S&P Capital IQ

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Allianz SE DB:ALV

FY 2016 Earnings Call Transcripts

Friday, February 17, 2017 2:30 PM GMT

S&P Capital IQ Estimates

	-FQ4 2016-			-FQ1 2017-		
	CONSENSUS	**ACTUAL**	**SURPRISE**	**CONSENSUS**	**SURPRISE**	**CONSENSUS**
EPS (GAAP)	3.55	3.83	▲7.89	4.04	▼(3.16 %)	14.69
Revenue (mm)	28362.00	30000.00	▲5.78	-	-	123275.84

Currency: EUR
Consensus as of Feb-17-2017 1:36 PM GMT

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Presentation

Operator

Ladies and gentlemen, welcome to the Allianz conference call on the financial results 2016. For your information, this conference is being recorded.

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

Oliver Schmidt
Head of Investor Relations

Thank you, Gail. Yes, good afternoon from my side as well, and welcome to our conference call. As you know, we have 3 presenters today. Oliver will kick it off and share his views on the 2016 result and our capital management; then Dieter will explain the numbers in detail; and finally, Günther will talk about our investments.

We have scheduled 2 hours for the call. In case that is not enough to cover all your questions, please come and see us at our analyst meetings that we will host next week. And we will host one in London, one in Paris and one in Frankfurt.

That's already all from my side. And with that, I hand over to Oliver.

Oliver Bäte
Chairman of Management Board & CEO

Yes. Good afternoon, or good morning if you are in New York. Thank you very much for listening and your interest. I'm proud and happy to present very good numbers after a very challenging year for us and good news on capital management. The headline for our presentations today is delivery on delivering, and that's what we have been doing for 2016.

Now I don't need to explain to you, like in the press call today, what a difficult environment it has been politically and economically in 2016, and it looks like it's going to continue; lots of unpredictabilities. And in this environment, particularly with the very difficult interest rate environment, our company has performed really well. Thank you, in particular, to all our employees and the leaders in the company for great results.

Now what have they been? With EUR 10.8 billion total year results, we are near the upper end of our target range. We have generated EUR 6.9 billion in shareholders' net income and we are, therefore, proposing to increase the dividend per share to EUR 7.60. That's up more than 4%. Earnings per share is the same number in terms of increase. It's now at EUR 15.1, and our solvency stands at a very strong 218%. We assume you have some questions around that, that Dieter will address later.

The return on equity is 12%. It's somewhat down from last year. That is due to very strongly rising equity capital with a couple of effects related to that. We're still sticking to our target of around 13%, so we believe it's not an issue around earnings. It's actually an issue around balance sheet strength, which we consider to be an extremely important asset in such a very difficult environment.

If we turn to Page A3, I'd like to highlight that all our segments are delivering. Life and Health is now with RoE above 10%; P&C, 13%; Asset Management, 15%. So let me hit the segments one after the other.

On the P&C side, we'd like to grow 3.1% internal growth. The combined ratio with 94.3% is getting closer to target. The restructuring of Fireman's Fund that is still impacting the AGCS results is still on track. And we have, after installing a new leadership team in São Paulo for LatAm, are making good progress and further improving our performance across the Latin American continent. Operating profit, significantly improving and, as you will hear later, without some further cleanup in the balance sheet on an old life portfolio that we still book under P&C because we only otherwise have P&C and health in Brazil, would have been already significantly more positive.

The Life and Health insurance story continues to be very successful. We have told you in November of 2015 that our most important strategic priority is the transformation of our life insurance business, moving it to new capital-light products that are both better for consumers and better for our shareholders. It is happening, and you will see that later. The trend continues strongly across core markets. The new business margin is up despite record low interest rates, and the disposal of Korea strongly benefited our Solvency II capitalization. I think some did not have that on their radar screen. And it has 3 positive effects: it impacts positively future profitability; it strongly helps our Solvency II capitalization; and it further reduces interest rate sensitivity, which is one thing that is of utmost importance for our risk management team because that has been impacting us negatively as a sector and also at Allianz. And I just wanted to say it loud and clear: we are committed to further reduce interest rate sensitivity and risk capital consumption. We have a slightly different view on credit spreads, which we're going to talk about.

So operating profit here in the segment is at a record level with EUR 4.1 billion and it's very strong. It's also a fact -- due to the fact that our U.S. life company is doing extremely well, and congratulations to the team in Minneapolis for another successful year.

On Asset Management, we've also told you clearly what the agenda is. PIMCO, as a company, has decided to rejig its team, find a new leader and then the investment team was able and capable to focus more strongly on investment performance and outperformance, which has been very strong in 2016. Congratulations. In return, net flows have returned, EUR 11 billion in the second half. That's in euros. And also congratulations, due to good cost management, the cost/income ratio is now, again, below 60%.

And not only did PIMCO perform really well, Allianz Global Investors delivered an all-time high in terms of operating profit, EUR 543 million, despite very strong outflows of the equity sector, particularly in the United States.

So overall, when you look at the portfolio, yes, times are really tough for all segments. But yes, Allianz has been performing really well.

So we're continuing our track record. Page A4 gives you an overview of the last few years of improvements in operating profit, earnings per share and dividends per share. And as described earlier, we're again raising the proposal for increasing dividends per share to now EUR 7.60. And that comes in addition to a share buyback of EUR 3 billion that we have started today.

