4 2008	(5.51)	(6.92)	NM

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Presentation

Oliver Schmidt
Head of Investor Relations

Good afternoon, ladies and gentlemen. Welcome to our conference call. Allow me one housekeeping remark before we get started. You probably know that our colleagues from Generali have scheduled their conference call today at 4:00 p.m. CET. Actually, we have moved our call forward by one hour and they have moved their call backwards by one hour in order to avoid an overlap. So in order to stick to the plan and to give everybody the opportunity to join both conference calls, we would like to end our call at 4:00 p.m. at the latest. I hope that with only 3 business segments remaining, 2 hours will be plenty of time for you to deal with your issues.

Well, that's actually also my side. And with that, I hand over to our CFO, Helmut Perlet.

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Thank you, Oliver. Good afternoon, ladies and gentlemen. Let's just jump right into the presentation. I think to summarize Q1, my takeaway would be we have coped successfully with the implications of the capital market crisis that is likely due to a pretty conservative and defensive investment portfolio ongoing de-risking, which puts our solvency ratio still on a very good margin in competitive terms, which has also as we will see in a second limit, our downside for potential stresses. And against this background, our core business has proved pretty much resilient, EUR 1.4 billion of operating profit and obviously, I read all the initial reactions on that. I think nevertheless, by and large, is a pretty good result.

Now on Page 3, we have the overview of the results. I think I do not need to comment a lot on that. EUR 1.4 billion operating profit is clearly below Q1 '08, worth EUR 500 million better than Q4 '08. And we have -- net-net, we have net income of EUR 29 million. That has been hit by EUR 395 million final impact from the Dresdner Bank transaction. I thought everybody is familiar with this. We have many often referred to this. I learned different things this morning, so let me just reiterate. This is not because there has been any renegotiations or further discussions on that transaction. This is a pure technical accounting consequence where we have been not allowed to recognize the whole loss of EUR 6.8 billion in 2008, which we would have loved to do, but we had to recognize EUR 400 million of loss in Q1. But again, this reflects the final impact from that disposal.

Our year-end equity decreased by EUR 700 million to EUR 33 billion, adjusted for the Dresdner Bank effect. The main contributors to this movement were the reduction of unrealized gains of EUR 1.1 billion and EUR 0.4 billion of net income from continued operations. Solvency ratio, slightly ahead of what we had indicated end of March before the AGM or at the AGM is at 159%. It benefited from the de-risking outperformance of our equity portfolio and some positive FX movement and has only limited downside risks, which we will see in a second. And just to be complete, it still reflects dividend approval of EUR 1.6 billion for 2008 as well as a dividend approval of EUR 200 million for the first quarter of 2009.

If you look at Page 5, the stress tests, and I think that you are familiar with this. The only one I would like to refer to is the equity stress of minus 30% that would put our solvency ratio down to 143%, which is still a very comfortable level and to make this clear, which would not put us in any way, shape or form in a need for further capital.

Now let me make 2 remarks on that. One point, number one, that whole equity stress test, that also include the liability side. It's not just isolated on equities but take into consideration the change of benefit reserves, which is largely effect of our U.S. business. That is included in the 143%. We have recalculated the respective numbers end of April, April 30. And based on that one, recalculated meaning adjusted the stress test new, and two, in equity update. That would mean that we had 161% solvency ratio and the equity stress test of 30% would put us down to 149%. That is a consequence of further reducing our equity portfolio in the months of April.

Now turning on to Page 6. Let me just briefly explain the new segment reporting structure that we have implemented in Q1. Following the disposal of Dresdner, we have revised our segment structure. I think I've already indicated this in our last call or conference in February. Our continuing Banking operations are now combined with our Asset Management operations and our Alternative Asset Management activities. To give you a brief insight, and you will see more information in the appendices to this presentation, that resulted in a shift of approximately EUR 7 million of operating profit from the Corporate segment to the Financial Services segment.

If I may give you some hint also with respect to the interim report due to the implementation of IFRS 8, we distinguish now between business segments that P&C, Life/Health, Financial Services, Corporate and the so-called reportable segments which now do reflect the corresponding responsibility of our board members. So the good news is if you have one-on-one with my colleagues, you have a clear-cut P&L and you can have a straightforward discussion with them with some regard for myself.

On the group side. Now if we talk about the key indicators, revenues are up to EUR 700 million. Now we record EUR 27.7 billion of revenues. That is if you go back in all the quarters and just look on insurance and Asset Management revenues, it's among the strongest quarters we've ever had. If you look at the gross numbers, 1.5% internal growth. Let me just briefly comment on the 3 segments. Financial Services, we will see that our fixed income business did remarkably well. But all other lines here obviously were impacted in line with market developments. On Life/Health, we see after some difficult quarters, we see now some momentum coming back again that is predominantly due from our bancassurance channels, which are picking up now and is also due to the fact that we see increasing demand in traditional type of product with some minimum interest guarantees. On the P&C side, it was plus 1.1% on an internal basis. As already assumed and discussed, there was fairly little recognizable impact from the recessions, and I think this will continue to be so.

Now on Page 9. I do not think we need to talk about this. It's just the overview and the breakdown of the segments. And obviously, we will come to that in some more details later on. Then let's look on nonoperating items. That contributed minus EUR 1 billion basically, and that's EUR 800 million versus compared to previous year. The main drivers for this development, as you can see on the right-hand side, the lower net realized gains and of some EUR 350 million higher impairments on our equity portfolio. There is 2 major positions or 2 positions we had major impairments. One is Banco Popular, EUR 165 million of impairment and the other one is Hartford, where we had an impairment of EUR 140 million, all based on market values. Now obviously, there was no impairment of Commerzbank. You know that Commerzbank is in our books at EUR 4.56. And obviously end of March, the stock price was higher.

If we look at the other items, I think they are pretty much in line with previous year and what you should have expected, restructuring charges are predominantly related to cominvest and to the restructuring of our Iberian operations, i.e., a more closer integration of Portugal into Spain.

And let me just one remark, we have made one further change. The fully consolidated private equities at that point in time is basically one entity, namely MAN Roland, a German corporation which we fully own at 100%. We have moved them from operating profit to nonoperating profit because we think that, that is a better reflection of the business because at the end of the day, those investments are held for sale and is nothing more than with the rest of our equity portfolio. And once we're going to sell them, obviously that contribution, whether positive or minus, is also reflected in nonoperating.

Let's move on to net income. I think there's really nothing to report about net income. You might wonder about the low tax rate, that's only 5% based on pretax income. There was an extraordinary item of EUR 55 million, some EUR 55 billion, based on tax benefits resulting from the application of the European Court of Justice's decision, but nothing extraordinary elsewhere.

Now with that, let's move on to P&C. Operating profit for the first 3 months is down EUR 500 million from Q1 2008. And that is basically a consequence of 2 issues. As you can see on the right-hand side, other is down minus EUR 180 million. And you might remember that in Q1, we had a one-off impact from the sale of owned used office buildings, where we had EUR 240 million of net gain. The other one is a reduction in the underwriting income, which obviously reflects the decrease in the combined ratio -- sorry, the increase in the combined ratio. By and large, I think there are 3 main components. One is our credit insurance result from Euler Hermes, which explains about some EUR 80 million of this worsening. The other one is lower runoffs, which albeit are still at a comfortable level of 2.3%, worth EUR 115 million lower than in 2008. And the third one is higher expenses, 1.3 percentage point increase in expenses, which translates into roughly EUR 115 million or EUR 120 million, and we come to the details of this development in a couple of slides.