Now talking about delivery. We are delivering, at the same time, on multiple cylinders. We are delivering strong results on our existing business, while in parallel, changing the company. That's a very hard thing to do. It's a particular stress for our managers, but it's working very well. A5 gives you an overview. I don't want to go into the detail. It remains at the heart of our transformation program, that we're focusing on bringing customer loyalty to top levels across our businesses. We're making progress here as we are on digital, thanks for those that visited us in Munich, as we do on technical excellence, on growth engines, on culture change.

On Page A6, I just like to highlight. People are asking and waiting for the big banks. It's not necessary we have a track record of continuously investing. Last year, we've invested in Rogge. We have done the Zurich Morocco deal. We have created a partnership with Standard Chartered. But we're not just buying. We've also decided, and you see that it's about cleaning the portfolio wherever it's necessary. So after disposing of the Fireman Fund retail portfolio and AGF in the U.K., we have successfully executed the exit for our Korean life portfolio with huge benefits for Allianz.

Now that already brings me to something that is probably very dear and important to you. That's slide A7. And let me spend a little bit of time on this slide. We have debated for a number of time how do you think about the commitment that Michael Diekmann has given a few years back on the unused budget for external growth. And we've always said if we do not find appropriate investment opportunities, which we are working on, because we want to grow this company, but if it's not possible organically or externally, we are going to be disciplined and return it to our shareholders.

We're keeping our commitment. That's another form of delivery. And we're returning EUR 3 billion to shareholders via share buyback over the next 12 months. Again, that has started today, and that is subject to a sustainable solvency ratio above 160%. That is the exact wording, and there's no other detail to bear in mind. We will cancel the purchased share over time.

Now this alone will create an EPS accretion of around 4.4% if you do a full rate analysis on 2018 numbers. And also, if you think about the RoE uplift, you obviously need to have a few assumption on how this counts. But prêt–à–porter, it's about 50 to 60 basis points improvement, and that is important to know.

Now going forward, we have decided to simplify and flexibilize our dividend policy in order to be able to return capital to shareholders whenever that is suitable. Very important because we don't want to run up against the 3-year wall and then being asked the last year, what are you going to do with the budget? What are you going to do with the budget? So we don't need to wait for the end of a 3-year period. If we don't need the capital, if our solvency remains strong, we can return capital in flexible solutions. It doesn't always have to be a buyback. It can be other ways. And I'd also like to highlight that we are committed to remain capital disciplined, as this first share buyback in our history exemplifies, because we have very demanding earnings per share growth targets and very demanding RoE targets. So these are going to safeguard capital management discipline.

And I'd like to mention also that you can see from our numbers that we have extremely strong cash flows to the holding. The vast majority of our earnings are flowing up. So we have the flexibility to continue doing what we're doing. I don't -- I think we are pretty unique in that.

Now Page A8 gives you just a repetition that is often forgotten. We are committing to pay out 50% in the regular dividend with a ratchet, i.e., that we'd like to maintain the minimum level of prior year even if earnings were to be a little lower. And I think it's important to understand that next to being busy and productive, we've also obviously been fortunate. Now, even if we're not fortunate and you have large NatCat or volatility in the markets, we have another 50% of the earnings that we can use to support both growth and flexible payout of excess capital, and if needed, also to support the ratchet. So you have an insurance policy in your hand with our very reliable dividend policy.

So let me summarize on Page A9 what the equity story is that we gave to our investors in November and have -- we have repeated at the Merrill Lynch Capital Day. Allianz is an outstanding downside protection investment. We have a super capital position. We have well diversified. Yes, sometimes one or the other segments is affected by short-term volatility. Overall, the portfolio is extremely strong. Operating profit CAGR has been 7%. And we have a very, very high-quality investment portfolio. Günther Thallinger is going to tell about that. It's not just the investment-grade rating. We also are building the earnings power through our alternative investments, so you're getting the best of both worlds: a well-diversified portfolio and investment income above what other people can do.

Now, that would already be a rock-bottom value proposition in these very difficult times. On top of that, we have an attractive dividend policy with a 50% payout with a ratchet and very strong capital discipline, which we are now demonstrating. We are honoring the commitment that Allianz has given, and we're buying back EUR 3 billion.

Further to that, we have upside potential. We're absolutely committed to achieving a 5% EPS growth. And remember, in 2016, we already delivered 4%, even including Korea, on an organic basis. The Renewal Agenda investments are starting to pay off. They're helping us, and most importantly, over time to improve Net Promoter Score; and half over time, to also help us on productivity. Now we're investing a lot at a moment, but productivity gains will have to come over the next few years. And we enjoy scale benefits on the investment side, both with Allianz Investment Management and our third-party asset managers that are hard to beat on a global scale.

And while we're doing good and we're talking about it, we'd like to emphasize that this is not a company that is running for quarterly earnings. We're trying to build a franchise that delivers on a sustainable basis to society. This is not for the press. It's also important for our investors. We're really trying to deliver contribution to all elements of society, whether that is around the investment side, energy consumption or as it is, with employee engagement. And we are very proud of that.