Now on the next slide, we have given you some information about rates. Overall, I think what we can say is in Q1 compared to Q1 '08, we had a positive, slightly positive price impact of 0.2%. This was really the first time since, I think, 8 or 9 quarters. If we look at the table, then what you see is the left, the very left column of this table is the price impact on business being renewed or has been renewed in the first quarter. We have about 40% of our businesses being renewed in Q1, with an overall price impact basically for our sample of OEs, that is a coverage of 75%, was 0.8%. Now obviously, that's not -- not all of that is earned yet, so that will only come through going forward.

Now on the right-hand side, the other 2 columns are personal and commercial. And the total is an update of the price indication we have given in Q1. Based on the experience so far and the renewals, that is slightly lower than what we have indicated in February, where I said that based on what we are planning, we are thinking on 1.5% positive price increase on new business written. Now the 0.6% is what currently is being expected going forward. That is -- I lost what I wanted to say. That is again slightly lower than what we have expected, yes. And the reason for that is that what we have seen in fact is that our expectations for price increases for some of the continental European markets, in particular, Germany, France and Italy, didn't really come through. And it remains to be seen how the need is going forward because, by and large, what we're seeing in many countries is that reserve ratios are coming down, capacity is slightly diminished. So we have to wait and see what the further impact for the remainder of this year is going to be.

Now in terms of top line. We have -- again, we had a 1.1% of growth. If we break this down in motor and non-motor, then on the motor side, we have a reduction of our premiums of EUR 200 million and a corresponding increase in non-motor of EUR 400 million. And the declining of business in the motor side also explains the growth development mainly in Germany, Italy and Spain.

Now let's talk about the combined ratio. And if you -- on Page 16, if you look at the numbers, then over Q1, combined ratio has increased by 3.7 percentage points to now 98.5%. Looking at the numbers, the calendar year ratio already contributes 2.4% on the loss ratio side to the combined ratio development and the expense ratio 1.3%. And we're going to talk about this on the next 2 slides.

If you look around the operations, then let me just point to some of them. Obviously, France and Australia were both hit by severe natural catastrophes, the windstorms in France and the Victorian bushfires, which explains their significantly above 100% combined ratios. I think everybody is aware about credit, it was 114%. That was probably in line with the indications we have given. The increase is likely driven by frequency claims. There was no large claim at that point in time. But as you know, we have reduced our exposure on the less favorable credit scores pretty significantly, up to 60% over the last 12 months. And we had overall about 10% price increase in our renewed credit business.

Now I think maybe one other remark on Fireman's Fund. Fireman's Fund, what you see is that the loss ratio on the combined ratios are increasing in the U.S. It's now at 98.3%, albeit this is a mixed and widely compensating development. We do see an improvement on the loss ratio, that's some 2-percentage points better. But that has been outweighed by the expense ratio where we have made, as you know, and the company has announced this, where we are making investments in our infrastructure, which again hit the expense ratio of Fireman's Fund by some 3%. We are pretty satisfied with the development of our industrial insurance carrier, HSCS, where we do see good improvement across the lines and also some stable runoff in line with the previous year.

Now let's talk about the loss ratio in more detail on Page 17. Basically, what you see on the left-hand side, that there has been a clear upward trend. Nevertheless, looking at this upward trend, it has constantly been better than inflation, which is basically owed to our efficiency programs and effectiveness programs, such as sustainability, which continued to pay off in terms of reducing claims and underwriting leakage.

What our rolling 9 months average is now up to 71% accident year loss ratio, including NatCat, as you can see on the upper left-hand side.

If we move on to the right, then you see the development for the quarter-over-quarter. We started in 2008, we had a loss ratio of 72.3%. Now if you take the first 3 impact, price, NatCat and credit, that by and large is 0 some gain, so the main driver really is frequency and severity, where we have to report an increase of 1.3 percentage points, which then gets us to the 73.4% accident year loss ratio for Q1 '09. I've already mentioned the runoff ratio. I think at 2.3%, still a comfortable level and also in line with what I have indicated.

Now if we move onto expenses, then our expense ratio has increased, yes, by 1.3 percentage points to 27.4%, probably starting first with admin expenses. You see on the right-hand side that admin expenses more or less are flat. But to be very outspoken, it was a run rate adjusted for reclassifications and the usual mark-to-market stock option adjustment, a run rate increase of EUR 10 million is not what we had in mind, and there is more work and more urgency necessary, very clearly so.

Now what is disturbing in the first glance is that the acquisition expenses are up EUR 160 million. And there's a few reasons for that. One is listed or mentioned on Slide 18. In 2008, we had a positive impact from a portfolio exit, where we received reinsurance commissions that was a one-off benefit of EUR 70 million. That obviously, you have to add to the EUR 70 million, the EUR 50 million of reclassifications from admin expenses because those have been reclassified to other acquisition-related expenses, which explains EUR 120 million of this EUR 160 million increase of acquisition expenses. Then there is investments, as I have said, on the distribution side, not only on Fireman's Fund but also in Germany. And by and large, for the whole organization for the first time, we see an increase in our number of agents and salesmen, which of course, requires some investments and that is a number of approximately EUR 45 million. So by and large, the increase of the acquisition expenses is explained by those 3 items, which would mean that regarding the increase in volume, there was basically some improvement, efficiency improvement in the overall run rate. But nevertheless, to put this bluntly, more work to be done both on admin expenses as well as on acquisition-related expenses.

Now finally to conclude with P&C, on Page 19 you have the usual breakdown of our operating investment income. And you can see that this is pretty stable at roundabout EUR 870 million, net of investment expenses and other. You might -- if you look at interest and similar income, that is down about EUR 100 million. Half of that is explained by lower dividends based on the reduced portfolio. The other half of that is explained by the fact that we are doing less securities lending and therefore, we have both less interest income, and that's reflected in the number interest and similar income but also less interest expenses, which is included in the number or in the line item investment expenses. So what we are really talking is the EUR 50 million lower dividend in Q1.

With that, let me go on to Life/Health. We made an operating profit of EUR 400 million, which after a loss of EUR 300 million in Q4, is a good result against the background of the ongoing difficult market environment. We have still an excess in investment margin of EUR 318 million, which means that our buffers are really strong enough to cope with market declines, and I think we have discussed a lot about this during our annual presentation.

Let me just comment on the expense result. It was minus EUR 123 million. That decline is made up by 2 components. One, a lower level of assets under management in our separate account business, which leads to a lower fee income of roundabout EUR 30 million or EUR 35 million. And then we had additional impact from higher DAC amortization of EUR 81 million. The impact of DAC amortization, of course, always includes an element of what I would call accounting noise. Just to explain this, we had in some of our operations our K-factors are slightly increasing, i.e. in the VA business in the United States, but also based on the current interest environment, a little increase in Germany. Higher K-factor always means that you need to restate prior year DAC amortization at the expense of current year. And that, of course, had some impact on our Q1 P&L. And obviously, as those assumptions are changing or have to be unlocked, that we will have continued noise on that. Apart from that, our admin expenses are some EUR 45 million better than last year, which points into the right direction and going forward, should leave this expense ratio or expense result apart from accounting noise and assets under management fee at an okay level.