And with that, I'd like to hand over to Dieter with one final mentioning: That's our outlook for 2017, not to be forgotten. Now, people have said and written some comments that we have a muted outlook. I'd like to repeat them. We have had a muted outlook for the last 3 years. What we are doing for next year is fully consistent with prior years. As you remember, we had a midpoint for 2016 of EUR 10.5 billion, that we've increased EUR 300 million or 3% to EUR 10.8 billion, so it's above significantly the last year midpoint. And we have various numbers in the segments to get to the number, with their own midpoint and variations. Obviously, not all will be top and not all will be bottom. So we believe that even in times when the political environment looks really difficult, when economic outlook for Europe might be under stress, particularly in government markets, we remain committed to what you find on Page A12, which is the same ambition we have given to you in November of 2015: Get the return on equity to 13%; grow earnings per share 5%; and also improve the health of the company to have our consumers give us 75% top marks across the business; and drive up our leadership index to 72%.

Thank you for listening.

Dieter F. Wemmer
CFO & Member of Management Board

So good morning, good afternoon. I'm now diving deeper into the numbers. That is then Section B of the overall presentation, and we start on B3. That is the only page which focus on Q4 stand-alone, and then we move to the summarized annual results pages.

We finished with a really strong quarter in all segments. Revenues up in total, driven by our P&C segment with an internal growth of 3.6% and also internal growth in Life and Health. Of course Asset Management is still slightly negative following the larger outflows in 2015. Operating profit, EUR 2.8 billion, almost 10% higher than a year ago; and 23% up on net income with EUR 1.7 billion.

Property-Casualty ended the year with a 94% combined ratio. I would call it a strong organic one-off of 4.9% without influencing at all the strength of our balance sheet. Life new business margin, 2.9% with good volumes, a very strong finish of the year. I think it is one of the highest new business values in a quarter you have seen so far at Allianz. The 2.9% new business margin we calculate with quarter-end or beginning of the year. Interest rates would be 3.2%.

And Asset Management, also EUR 640 million operating profit, slightly up over the quarter a year ago. That is certainly a good turning point. PIMCO cost/income ratio below 60%, and inflows of EUR 6 billion, even EUR 1 billion better than in Q3, and I am I allowed to say this: January started at PIMCO very strong with about -- above EUR 5 billion net inflows in January.

So now turning to the overall annual results. EUR 10.8 billion operating profit. Strong contribution from Life and Health, where P&C reduced by the falling investment income following the natural decline of our average yield in the portfolio. Asset Management, as I said before, still the consequence of 2015 outflows, resulting overall in a net income of almost EUR 6.9 billion, 4% above last year, and then also resulting in a 4% EPS growth. So organically, already pretty close to our 5% target for the year.

So when I focus a little bit more on the balance sheet and then go a little bit quicker through the segments, because due to our ad hoc requirement, you had 12 hours more time to read all the details. So I assume you have used this and then I would focus more on the balance sheet because I think that is of more interest.

Shareholders' equity, no surprise, slightly lower than after the 9 months falling unrealized gains on bonds, but EUR 1 billion more in unrealized gains on equity investments. Compared to beginning of the year, our liabilities for own pension increased. However, compared to the 9 months' figure, we have a lower pension liability. And FX actually contributed also to a further increase of our net asset value. The biggest jump you'll see in our Solvency II capitalization, and I would then move directly to the next page to have chance to discuss it in more detail.

So there are 2 ways to look at it. I personally like the simple description first. Look at the 12 months development. Forget that there were 52 weeks, 5 days a week of daily volatility and just look what has happened over the 12 months. Yes, interest rates lowered over the full 12 months. Credit spread actually increased a bit and also, stock markets went up. So all these market movements, we were actually able to compensate by management action. That means we find asset liability management as well as some equity hedging in particular in Q4. So that was awash. Then the 18% increase from 200 to 218 is just the earnings plus rounded 10 percentage points for the disposal of Korea. That explains over the whole year the full movement of the solvency ratio.

When I go into the Q4 details, then we go much more into a lot of nitty-gritty movements. For example, what you, from the outside world, cannot really guess and calculate is how did the swap volatility move in Q4. And a key indicator here is the 10-year tenure interest rate volatility on the euro swap. That is 19 points lower in Q4 than in the previous quarter, that it let our group solvency increase by 4 percentage points. Then I think you have, in general, calculated Korea impact a little bit lower. Well, it's 10%. We had a better capital generation through life profits, high new business value and, of course, increase in interest rate also reduced the cost of options and guarantees a bit. And then improved and refined asset liability matching are the key driver besides the market movement, what we have seen in Q4. But personally, I like more the simple full year story because that is then giving the strategic picture and not trying to explain every movement in the financial markets.

Moving to P&C business, Page 13. Well, roughly the same operating profit than a year ago because net earned premium, pretty flat. Yes, combined ratio, 0.3 percentage points better, but we lost EUR 170 million on running investment income. And under other, we had 2015 a little positive impact from the disposal of the Fireman's Fund retail business, not repeated in '16. Therefore, other is a lower number.

The combined ratio, I would say similar good cat year as before; actually, Q4, almost no cat. In Q4, we have seen, in particular, on the books of AGCS, some special and material large losses but that is no concentration. That is, I think, just our normal regular business that from, time to time, large losses are incurring. Expense ratio, 30 basis points up. That is not yet the reduction in expense ratio we are looking forward to in the future. We have half of it, so a bit more than 10 basis points is increase in commission. The rest is also higher investment level we have done also for the change agenda. So our investments are, in the change, running at fairly high level.