Now in terms of top line, I think I have made the most important points already of upturn in bancassurance distribution. You can see from the numbers in Italy and Spain and also in Europe. I have said we have a higher demand for traditional types of products. There's minimum guarantees. That was, by and large, sales in Italy by our credit trusts, also in Germany and in Spain, where we have on average interest guarantees anywhere between 2% and 2.2%. And then obviously, what we need to talk about is the U.S., where we have 40% growth. And you might very well argue at the wrong time and in the wrong product, but we're going to talk about this in our next slides.

What is important and what I want to mention here is our lapses and surrenders are very stable. We don't see any negative impact on our business, no negative impact from the recessions. We have about lapses and surrenders in the order of magnitude of EUR 4.5 billion out of a total of EUR 3,360 billion of reserves. So that is about 1.2% by the border, and that number has been very stable over the last, I don't know, 8 or 10 quarters. So no concern regarding lapses and surrenders at that point in time.

Now the battle obviously comes on Slide 23. We have a new business margin of minus 0.1% and we have a value of new business of minus 5%. Now let me put this in the right context, and that shouldn't come as an excuse. As you know -- but let me make 2 remarks. First of all, we do not do a fully-fledged MCV calculation by the quarter, so the estimate of the new business value and the margins are being done with year-end assumptions, where you will remember that we have been in line with CFO Forum principles. So having said this, we still do not apply any kind of liquidity premium in this calculation. On the other side, it's obviously that volatility has slightly increased in Q1 over what we have used last year, the Q3 volatilities. But on the other side, interest rates and Q1 have come back somewhat according to the end of 2008, which is, by and large, a 0 some gain. So that is just as a background explanation of how we came up with the numbers.

Now if we look at the composition of these numbers on the right-hand side, obviously, what you see is that this development is largely driven by the U.S., with significant negative new business value and negative margins. In Europe, still we have to report a significant decline from of 3.5% to 2.2%. That is in essence a consequence of lower rates, which obviously drives the margin.

Now let's look at the U.S. on Page 24. And let's start with gross written premiums. As you will recall, we told you that I said Life would be making some major product revisions up to and including outright suspensions and withdrawals in Q1. We redesigned products, we pulled a few products and we changed prices. And we knew these actions would result in significant sales spikes as the effective dates of those revisions during the year. You can see this coming through in our sales in Q1 across the board, albeit fixed annuities is more or less in line with the average of the last quarters. But variable annuity has a significant or has reported a significant spike in Q1. Now AZ Life expects that the variable annuity sales to be stable throughout the year, but we also expect that the VA sales will diminish very significantly in the next few quarters.

If you ask me, am I happy about $1.2 billion of production of variable annuity in Q1? No, I am not. But I think it was hardly avoidable because you always have some time, you have leeway between the announcement and the actual execution of those actions. And I think pulling our High Five product with just one week of leeway, we did this pretty risky.

New business margin, minus 8.4% on fixed annuity, minus 4.3% on variable annuity. As stated earlier, our new business margin again is a market-consistent view, and it's based on present value of new premiums written, of our present value of premiums and not on annual premiums, AEP. As such, as you know, we take no credit for the additional expected returns for our corporate bond portfolio in calculating the value of new business. And of course, that has an impact on the new business margins on our equity index annuity business, but we are pretty comfortable. We had a long discussion in February that we will be able to recover a good part of that during the year as we think that we are able to earn some credit spreads.

Obviously, VA is a different story. A part of that should be -- a good part of that should be considered as lost. And I'll come to that in a second when we talk about the operating profit.

In terms of operating profit, part of that recoverability story can already be seen on the contribution of fixed annuities in Q1, where we have positive operating profit of $76 million. We can see this recovery in Q1 as spreads narrowed and interest rates went up slightly. The VA business, on the other hand, remains pretty challenging, as we all know, under the current market conditions. And from a recoverability standpoint, this is inherently very much less achievable for VA than on the fixed business, where in the fixed business management levers exist to recover economic impacts and where losses have been caused by, to some extent, by accounting mismatch.

Now with that being said, maybe a final remark on the operating profit. For the company as a whole, operating profit is basically breakeven because a part of that is outside the VA and the FA business. Having said this, quick outlook going forward with all our actions in place and with an environment as we currently have, we do believe that for the new business margins and new business values, we'll continuously improve over the remainder of this year and that then we might be able to break evenly in terms of new business written in the first quarter.

Now let's move on to inflows. Inflows are still nicely positive at EUR 5.4 billion. I think there's nothing more to report about that. And also investment income on Page 26 continues to produce a very stable interest and similar income of EUR 3.3 billion for the quarter, obviously reflected in other that contains the hits from impairments and lower capital gains, i.e. slightly higher capital losses.

With that, I would like to continue to Financial Services. On Page 28, we have a breakdown of our new segment setup now. And I think I do not need to spend time and explanation on Banking and AAA activities. Let's concentrate on Asset Management starting on Page 29. Operating profit has declined EUR 30 million to EUR 211 million. On a like-for-like basis, i.e., adjusted for FX and the first-time integration or consolidation of cominvest, that decline would be EUR 43 million or roughly 20% on a like-for-like basis. The major driver for this development, there was a decline in assets under management, which to a large extent affected our equity-related revenues. And this shortfall was only partly offset by expense reductions. That is why the cost income ratio is increasing to some 70.4% for the total Asset Management segment.

On Page 30, we have given you the development of the assets under management, which do grow on a nominal basis year-on-year by 4.1%. Again, on an internal basis, making the same adjustments, cominvest and FX, there is a decline of 14.6%, which is largely driven by the decline in the market value of our equity business. And you can obviously see the reflection of that development in our net fee and commission income. Now albeit at pretty stable margins, we have also a decline in internal growth of 14.4%.

If we look at the expenses, and obviously the company is reacting to the development. Expenses on a nominal basis are up EUR 17 million to EUR 504 million. But excluding currency effect and cominvest, et cetera, on a like-for-like basis, expenses declined by EUR 50 million or 10%. And there is an expense reduction program underway in order to get our cost income ratio again down to below 65% of the investment cycle.

If we quickly look at the 2 main lines of business of Asset Management, our third-party equity business on Page 32, obviously, the market crisis has taken its toll on our business. And I think for the first time since 2002, we are reporting an operating loss in the order of magnitude of minus EUR 12 million, which as you can see on the left-hand side is a consequence of significantly declining assets under management, albeit with that going forward is probably the good news here, albeit our performance track record is pretty much okay and up and running and should position us in a good way once the markets get back to normal.

Now finally, our fixed income business continues to perform strongly. We have strong net inflows and ambitiously growing operating profits despite the shakeup in the credit markets during the first quarter. I think this is very much owed to PIMCO's outstanding reputation and market position. Assets under management developed positives. Net flows are positive and our cost income ratio of 54.5% I think is still an outstanding market -- an outstanding mark in the competitive environment.

Now final remark from my side, a few remarks on the investment portfolio. You'll get all the details, which Oliver forced me to introduce in Q2, introduce in Q3 and Q4. In the backup, I would just like to concentrate on 2 key issues. One is the fixed income portfolio and the other one is our equity exposure.

With respect to the fixed income portfolio, I guess I have 4 overarching messages. Message number one is the quality of our fixed income portfolio is still very high. As you can see from the rating breakdown on the left-hand side, we had hardly any negative impact from rating migrations. This was basically limited to some development on the government bond side and on covered bonds, but all in the investment-grade, i.e. an even better AAA and AA area. We have barely no rating migration in our ABS portfolio. They are still 97% at AAA. The asset allocation is very much unchanged, as you can see on the right-hand side. This is important in a sense that we -- as we have said in February, we are not going for short-term higher yields or profits at the expense of a higher risk and threat of our capital position. We have still a very high liquidity and fungibility in our portfolio in the sense that our government bond portfolio and the German Pfandbrief portfolio is eligible as collateral for the ECB.

And from my point of view, probably the most important message here, that is very, very limited subjectivity in the valuation of those fixed income portfolio because only 1% of our total portfolio is based on mark-to-model, 78% is on mark-to-market and 21% is observable market prices. Having said this, I think it is important because every other discussion of earnings quality of financial institutions centered around how much did these guys get out of the relaxation of accounting rules from the FASB and from the ISB. The simple answer from an Allianz point of view is there was no impact on our operating result in 2009 from that relaxations of accounting rules.

Second core message on Page 36 is our equity exposure. We have continued, as announced, to reduce our equity exposure, both gross as well as net. And that continued to the end of April. Our equity gearing, obviously, with lower shareholders' equity, is still at EUR 0.5 billion, and was slightly below EUR 0.5 billion, where you can also see from the right-hand side even in a potential crash of the equity portfolio than the available excess solvency, that 12.2% on the right-hand column is an excess of our net exposure which we carry.

Now on Page 37, I think you are familiar with this slide. I do not need to get into the details. That gives you an idea what could be the impact of further equity market scenarios in terms of impairments. Obviously, all that is calculated against the indices end of March.

Now to sum it up, albeit we are not entirely satisfied, I think we've weathered the storm. We have a robust underlying profitability and most importantly, we have a very strong solvency ratio with a pretty much protected downside.
With that, the floor is open for your questions.

Question and Answer

Operator

We'll now move to our first question from Andrew Broadfield of Morgan Stanley.

Andrew Broadfield
Morgan Stanley, Research Division

And 2 things I want to just focus on. One -- and it's back to the U.S. Life. I think you injected some capital in February up until -- within the U.S. subsidiary. But you still had quite a significant gap between, I think, where the rating agencies would typically wanted you to hold capital and where it was. I was just wondering if you can give me any more information on your thoughts about whether you will or how you might close that gap, and especially in light of the fact that you have this uptick in sales and potentially, I guess, the new accounting [ph] rules coming in on the reserving and capital side of those products. But yes, so just a bit more background on that. And perhaps that might even give us some feel about the strategic direction you're taking there because it seems you're being relatively, what's the word, politically sensitive about how you're managing that business. So I'd be interested to know if you can add more color on that. And then just a second thing on capital, you've given us your regulatory numbers. I was just wondering, and I don't wish to get ahead of myself right now, but as you move into the 160s and as the world might look a little bit better, I'm just wondering how that relationship between the regulatory and the internal models are evolving and if you have any idea or any way of giving us a clue as to where you are in your own internal capital model at the moment.

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Okay. So with respect to your first question, yes, we injected $300 million in the first quarter, USD $300 million into AZ Life. There is further need for capital. Andrew, I'd rather like to repeat what I said in February, that will be at the end of the day, is subject to the discussions we have to have with S&P. Those are scheduled for, I think, the months of June. And I simply do not want to preempt or prejudice these negotiations with a public statement here. Yes, there's more to come. It's certainly a sizable amount. We are committed to provide that capital, but it remains to be seen how much it's going to be. Having said this, again, what I'd like to reiterate is that would not have any impact on our overall capital position. It's "trust", a liquidity or a cash issue that you need to provide and contribute additional cash to the company, and that cash currently is at the holding company level in Munich. Now about the future of how do we manage the company, I think we are trying to, as I have said, to develop our fixed -- our equity indexed annuity business consistently with what we have done in the past because we believe that as the product is designed and as it has been repriced, at the end of the day, it will throw off a positive operating profit. We are very defensive on the VA business. I think currently, all the old products, everybody is now in pretty hectic action to revise the products, full products, full guarantees. It remains to be seen if and when the market is ready to accept reasonably priced products, which are, for benefit of both the customer as well as the company. Currently, that is not the case because it's only for the benefit of the customer, and the company is left in a significant loss position. That's why we said or I've said, all things being equal, we do expect that our VA production in the coming quarters is going down significantly. But to make this also clear, we do believe that the market as a whole will come back to a reasonable approach with respect to this line of business because at the end of the day, it's an intelligent product, it's a question of pricing and it's a question of how much guarantees can you give. You can't have always everything. Therefore, that needs to be rethought. But at the end of the day, I think there will be a future for this business, and then we are committed to further stay in that business and develop that business. With respect to capital regulatory versus internal model, I think we've given you the internal number end of 2008. That was around 140. Based on the Q1 numbers, we have the high-level estimate that it has come down somewhat in the order of magnitude between 130 and 135. As you know, that is calculated from a group perspective at a competence level of 3 basis points. So what I wanted to say with this is we should not take this as an indication for any kind of Solvency II ratio, which is only calibrated at a 50 basis points level and therefore should be significantly higher.

Andrew Broadfield
Barclays PLC, Research Division

Okay. And then do you -- so just to come back on that, do you have a -- if I remember correctly, your target was not hugely different from the regulatory target that you threw -- averted nicely?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Correct.

Andrew Broadfield
Barclays PLC, Research Division

Yes, okay, okay. So a bit below where you want to be?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Yes.

Operator

We'll now move to our next question from Michael Huttner of JPMorgan.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

I had a couple of questions. One, on the non-Life, you sound -- you say pricing's up, but the claim's up more. So pricing, I don't know with the new business or whatever, up 0.8%. Claim's up 1.3% and I just wondered if you can give a bit of a light on that. And then on the -- on Hartford, I can see you've impaired the equity investment. This was on -- have you also impaired the investment, the subordinated loan note? And then final point which comes from the previous question, if you cut VA production hugely, does it mean that there'll be a DAC impairment as well at some stage?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Okay. Now with respect to your first question, Michael, yes, price is -- price increase is below claims inflation. That is what we have seen over the last, yes, 2 years where we had very soft markets. We managed always that our -- the impact from that pair of scissors is that we managed our loss ratio, the risk of our loss ratio lower than claims inflation. But at the end of the day, the question is how -- and that's probably the background of your question, how that will play out for the whole year 2009, and this is probably of common interest. Maybe I take the opportunity to give a little bit of guidance and the more enlarged or more detailed explanation of that one. And obviously, this is no more than a guidance of, based on, call this a precise estimate. But let's take the following exercise. If we are starting from the accident year loss ratio for the full year 2008, then we had an accident year loss ratio of 71.8%. Now if we think, and I guess based on the evidence we had from our prior quarters' experience, that this 1.2% uptick on severity and frequency is kind of an indication for what is happening throughout the year. Then all things being equal, adding this 1.2% loss ratio should go up to 72 -- accident year loss ratio before any price impact should go up to 73%. Now if you assume that expense ratio is going to be better than 27% by year end -- and I don't want to put Oliver under too much stress to deliver on that one, then we are anywhere slightly below 100%. Now add back 2% runoff, then we are below 98%. Now we had 0.8% price increase on the renewals. Now what we are currently estimating is 0.6% for the remainder of our business as price increased. We certainly have committed and tried to push through harder and more aggressively to exploit the opportunities we have. If you estimate now that for the remaining book of business, there is a potential price increase anywhere between the 0.6% I have on my slide and the 0.5% originally assumed, then on average with the renewed business, you would end with some price impact with of 1 percentage points for the whole in-force book and for the year 2009, which then would get your combined ratio somewhat below 97% for 2009. Obviously with the usual caveats we've made with respect to net caps where we assume on average of 2 percentage points. I hope that answers your question. Coming to your second one, Hartford, we have no impairments on the notes. And with respect to DAC impairments, we have -- let me elaborate a little bit on that one. We had basically no DAC impairment in Q1, with the exception I've just said at unlocking of assumptions, which kind of led to a hit in Q1 with regard to previous years. That was about U.S. $50 million or U.S. $60 million. Now in general terms on the VA business in the U.S., we have EUR 1.7 billion of DACs. The K factor is 94. So that is pretty close, and we strived or we think that there is write-offs will be start on this DACs once the S&P is going down or approaching 700. That is below the 800 I've given you in February. But we've spent some further money and fine-tuned and increased our hedging program in order to protect our downside. Now for the simple fact, are we spoiling or are we triggering some DAC impairments with lowering production? The answer would be all things being equal, no, because that DAC is related to the in-force business and the profitability of the in-force business.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

That makes sense.