Run-off, 4.5 percentage point for the full year, yes, above our long-term level of 3.7 or even when you adjust for Fireman's Funds, 3.9 level, so we are slightly above. But we had very strong run-off in some markets, and it's not damaging the future balance sheet. Our accident year underwriting result, so loss ratio improved slightly over the year and will help us to achieve our 94 flat result or better in 2018.

I think I skip the details on the individual markets as it is probably good for your reading. Also, I would not go into the details of the investment income of the segment because that is very self-explanatory, nothing special in it.

Let's move to Page 19, the life business and what we achieved there. The Q4 picture looks pretty much the same as the previous quarters. Our shift in mix was about 40% of the new business volume in our capital-efficient products. The main markets here are Germany and U.S., not only in share but also in volume. Overall, our life new business is on a strong level. You can see it on the right-hand side of the chart: the German life business, 12% up in new business volume; and the U.S. also rounded 12% up in new business volume, where in the U.S., our fixed index annuity business continues to deliver. And VA is this EUR 2 billion out of the 12 [ph], flat compared to previous year. So that means our focus to grow the business is clearly the fixed index annuity business.

And overall, for the year, we are still down in present value of new business. Why is it not flat or up? We have 2 markets, which could not repeat the sales successes on unit linked to the same extent. That is Taiwan and Italy. I think Italy's volume in 2015 was just huge. And this year, it is still a high level but lower. And in Taiwan, some unit-linked market has not really recovered from the low sales following the March, April hit to the stock market.

The profitability in our life business, Page 21, on EUR 4.1 billion for the year, as I said already in previous quarter, might be slightly above a fully sustainable level. For example, our investment margin, which is up, includes a substantial swing also from basis risk in our U.S. VA business. We cannot expect that this gain is repeating every quarter and every year. So therefore, we are normalizing our life results a bit lower, as you can then also see, including a growth assumption as we have done it in our outlook figure, as just explained by Oliver.

By countries, who produced the growth in profit? Well, that is the U.S., France and then, of course, the nonrepetition of the operating losses of Korea. That gives, actually, I think the easiest way to explain the increase. Germany produced a high but flat operating profit in 2016.

So when we move to the page, and a little bit spending time on the value of new business. As I said before, record level, EUR 1,448 million new business value. We are measuring our new business value and our new business margin in -- following the Solvency II rules for calculating the market-consistent balance sheet. So when you are grossing up this value of new business to make it comparable to other, you would add back the risk margin, which is included in this calculation. You would move to a real-world assumption. And when you then actually gross it up from the discounting effect and ask how much operating profit will this business produce over the run-off time of this tranche of new business, you end up with a number clearly north of EUR 5 billion of operating profit.

In our 2016 numbers, the day 1 accounting of this new business was a loss of EUR 400 million. So that would actually, also, come on top of a new business value gross-up. So that means this value is clearly sufficient to replace maturing life business profits as well as giving us a long-term growth perspective for our life operating profit.

Page 25, the usual health check for the investment margin. On statutory liability basis, our yield's still 5.1%; unchanged minimum guarantee with changed new business strategy, surely and slowly moving downward so that actually, the gross investment margin, stable to slightly up. And the profit sharing to our customers, also, that very much unchanged compared to last year. So not only our shareholders can be very happy about the results, I think our customers should be as well.

Moving now to Asset Management business. I think I have already given the highlights. That is the flow turnaround at PIMCO. Actually, our assets under management for the whole year, more than EUR 100 billion up: EUR 31.5 billion comes from the Rogge acquisition; a similar amount comes from currency impact; and then the rest is market value growth coming also from the slightly lower interest rates plus higher equity markets. That gives then the market movement of EUR 47 billion. And then in total, we still had outflows because we have not fully compensated the first 6 months of outflows.

Allianz Global Investors, so far, every quarter positive and ended the year with minus EUR 3 billion. Simple explanation is that actually, organically, the 4 quarters added to a 0. And the EUR 3 billion outflow was roughly the outflows we had on the Rogge acquisition right after the acquisition and was part also in our assumption for the business plan of the acquisition.

When we move to the revenue page, yes, revenue is down 7%. At -- in total, PIMCO, almost minus 10%; Allianz Global Investors, a small positive; adjusted for currency, minus 1%. So -- but what I think is important is that PIMCO, after the little jump in fee margin beginning of the year, kept it over the quarters pretty stable, which I think is important also going forward. Also shows that the inflows we have achieved are also adding revenues pretty much at the average fee margin of the existing business.

So our profits, Page 31, in Asset Management ended very much at the midpoint of our outlook page we published exactly a year ago, EUR 2.2 billion operating profit. Good last quarter with also good performance fees achieved, not the one-off performance fees we had previous year from the distribution of the Bravo fund returns, actually very much ongoing performance fees. Also, being reflective that PIMCO got a new traction on its performance. 12-month performance on the PIMCO funds was 92% at year end. I think the 3 year was some 86%. So actually, really getting back the traction of good customer returns, what defines PIMCO's trademark for so many years.

Corporate segment, Page 33, nothing really special to report. Flat development on the expenses, a little bit less income on the banking following lower interest rate spreads in the banking industry in general. And our improvement in profit under -- shown under the Holding & Treasury segment is a lower contribution to our own pension fund. The rest stayed very much flat.