Operator

And we move to our next question now from James Quin of Citigroup.

James B. Quin
Citigroup Inc, Research Division

Two questions please. The first one is on -- Helmut, I think you mentioned that you were accruing EUR 200 million in the first quarter for the 2009 dividend...

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Yes.

James B. Quin
Citigroup Inc, Research Division

Which obviously looks rather low in the context of 2008. So I'm just assuming, first off, was that -- we shouldn't annualized that to get to a new run rate for this year, is that right?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Yes, you are right, because that would mean that we are ending the quarter with -- the year with EUR 1.6 billion from continued operations.

James B. Quin
Citigroup Inc, Research Division

Right, yes.

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

And we still think we can. But now we stick to what we have done in 2008. To answer your question more precisely, we are simply approving 40% of the income, net income from continued operations...

James B. Quin
Citigroup Inc, Research Division

Okay.

Helmut Perlet

Former Chairman of Supervisory Board and Member of Joint Advisory Council

Without preempting any final decision of our supervisor report.

James B. Quin
Citigroup Inc, Research Division

And the second question is just coming back to the U.S. VA business. Obviously, given that the U.S. VA sales were heavily down to the industry in Q1, and your sales were up 34% and given your sort of previous reticence about the U.S. VA business, it does look a bit puzzling as to why the management of that business has been pursuing a growth ambition. It just made them also look rather slow to react. I mean what would your thoughts be around that? Is it -- for an external perspective, I have to say it does look quite strange.

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

I'm with you. At a first glance, it does look strange. But bear with me for a second and repeating what I've said during the presentation, what we have seen and that to my extent is the consequence was really some fire sales because obviously the guys at the front office, i.e., the agents, FMOs, et cetera, these guys are also smart. And as soon as they understand that there's product changes to come which makes that product less attractive to the customer, they're trying to sell as much as possible to make money. Now we can have a long discussion. Have we been aggressive enough to prevent these fire sales or limit that to a whatever number, I think at the end of the day, we have reacted pretty fast and we have reacted in a way to protect our distribution sales force. I've been in a position if the market returns to normal to really develop our business further.

James B. Quin
Citigroup Inc, Research Division

Okay. I mean it just looks like your competition was acting more quickly than you were. I mean is that a reasonable comment?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Well, I hate to have a discussion about the competition. But if I look at some of the competitors who first of all cut back distribution then enriched the product and then reduced commissions and then were only ready to accept cash and then ultimately pulled the product, I don't know whose reaction were more straightforward.

Operator

We now move to our next question from Mark Thiele from UBS.

Marc Thiele
UBS Investment Bank, Research Division

Let me follow up with the U.S. Could you give us a bit more detail regarding the future of variable annuity product that you plan to offer in the U.S.? Is this something with high charges and high guarantees? Or will this be something where you've sort of tried to relaunch the product as a low-cost provider? How do we need to think about the business going forward? My second question is then related to the Hartford state. It looks like Hartford has tried to sell its life business and that it works only on the process of trying to sell their P&C operations. Does that change any of your views regarding the stake and the treatment of the stake? And would that potentially give you the opportunity to exit it? Or would you be willing to increase it? Can you give us a bit of flavor for how the contract with Hartford works in that regard? Maybe finally on the U.S., can you give us an update regarding these lawsuits for the Life Insurance business in general?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Okay, very good questions, Mark. Upfront, I think you're understanding that to some extent I can only give limited transparency or response to that. With respect to the VA business, of course, that is being under development. We are not yet ready to really disclose what the product ultimately looks like. But at the end of the day, it will have not as many and as rich guarantees as the product used to have. And we are trying to really price the options of this product in a way that at the end of the day, we can make a margin out of the product. I know this is pretty much high level and trivial, but we really want to develop this and then come out with the news to the market and not make the noise long before we launch the product. And the launch of this product is anticipated for the end of Q2 or Q3. Now with respect to Hartford, I can only repeat what we have always said. This is a financial investment based on contractual obligations and legal obligations. We are not allowed to hold more than 25%. And in case that there is a sale of their P&C operations or the life operations or somebody's is coming in and taking a larger share, we have the usual dilution protection for us, which gives us some compensation for that case and gives us also option whatever we want on -- and basically also to exit that. With respect to the lawsuits, there is really no update. I think our assessment remains the same. We think we can get out. And I know there is some assessments out there, which as we continue to say which have no merits. But apart from that, I think what I hope you will understand that I do not want to comment on pending litigation.

Operator

We now move to our next question from Michael Haid of Cheuvreux.

Michael Hermann Haid
CA Cheuvreux, Research Division

Three questions. I'm sorry, one on variable annuity, again. Asking bluntly, you said that the recovery will be difficult. From today's perspective, what do you expect in terms of losses of -- in operating -- on IFRS operating profit for the following, for the forthcoming quarters? Second question, can you give us an update on your bancassurance agreements in Italy, if I have it correct, in Poland and in Spain? From my understanding, the maturity of the margin goes to the distributor. And is this similar in all countries? Or are some bancassurance agreements more attractive to you than others? And the last question, a new business generation in Germany Life, can you give us some information on how it developed in terms of how much was sold via bancassurance, how much via agents? How much is the new business down, and how much was the recent effect?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Okay. We had business outlook for the remainder of this year and how much in terms of losses do we expect. I think that depends very much on what the markets are going to be. If we have ongoing volatility and if we have ongoing weak equity markets, then of course we will suffer further losses. If that kind of stabilizes, I think a slightly positive result will come through. Sorry for being so vague, but it really depends on the markets. I mean to put this in a more theoretical context on the VA business, basically what we have hedged is the delta risk. We have still on our books, we have quite of the gamma risk and the base risk. And if you look at the Q1 numbers, then basically we had a change of our benefit reserves of EUR 200 million and the hedge gain of EUR 100 million. So that net-net translated into that $100 million loss -- I have U.S. $100 million I have shown on Q -- for Q1 on my, I said last slide, but that probably gives you some indication. On the bancassurance business, I think in bancassurance business in Italy, Poland and Spain, yes, it's certainly true that for bancassurance, and that goes by and large for Italy and Poland, that the major point of the margin is risk distribution. And that is slightly different in Spain. Just to give you an indication, I'm just looking in my sheets here. I think I have a separate breakdown on the banc business in Italy and the margins. Sorry, I don't have it out of the top of my head. But the new business margin in Italy on the business, we sold via credit rise was 1.1%. I don't have it right here for Poland and/or Spain. For Spain, the margin is higher. It's significantly higher. For Poland, it's probably in the order of magnitude of, yes, that's what it is, 0.7%. New business in Germany, I think if you look at the breakdown, with regard via banking is about EUR 357 million. And that is now not exactly in premium. That is what we call [indiscernible], in some report, that's a pretty good equivalent for the premium. That is slightly above previous year. Out of our distribution affect, we have also a slight increase, we have also a slight increase. There is EUR 2.3 billion. And from broker and others, we have EUR 1.3 billion. That does not exactly coincide with the premium development. If you want to have more details, Michael, I can -- Oliver can come back to you and give the precise numbers. I'm sorry for that, but I don't have this in my files, and there is a little bit of mixed information.

Oliver Schmidt
Head of Investor Relations

I have that Michael, so please just come back to me, okay?

Mitchell Todd

Yes, I will.

Operator

We'll now move to our next question from Brian Shea of Bank of America Merrill Lynch.

Brian Shea
BofA Merrill Lynch, Research Division

I have 2 questions please. First of all, the part of operating profit in Life Insurance that's the investment margin, the EUR 318 million in Q1, that was a little bit bigger than what you recorded for the full year 2008. And I'm just trying to understand why it was so good. When I look at the investment yield achieved across all of Life, it was similar to 2008. So that was the only driver you think over the Q1 margin will be maybe one quarter of 2008. And then also, you have had these losses in U.S. in variable annuity. I'm just wondering where that is booked. Is that not booked inside the investment margin? Maybe there's some funny quarterly accruing going on where you accrue as if -- on the exhortation of a normal yield for the full year. Maybe if you just explain that though, I'd appreciate it. And the second question is hopefully a lot easier. It's just a running yield in non-Life. It's very difficult to forecast that. I know in the past you've had strong seasonality associated with that. Maybe seasonality is lower as you've been exiting equities. If you could give us any help on how that running yield in non-Life might trend as for the full year, I'd be grateful.

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Okay. On the investment margin, why is that already on -- close to what we had in 2008? I think if you look at the numbers and if you look at the operating profit result, basically what you see is that we have about an excess of EUR 200 million over what we need to feed our guarantees. Now there's 2 implications one needs to understand. I have given you a back-of-the-envelope calculation for a kind of a normal year how this excess margin we are making on the investment side is going to be split between policyholders and shareholders. And I gave you, as a rule of thumb, 30/70. Now in this quarter, we have the situation that this excess return was much lower and therefore it very much depends what the share between policyholder and shareholder is of what is the portfolio composition. Now this in Q1, we had a situation that we had a release of unallocated premium reserves in Germany of roundabout EUR 150 million, which got positive based on the HP-1 [ph] results they have for which got fully allocated to the shareholder. And that had, as a consequence, was a huge change in the allocation of the remaining EUR 200 million who were outside Germany where we have a lot more discretion if and how much of that we're going to share with our policyholders, which very often is not only driven by legal obligation, but simply by market expectation and what the market gives. And therefore, we basically had a high share of that excess return for the policy for the shareholder. So that explains why we are still at EUR 300 million investment margin in Q1. The VA side in theory, yes, that is right. That is -- the change in the benefit reserves is compensated or covered in the investment margin. But on a year-on-year basis, that was even a EUR 18 million positive impact on the investment result because we had some increase of the benefit reserves in Q1 '08 as well. Now for the run rate on the non-Life business, I think if we go into -- sorry, I'm now lost in my paper. If you go into the presentation on Page 19, then I think that with respect to the yield on the fixed income portfolio, the 108, the 106 is a pretty good indication going forward. So that should not change by and large. What is really changing at the end of the day is that we will have lower dividends.

And I don't have a good number out of the top of my head. That also depends on how much dividend we will basically receive, but we probably should expect that we get what that is now really a guess, and I'm a little bit hesitating to give that number, but this could probably go as high as EUR 150 million less than in 2009. But take this as a rough guess, and Oliver will come back to you.

Brian Shea
BofA Merrill Lynch, Research Division

Okay. I understand the first question. I didn't fully understand everything, but it sounds like the basic gist of it is that even though the investment yields that you booked was low in Q1, that wasn't necessarily reflected in the investment margin. And so if your yield and markets, impairments get better as the year goes on, we should not necessarily expect to see that investment margin get bigger than you booked in Q1. Would that be fair?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Well if we take this from a different angle, you remember what we gave as indication for the underlying profitability of that last book end of February? We said for normal markets and with zero harvesting, we expect around EUR 2.4 billion, with roughly EUR 1 billion or EUR 900 million coming from technical result and expenses and EUR 1.5 billion from investments. So as a run rate for normal markets, you would expect some EUR 600 million of operating profit.

Operator

We now move to our next question from Nick Holmes of Nomura.

Nick Holmes
Nomura Securities Co. Ltd., Research Division

I apologize for this, but I have a couple of more questions on U.S. Life.

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

What a surprise.

Nick Holmes
Nomura Securities Co. Ltd., Research Division

Exactly. First one is what RBC ratio are you aiming for? I think it was only...

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

What, what ratio?

Nick Holmes
Nomura Securities Co. Ltd., Research Division

RBC, risk-based capital ratio. I think it was only 206% at year end?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Yes.

Nick Holmes
Nomura Securities Co. Ltd., Research Division

Do you want me to go on to the second question, which is just on this new SEC rule requiring equity indexed annuities to be registered in 2011. I know it's a little way off, but I just wondered what you think the effect on sales will be from that? And then, you'll be pleased to hear that I have a question not on the

U.S. Life, which is about the solvency ratio. And I wondered if you could just explain your thinking why the free RfB is included as group capital when I thought that in reality, it was only available to meet the liabilities of policyholders in Allianz [indiscernible]?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Okay. With respect to the RBC ratio of 206% -- maybe, Nick, I can put this in a different way. We would like to have -- a, with the group support, the equivalent of a AA rating for AZ Life. Say put it the other way around, I have no clue how the ratings is going to develop for the rest of the competition, with all the top money and all the issues we have around. At least we won't stay in the market with a solid and competitive rating. So how much money that ultimately requires? Again, we will see from an internal point of view, AZ Life has to comply as everybody else in the organization with our 7 basis points approach on a stand-alone basis. Now 151A, our interest as a political statement, we and the company are against this rule. We think there's no merit. As a practical statement, I think we are at least prepared if the rule is being enacted in a sense that we have a significant presence in both in the fixed as well as in the variable marketplace and therefore already have experience with registered products. We own a wholesale broker dealer, and we are currently providing substantial training and the related tools to our sales force. So long story short, I think at least we are positioned once the rules are changing. How much effect this is going to have in 2011 on the overall marketplace, currently, frankly, I haven't thought, spent a lot of thinking on that. Let's wait and see how this is going to develop. What really -- I mean putting that aside, the message is the company is such, I think, is okay positioned and prepared if that change is come -- is likely to come into effect.

Nick Holmes
Nomura Securities Co. Ltd., Research Division

So what...

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Sorry?

Nick Holmes
Nomura Securities Co. Ltd., Research Division

Sorry, Helmut. What percentage of the sales force is currently SEC registered? I think you've given this number before.

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

That's 40% of our agents.

Nick Holmes
Nomura Securities Co. Ltd., Research Division

It is 40%?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Yes.