Moving to the Page 35, the translation of operating profit into net income. We have indicated here what we had in total to consume or to absorb for Korea. Korea did hit our balance -- did our P&L with EUR 450 billion -- million. Billion would be a lot. That is the local currency -- million in the year of -- that contrasts quite a bit to positive impact in our Solvency II and market value balance sheet of plus EUR 3 billion in total when you add the impact on risk capital and on fund calculation.

So that got compensated by some realized gains and losses. We had here some also block trades reported about earlier in the year. The impairment includes EUR 210 million from Korea and also some impairments for our small bank in Germany called Oldenburgische Landesbank or OLB, which we are now accounting for as held for sale in the year-end accounts.

The tax rate, yes, looks a bit lower, 1 percentage point. But I think it is, at the moment, reflecting more or less unchanged tax rates in our major markets. But we had more tax-free realized gains from equities that reduced the overall tax rates by 1 percentage point and helped then also us to achieve a 4% higher net income.

And with this, I would summarize. 2016 is a year of -- another year of strong delivery. Fifth time in a row increased net income and dividend, very much on track to achieve our 2018 ambition organically the EPS growth target. The RoE, I think what it is in the way that we are a bit rich in capital, but I would consider this as a luxury problem and not a challenge. Combined ratio, I think also moving in the right direction while preserving a strong balance sheet. Our life OEs, 75% are already on an RoE above 10%, and the rest we are getting there. And life new business margin, I think the 3% target is clearly in reach.

And with this one, I would hand over to Günther to give you a much deeper insight into the investment results.

Günther Thallinger
Member of Management Board

Thank you. Good afternoon, good morning, also from my side. Now about, let's say, the investment portfolio. We are talking about EUR 653 billion of assets, a portfolio that is continuously growing. When I was allowed to start to head the investment entity, AIM at Allianz, the portfolio was slightly above EUR 500 billion. This was 2012. So there you can see, it is growing very strongly. However, it is not changing in the overall structure, and that is very important. The asset allocation, as you see it roughly on Page C2, remains fairly constant with close to 90% of fixed income, which is obviously because we are really matching our liability side. And also, the overall risk structure of the portfolio remains fairly constant, which you see on the right-hand side, upper right-hand side of C2 with the rating structure.

Very important for us is that we continue to take out the interest rate risk or the risk driven by the interest rate, the interest rate sensitivity. You see this is indicated by the duration figures, again on C2 bottom right-hand side. We have achieved, now during 2016, to get on the life side, for instance, to 9.5 versus 9.7, which is really very, very close to an almost matching. Now duration is only one indication, clearly. And I believe it makes sense to indicate or emphasize that we are managing out a larger set of KPIs. And actually, we are not managing the duration as such, but we really manage the cash flow profile of the liability side.

The portfolio is a very diversified portfolio, as you can see, in the second chapter of the slides that we have provided on investments. I will not go through these slides, but it makes sense to mention those here, because if you read those through, you will see how well diversified the portfolio is, especially if one considers the liability side in connection to the asset side; meaning, that we have, of course, the various insurance portfolios in these markets that are then reflected on the asset -- in the asset allocation.

Now on Page C3. There you see the yield that we have achieved in 2016. It's 4%. And I'm just indicated that there might be a different page numbering. But I'm on the page total IFRS yield -- 4% total IFRS yield. 4% is what we have achieved. The current yield is 3.3%. The difference there is especially realized gains and losses position of EUR 8.4 billion. This EUR 8.4 billion is indeed a fairly big number. That number is a result of our overall investment strategy. It is not a result of we want to especially harvest up to a certain level. What do I mean with investment strategy? That refers back to the duration management, the cash flow management that I indicated before. And in an environment where the rates are fairly low or even decreasing, then any management on the fixed income side has as an implication or an effect this realized gains position.

Total performance is 5.6%, which leads me already to the next page. The investment result is indeed very strong, we believe, especially if you compare it against Western European peers. The page shows the performance in the range of 2007 to 2015, and is 50 basis points above the Western European peers. For us it's very important that we have a very competitive position, not only because the investment result is that strong, is that important for the group as such, but also because this drives the attractiveness of the product that we offer.

Let me go to the reinvestment yields. Reinvestment yields, economic reinvestment yields as we show them here, reflect, obviously, the market environment. That means they are lower than in 2015. They are decreasing. There's not really much that we can do. We have to work within these markets. However, they do not simply reflect the market yields there. We are, as we'll show later on, very much into alternative assets because we want to boost the reinvestment yields as much as we can. And we believe with our scale, we are in a position to have underwriting capabilities and capabilities to go into alternative assets that help us to keep these yields still at an attractive level. However, not all of the assets we can reinvest into are alternatives and, therefore, you see this reflection of the market yields as they are out there. And one should remember here that the year 2016 had a fairly strange overall pattern, which is we had decreasing yields until the beginning of the fourth quarter. And only in the fourth quarter, we really had a very strong increase. And we have to work, of course, throughout the entire year.

Before I come to the alternative assets, quickly about the margins in the Life/Health business. Margins in the Life/Health business are very resilient, we believe. If you especially compare the business in-force figures on a reserve basis, the business in-force yield versus the average minimum guarantee is really far, far higher. And that is actually a pattern that you have seen for quite some years by now. So we are actually quite happy with the achievements there, and do believe that these margins are not only resilient but they deliver quite some buffers.