Nick Holmes
Nomura Securities Co. Ltd., Research Division

And then with the solvency ratio and the free RfB?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

The free RfB, I think from a solvency perspective, then we are still talking about Solvency I. What is being included in the solvency calculation is from a calculation point of view that you allowed to use free RfB to the extent that your nominal capital is not in line with solvency requirements, et cetera, and a portion of what you have used to absorb current losses. So we currently get credit for roughly EUR 4 billion or EUR 4.5 billion of free RfB, whereas our total free RfB is around EUR 10 billion or EUR 11 billion. So we are not allowed to take full credit for the free RfB. Well, is that a reasonable approach, Nick, or not? We can have a long discussion, and I'm probably, to some extent, sharing your opinion, but the whole Solvency I regime is not a very reasonable approach. And we have consistently tried to point out that under Solvency II, which we think is much more in line with economic considerations, our position will clearly improve.

Nick Holmes
Nomura Securities Co. Ltd., Research Division

Would you think that the free RfB can be viewed as an open estate in effect that could be distributed to shareholders? Or is that not something that you'd really want to, sort of, go into?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

They could basically not be contributed to shareholders. For most of the countries, it's locked in for losses. And to utilize that or to be -- to replace tangible net asset value on net capital if you had free RfB, basically you could run a company with close to 0 tangible equity.

Operator

We now move to our next question from Terry Shu of Pioneer investments.

Terry Shu
Pioneer Investments

I have 2 questions. If you don't mind, if we can go back to the U.S. VA question. When you talked about the new basis values, you talk about the fixed annuities, indexed annuities that part of the reason for the negative new business value is because of mismatch of asset and liability. But for the VA, when we see a negative new business value, that's really negative economic value, correct? Because it's not yet adjust -- your pricing has not yet been adjusted.

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Correct.

Terry Shu
Pioneer Investments

Okay. Because it's a negative value, how were you deferring your acquisition costs? There was an earlier question of potential debt write-off, and I got a little lost because you talked about the EUR 1.7 billion debt which applies to the existing books. And you said -- I think you implied that there will not be a write-off. Can you go through that whole discussion again?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Yes. I think that is one difference we have to keep in mind. New business margins, the way we calculate it is in the risk-neutral world, i.e., we eliminated all excess returns we think we get from credit spreads, from equity business, et cetera. So the U.S. GAAP and IFRS world is a real road assumption where you basically apply normalized assumptions over the longer term and think what is your expected gross margin. Based on those real road assumptions, we still think and not only we, also our auditors, think that implied growth margins in the in-force business are slightly in excess of our debts. When I say slightly, this is illustrated in a K factor of 94%. So when I say K factor of 94%, what does that mean is that the capitalized acquisition costs are relating or equal to 94% of the expected present value of our gross margin. It is very tight. If things are changing, if we have continued lower interest rates, et cetera, then we might well get that we need to unlock our assumptions, revise them that we have to use lower interest rates and then all of a sudden, the K factor would be in excess of 100%, and then we need to write off the decks.

Terry Shu
Pioneer Investments

All right, that seems very clear. But the implication also is that if your K factor is, in fact, 94%, that as this business goes through its life, that it will generate very little in terms of earnings because most of the expected profits will be used to amortize that, correct?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Correct.

Terry Shu
Pioneer Investments

Okay. And the first quarter business is just not profitable. So therefore, when you were booking that business, you wrote off more of the acquisition costs, right? Or you wrote off all of it?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Yes.

Terry Shu
Pioneer Investments

All right. If we could go back to the non-Life side. You went through to exercise on how you get to 97%, possibly, not a forecast, just an exercise for 2009. I think implied in all of that is cumulative rate increases of approximately 3% and underlying claims cost increase frequency severity of about 3% and approximately 2.5% of reserve releases for '09. Is my sort of quick arithmetic approximately right?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Not exactly.

Terry Shu
Pioneer Investments

Okay. Can you correct me, please?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Yes. What I think is that it assumes 1.2% of GAAP around 1% of rate increases and call it claims inflation of 1.2% and a runoff of 2%.

Terry Shu
Pioneer Investments

Okay. Because there were these different -- that's why I used the word cumulative because you talked about rate increases for this period and then the next period. But those are annualized rates?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Yes, yes. I talked about rate increases for the business we have already renewed for Q2, and which is still up for renewal in the remaining [indiscernible]

Terry Shu
Pioneer Investments

Then a follow-on question is why is the claim cost increases so low. When one thinks about underlying inflation, it's very low. So frequency must be quite favorable, is that right or negative?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Frequency is about stable,

Terry Shu
Pioneer Investments

It's about stable flat.

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Very, very marginally increasing. The impact is severity. Yes, severity observed on our book is below overall inflation, but this is because we spend a hell of time and work on claims management, underwriting leakage and [indiscernible] leakage, which continues to pay off.

Terry Shu
Pioneer Investments

Right. But going forward, there is the risk that inflation might accelerate and you may run out of room. So therefore, you may need to push through higher rate increases, is that it?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Exactly.

Terry Shu
Pioneer Investments

And the final question's on your reserves, the kind of runoff or the favorable development of around 2% annually, how much longer can that go? Or is it that you're always setting up your accident year loss ratio at a conservative level so that the favorable development is sort of built in? Is that the right way to look at it?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Yes, that's the right way to look at it. And this is what I have always said or stated in our conferences. We are trying to consistently reserve -- best estimate was in a certain confidence level. What we have illustrated reserving policy and therefore, on average, we do expect positive runoffs.

Terry Shu
Pioneer Investments

Okay. Unless we see unexpected kind of acceleration and cost, which means then you go up to the higher end of your band?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Yes.

Operator

We now move to our next question from Stephan Kalb of Sal. Oppenheim.

Stephan Kalb
Oppenheim Research GmbH

I would like to ask 3 short ones. And the first one is on credit insurance. And the increase in the loss ratio in the first quarter, is it something we should expect all for the following quarters? As far as I know, the business development and surroundings have not improved since the first quarter. Or is it a one-off bad result in the first quarter? Second question, you have a sensitivity of impairments as of end of March. Do we also have impairments in the second quarter if the stock market would remain at the current levels because of the 9-month rule? And the third question is on the effects of the restructuring programs, 2006. And do we already see some cost relief in the first quarter out of restructuring programs?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Well, with respect to your first question, what we have seen on Euler Hermes really in Q1 is frequency claims. So having said this, those frequency claims likely are to level out in the remainder of the years, frankly, I don't think so. I'm prepared that we see a level of claims which is in the order of magnitude of what we have seen in Q1, obviously, and that is good. If I talked to Wilfred first quarter and his team, they are a bit more optimistic on that. But it's my job to be rather on the pessimistic side. Long story short, I do not view Q1 as one-off. I personally do believe while we see some signs of recovery in the overall economy, it's too early to call this the end of the process. Or I do believe that the real recession has not yet hit the labor market really and some defaults will come through. So all in all, I do not believe that the loss ratio of Euler Hermes is going to be better in any shape or form than what we have seen in Q1. It could be slightly worse, sorry, in Q1 in 2008. In 2008, we had a combined ratio of 104%, and my own expectation would be that we -- the year 2009 is certainly below 100%. How much is a little bit of looking into the glass ball. It could well be that for the rest of the year, we will kind of in the order of magnitude of Q1. Now sensitivity of impairments, I'm afraid I cannot give you an update based on the equity markets of one step back. We have provided this calculation based on March 31. And based on March 31, because of the 9 months rules, everything's stable. We will see EUR 300 million of impairments. If the market stays where it is today or yesterday, that number will be lower, but how much I really can't give you a solid guess. Effect of the restructuring programs. I mean if you go back over the last quarters, you have always seen a reduction in the run rate of our admin expenses, which on average was probably in the order of magnitude of EUR 40 million per quarter. So yes, there is impact of -- there is positive impact and visible impact of the restructuring programs. We are just not pleased with the outcome of Q1.