Similarly on the new business side, on the new business side, I would like to mention 2 things: One thing is the volume behind the average guarantee of the new business is relatively declining, as Dieter has explained, because we are working on our product portfolio such that we have an efficient capital utilization. That is one thing. The second thing is just a technicality, but important to note. The 2% economic reinvestment yield cannot directly be compared to the reinvestment yield that we showed in prior years because the economic part is roughly 20 basis points. That reflects the currency hedging costs, and that should be considered there. So if you compare it to prior years, please reduce the prior years by 20 basis points, and then you get to the comparable figures.

On alternative asset, let me jump to Page C10. Here, you see the development or the total volume in the various asset classes and the growth versus 2015. What you also see is our total and the ambition. The ambition is EUR 140 billion in these asset classes. In total, what we want to achieve, we are now at more than EUR 100 billion. We grew -- or -- yes, we grew in 2016 by EUR 15 billion. That is something that you cannot directly see from comparing the figures if you do not consider the deconsolidation of the various entities that Dieter has explained. But it's EUR 15 billion that we are growing there, and that's why we believe EUR 140 billion is an overall ambition that we can achieve midterm. The assets that we have under alternative assets are as explained in many discussions with some of you. Very, very relevant for us, not only because of the duration pattern but also because in correlation, in other words, the diversification effect is something that makes those assets also very attractive.

What I also should quickly mention just simply coming from the alternative assets, because they cover what we call sustainable assets to a certain degree, wind farms or other renewable energy for instance, is then ESG for investment management. We have now rolled out our scoring. We are working now on more than EUR 250 billion of our assets with that scoring. We do believe this is really strengthening our overall customer value proposition. And in addition, it helps us to identify risks in the investment portfolio. We would not go that far that we would say that an asset allocation that uses also ESG scoring is going to deliver a higher investment result. But we indeed, as mentioned, believe for risk identification, this is a very useful tool in addition to, of course, to the sustainability value proposition that we should deliver.

Well, that brings me already to the end with my summary page. I'm not going through that summary page. But I just would like to emphasize once again the size that we have with our portfolio is not only a figure as such. It's really a driver of excellence that we can recruit and develop. And that is important, especially in a low-rate environment because only with certain expertise, such a portfolio can be managed with that diversification. And we believe we have that all on board, and the figures show this quite clearly.

Thank you.

Oliver Schmidt
Head of Investor Relations
Okay. With this, we would be happy to take your questions.

Question and Answer

Operator

[Operator Instructions] Our first question is coming from Peter Eliot from Kepler Cheuvreux.

Peter Eliot
Kepler Cheuvreux, Research Division

I have 3 questions, please. The first one is on solvency. Can I just confirm this? There's no change to your target range of 180% to 220%? And also, there's no change to your guidance on the underlying rate of solvency capital generation. I mean, I guess, just in context, I mean, you're probably now well above the top of your range, I'm guessing, gross of the buyback. And I'm guessing the buyback drag should basically be offset by your ongoing capital generations, so just such context there. Secondly, on M&A. I guess, I mean, your recent deals have tended to be friendly from willing sellers, et cetera. And there's been a lot of press speculation recently about potential unsolicited approaches. I don't know, I just wanted to give you opportunity to comment on that, if -- on that sort of disconnect, if you wanted to. And then perhaps, thirdly, just on the outlook. Just wondered if I can understand your thinking behind the Non-Life segment, which is obviously EUR 0.2 billion lower than it was last year. I'm sort of guessing you're hoping for less of a drag from Latin America, an improving expense ratio and organic growth. Now, I know we've got some investment income compression, but I'm surprised that, that fully offsets the positives. So I'm just wondering if you could talk us through your thinking there.

Dieter F. Wemmer
CFO & Member of Management Board

I think I'll start with the Solvency II question. I did win the internal debt that this would be the first question, yes. So our target range is unchanged, 180% to 220%. Yes, the capital of profit generation is some 2% to 3% a quarter. Hard to be more precise and you are fully right when it takes 12 months to execute a share buyback, we earn it in parallel over time. The outlook question to P&C, and I'll leave the M&A question to my boss. We have reduced the outlook EUR 0.2 billion. I would put it this way; I think P&C has probably, of all 3 segments, the best chances to help with the outperformance. We have subtracted just the EUR 200 million investment income. And if we turnaround further the businesses, you have mentioned, Peter, plus we have another year where we have actually demonstrated that our NatCat exposure is maybe a little bit lower than it used to be, we should be sure, and are working and producing results in the right direction. But when you take our full cat load and the reduction in investments returns, then, I think, despite improvements, the midpoint is very much justified.

Oliver Bäte
Chairman of Management Board & CEO

Yes, on M&A, nothing changed actually. This is quite funny, because you always need to ask yourself cui bono, Peter. This was an interest in sort of tooting around. If you're not a bank and getting a fee, then it's somebody who would benefit from being a target. And if you are one of the guys that have the strong balance sheet, then you obviously always assume to be an interested bride. Well, we are interested but we are not obnoxious about it, and therefore, the criteria are the same. The first thing, it has to be friendly. Yes, it should be friendly. It has to be EPS-accretive, yes. And it needs to make sense strategically, yes. And it needs to be in a market where we have a strong management team and a strong platform, yes. And ideally it is in P&C. That's it.

Operator

Our next question is coming from Michael Huttner from JP Morgan.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Fantastic. Brilliant results, well done, 4%; and with the buyback, you're well on track. Just really numbers questions. On the turnaround potential, could you put figures to, I guess, Brazil and Fireman's Fund? On the Korea, so EUR 454 million losses in 2016, how much can I assume this is nonrecurring? Or how much was offset by maybe your gains which are a little bit higher than normal? Maybe you can say a word on Ochten [ph]. I didn't hear -- I didn't see a mention of it. And then finally, on cash flow, I noticed in the Life embedded value Solvency II kind of forward EUR 2.4 billion capital movement, which would imply, and I know, it doesn't really work like that, but that about 70% of your dividend is paid out of Life and I just wondered if that's the right way of looking at it.

Dieter F. Wemmer
CFO & Member of Management Board

I think, first of all, we are showing under the P&C results for Latin America a loss of EUR 75 million. The number is very much driven by a really one-off reserve strengthening of a Life business which was retained after the disposal of the Brazilian Life business I think some 9 years ago. And that was a book which was retained and which we reviewed over the summer and then in Q3 and Q4, booked the reserve. So without these funds and when you look really at the 2 P&C businesses, that should not show up in P&C numbers, but it was a composite legal entity as far as I know. So then we would have been already at close to a 0 operating profit for the year. So I think we are turning the corner really in all 3 markets, Colombia, Brazil and also Argentina. Mexico is, anyway, on a good profitability level, so that is not a turnaround story. That is a continued growth story at good profit margins. So how much this is? Yes, well, I think if you want to take, for all 3 and the Life runoff, some small triple-digit number that is fair. Fireman's Fund continues to be -- actually, our accident year loss ratios are, I would say, very much U.S. market standard where we still are working on actually replacing very inefficient expensive IT systems, and that has certainly taken longer than we originally thought. So it is less of we don't know how to do the business. We know it, but it is technically less easy to get there. Korea losses, well, that would be hard to say, that we can -- that it would not be -- yes, it will not be repeated in 2017. However, I think, also, some of the realized gains will, I cannot promise this, it will be repeated at this level. So therefore, I see this not as a big positive for 2017. And yes, I did not mention Ochten, but we have taken already some reserves in our U.K. book for a move in the discount rate in the Ochten tables. And your last question on the capital movement in Life. No, it's not correct that Life is paying all of our dividend. The highest payout ratio is still coming from our Asset Management business. Actually, I think they paid, in '16, 105% of their earnings. That are the numbers I like. And P&C has also a strong dividends distribution. So it's not that Life is the only one, but Life is also returning on a very good level. I cannot tell you exactly by heart how Korea did influence the overall movement of this individual number, but I think it is as I've just said.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

And on the -- just the P&C payout. In the past I remember, was it 70%? Is that the figure we had this year?

Dieter F. Wemmer
CFO & Member of Management Board

Yes, that is certainly on the run rate. And I think on the -- on our cash flows from subsidiaries to holding company, I think we are in a very good shape. Our treasury overachieved its annual target and that is a good way to handle it.

Operator

Our next question is coming from Vinit Malhotra from Mediobanca.

Vinit Malhotra
Mediobanca - Banca di credito finanziario S.p.A., Research Division

Dieter, can I just ask a bit about the interest rate gearing from an earnings perspective? Because I think it was a few years ago, where there was a presentation you made in London -- or Allianz made in London, which suggested that it takes several years for the earnings to start really materially coming in. Is there any change to that? Or should we assume that I know duration is now longer, but is there an intention to change that? Is that the way to put the -- maybe that's a better way to ask this question. Second question is, obviously, you have commented on P&C, but I'm just wondering whether it was too cautious a target, simply because probably this is the first time that -- in several years, that the outlook year-on-year is lower than the previous outlook. And in this context, I have noticed that you said AYLR [ph] is flat. But wasn't it true that in the last quarterly results, we were hearing that the claims inflation was being beaten by the price increases a bit more. If you can just comment on that in third place.

Dieter F. Wemmer
CFO & Member of Management Board

Okay, Vinit. The interest rate gearing on our earnings, well, I think that is very much part of the business model. That is not something we can influence as we like when interest rates go up. Look, in P&C, we are turning around, Günther, maybe 20% of the portfolio every year. So that means you have the chance to reinvest 20% of the portfolio. And the speed of this, yes, we can certainly look to speed it up where bonds are ready shortly before maturity and if the reinvestment opportunity is there, our team will, for sure, do this and they are doing this already and now quite a bit. But by and large, it is driven just by maturities and business model. And in Life, the same. We can invest new money and we can invest mature businesses of -- as a steepness of the interest rate curve allows a good trade between turning a short maturity into a longer maturity, because interest rates got even steeper and the long interest rate. That type of optimization we will always do. And in Asset Management, it is obvious what is happening. First, on a fixed income fund, the market value goes down. That means even if the average fee is the same, that means on a lower AUM, you are earning in the first moment less on a fund which has a smaller market. Well, view that as that is just the physics of the setup, that is no chance to influence this. But in the midterm, it clearly moves up and still our Solvency II balance sheet has an interest rate sensitivity towards rising interest rates. So we have a better capital position. We will be easier able to sell new products in Life, also new products in Asset Management. So overall economics, I would see very positive for interest rates, but P&L will a little bit slower follow. And in P&C, I don't think that inflation is already our enemy. I think the claims inflation is not really changing at the moment. Yes, now everybody says in Europe, our inflation rate is up. But when you drill deeper, the negative inflation rates in Europe were driven by lower oil prices. Now you have, with the higher dollar and slightly higher oil prices, the cost of energy driving up inflation rates. That is pretty much delinked from what we pay for our claims. So -- and we have seen, in 2016, the latest analysis. We have still, overall, seen a favorable reduction in inflation compared to original reserving assumptions. And that allowed us, and continues to allow us, to recognize reserves strength as we show it.