Operator

We now move to our next question from William Hawkins of KBW.

William Hawkins
Keefe, Bruyette, & Woods, Inc., Research Division

Most of my questions have been answered. I just got one, really, on your embedded value disclosure. The CFO forum seems to be meeting quite a lot recently to discuss potential changes after last year's experience. To the extent you can, I wondered if you could just tell us where the current thinking has got to in terms of an update of embedded value methodology. Presumably, this could have quite a positive impact on Allianz' reported numbers. But I just wanted to see if I'm correct on that general thought. And if there is any kind of change, do we have to wait till next year's reported figures to see the impact of this? Or is there a possibility that you and other companies could be giving us some kind of interim update once -- if a new system is approved?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Okay. Good question, William. I think -- I mean to put this bluntly, embedded value disclosure for 2008 was a mess. The CFO forum has recognized that there's need for action. Yet there is still a variety of diverging opinions, and we are not yet prepared. Let me put it neutral. It's work in progress, and we don't have or I don't have any concrete news for you right now at that point in time, but the forum is committed to resolve that issue very quickly. Does that mean that you will only see a different disclosure and more standardized disclosure year-end 2009? Probably yes, because whatever the change is, maybe it requires some more work and some more test runs and it will cost some time.

William Hawkins
Keefe, Bruyette, & Woods, Inc., Research Division

That's a shame. All right.

Operator

[Operator Instructions] We'll now move to a follow-up question from Will Morgan of Goldman Sachs.

Will Morgan
Goldman Sachs Group Inc., Research Division

Most of my questions have actually been asked. I just have one very quick one left. In terms of your Solvency II ratio, you mentioned that obviously that will be a big boost for your company. I just wondered how you're thinking about that in light of, as far as you can tell, the latest proposal seem to be reducing the level of diversification benefit that they can be to some of the larger groups. I just wondered if that's going to change your view of where your Solvency II ratio would be. And if you could just comment on that, that will be very helpful.

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

I mean, it's absolutely true. If you look at the most recent outcome of Solvency II, that there is a potential reduction and maybe a significant reduction in diversification benefits. Having said this, obviously, it depends ultimately, and we need to see how the final regulations are going to look like. How group support is ultimately defined, that will have impact on that diversification benefit and the order of magnitude. I mean if -- I mean to put it frankly, many people are very positive about the outcome. I'm a little less positive. I think it was one step in the right direction what they simply missed out from an economic point of view to address the key issues. And the key issues are diversification and the other key issue is group support. There is still a major lack of deficiency from my point of view. And against the background of what we have seen in the markets, I shouldn't be that blunt, but I view this close to being a choke. Now having said this, even so if we have some unreasonable outcome, we clearly have still some management levers which we could apply to mitigate those reduction and diversification benefits that could go via capital management, via reinsurance, via outbranching of our operations. That sounds a little bit radical, but if the regulations are unreasonable, you need to react accordingly. So I still think we have enough leeway to benefit from Solvency II. And ultimately, I do believe that we have also enough time to continue with negotiations to come to an acceptable result.

Operator

We move on to our next question now from Fabrizio Croce of Keppler.

Fabrizio Croce
Kepler Capital Markets, Research Division

Three questions actually. The first one is on credit insurance. Now the rates increased from 10%. You reduced some exposure to the risky classes by some 60%. How is it, first of all, the overall exposure? And secondly, how do you look in terms of appetite for the time being? The second one is still about risk appetite. Are the 3.7% change in combined ratio already enough to let change your reinsurance policy? Or are you -- what is some sort of level at which we would see the more business to reinsurance companies? And the third one is about Italy Life business. You grew there some 38%. Now having -- if I did not understood badly, the product which was sold most was credit, which did plus 71%. And this is a product, a unit-linked product, which has some guarantees and on capital and return. Now the question is, how big are these guarantees on capital and how big the one on returns?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

Okay. Now on your first question on Euler Hermes, yes, we had a 10% price increase. What is our overall exposure? I don't -- if your question refers to kind of distribution of exposure alongside or according to the different scoring of the clients, I don't have this with me. We can deliver that, but probably Euler Hermes has it anyhow in their analyst presentation. We follow up on that one. I think in terms of risk appetite, we are trying to be very careful to push through with our price increases, which so far has been very successful. But obviously, we always do not say goodbye to the market and leave the customers and long-standing relationships in the rain. We are paying a toll to that. That is evidenced by the 114% combined ratio. But everybody of us has to understand that credit business is a cyclical business. But I think if you look over the cycle, we have managed this business with a combined ratio well below 100%. I'm even tempted to say below 90%. So it's an attractive business. We are committed to this, and we do not want to spoil our overall platform. On your second question, the risk appetite with respect to reinsurance policy, I think the shorthanded answer is with respect taking reinsurance, currently no change in our risk appetite. We want to get rid of the spike risk, which we have done. That is what our reinsurance program covers. Everything else is kind of an opportunity calculation. It's the cost of running this business, i.e. the cost of capital and the expected return. How does that compare to what you have paid to the reinsurers against the background of the fact that all reinsurance [indiscernible] in the public, they're going to increase prices pretty significantly. I think my risk -- my appetite to go for higher levels of sessions is very limited. With respect to our Life business, in Italy, which we sell through UniCredit, yes, there is an interest rate guarantee. As I said, that's on average around 2.2%. Currently, it's running at 2%, which is well below the accepted level of guarantee from the regulatory side of 2.5%. There is a capital guarantee in a sense that the insured capital is reevaluated every 12 months.

Fabrizio Croce
Kepler Capital Markets, Research Division

And could you attach to the risk capital, you allocate to credit insurance also some figure? For instance, say it was 100% now given that the rate increased 10%, we are going to increase these type of risks by some 20%, 30% or 100% or things like that?

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

No. I don't have the risk capital out of the top of my head. I do believe that, yes, we have a slight change in the risk capital, which is based on the level of reserves obviously, so actual risk is going up. Apart from that net premiums earned, et cetera, it's pretty stable. So the number shouldn't have significantly changed. We have the overall number we have allocated to Euler Hermes? I think you have the number in the back up in the appendix of the annual presentation that we have given a breakdown of risk capital and ROEs for the various businesses.

Fabrizio Croce
Kepler Capital Markets, Research Division

Okay, wonderful.

Operator

We now move to our next question of Andrew Broadfield from Morgan Stanley.

Andrew Broadfield
Barclays PLC, Research Division

Just one very quick question on Euler Hermes again. It seems it had gone up the rate of most people, but valuations having gone down your ownership position of Euler Hermes, your commitment to it, and I was just wondering whether there's any more thoughts in terms of consolidating Euler Hermes again and whether indeed you can make any comment about that, that would be useful to know.

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council

There's always thoughts around here. But I think at that point in time, there is no decision in the pipeline, so nothing new to report.

Operator

As we have no further questions, I'd like to turn the call back over to you gentlemen for any additional or closing remarks.

Oliver Schmidt
Head of Investor Relations

All right. Ladies and gentlemen, thank you for joining our conference call. We say goodbye to everybody, and we wish you a very nice remaining pleasant afternoon.

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council
Thank you very much. Goodbye.