Operator

Our next question is coming from Farooq Hanif from Crédit Suisse.

Farooq Hanif
Crédit Suisse AG, Research Division

Firstly, on the Solvency II own funds and SCR movement. I can roughly calculate that the operating capital generation's roughly EUR 5 billion to EUR 6 billion, something like that, posttax. Is that right? And how does that compare with the holding company cash flow that you referred to earlier? And are there any operating variances in Life that we should take out going forward? And the second question again on Life. In the investment margin breakdown that you calculated, there is clearly a big increase in harvesting. And I know that that's an output, not an input in the way you run your business. But what risk do you see of that declining quite sharply in the next couple of years? Or is it something that will possibly increase with movement in yield curve and change in your portfolio? If you can comment on that, it would really be helpful.

Dieter F. Wemmer
CFO & Member of Management Board

I will pass on the Life realized gain question to Günther. Let me start with Solvency II. We have a before-tax and dividend and operating capital generation Solvency II of 30 points. Is this fully matched by cash flows? No, because I think the Life new business value is obviously a noncash item which you have to realize over time. Actually on day 1, Life new business costs you cash and it's not creating cash in most circumstances. So that part is certainly not cash. But as I said before, we have a strong cash flow when you calculate it relative to our IFRS net income. And in the end, we are paying out the dividend out of our IFRS net income. And as you all remember, Farooq, we have done quite a lot of excess capital return activities over the last years and continued in '16. So I think we are in a very good cash position, as I indicated before. But I think to say that we could really cash out every quarter Solvency II earnings, that would go a little bit too far. And now I'll hand it over to Günther.

Günther Thallinger
Member of Management Board

Yes, regarding the gains realization. You do know, perhaps, the total figures that we have. We have EUR 8.4 billion now, we had EUR 7.9 billion in 2015 and we had EUR 4.3 billion in the 3 years before that. So that is more the normal level in terms of total investment picture. On the Life side, one should actually expect, indeed, if rates increase, that this realized gain position goes down, of course, considerably. That's -- it is simply following the approach that we have. Is that a risk? No, this is not a risk, because as said before, it is more a result of implementing our investment approach rather than a form of generating the IFRS result. There's perhaps the final remark to this. One should see that this gains realization, not necessarily is always fully into the operating profit because it is, of course, shared with the policyholder. And in that respect, let's say, even a big figure should not be seen as a major operating profit contributor.

Farooq Hanif
Crédit Suisse AG, Research Division

Quickly, on -- if I may return on the capital generation. Dieter, would you be willing to give us a percent to conversion ratio, roughly, of earnings to holdco cash?

Dieter F. Wemmer
CFO & Member of Management Board

I must say then that is really a creative new question, so I like it. But before I now start a back-of-the-envelope calculation on it, I think we will try to figure out whether we can really find any logical combination between the 2 that we can give a rule of the thumb for the future, but I would stay away from an answer here and on an ongoing basis. I would only like to add on the Life realized gains. You should not forget the situation in our German Life business, which is a major part of our traditional Life liabilities and also assets. Under the local statutory results, there is a transition with the so-called ZZR actually to build up additional statutory reserves, which is, I would describe it technically, nothing else than moving unrealized gains from the asset side to the liabilities side. That has certainly driven an increased level of realized gains in our overall portfolio. You have to remember that the German number makes almost 1/3 of our overall traditional Life portfolio and that, the ZZR contribution, I think are going to peak in 2016 and '17. And that is something which is certainly part also of our investment management.

Operator

Our next question is coming from William Hawkins from KBW.

William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

On your change of definition for operating profits, I'm now ignoring restructuring charges. Just a numbers question. Should we still be penciling in as a normal expectation the couple of hundred million a year we've seen in the past? And then more strategically, I guess you're deliberately sending maybe the positive message to your colleagues that they shouldn't be scared to invest in growth by removing that from a performance metric. I mean, is there any material way that might manifest itself in terms of company behavior? And then, secondly, could you just highlight for us this year life markets that you think are going to be getting particular attention around your 10% RoE target? They could already be above it. Clearly, the ones that are below it, where you expect there to be the most kind of attention for either earnings or for capital release?

Dieter F. Wemmer
CFO & Member of Management Board

William, I somewhat missed your first question on the operating outlook. What was your link between the restructuring expense and behavior?

Oliver Bäte
Chairman of Management Board & CEO

Oliver, here. I think the question was, given the signal on the change in definition, is this also signaling a change in strategy in terms of restructuring our business?

Dieter F. Wemmer
CFO & Member of Management Board

Then, I got it right, thank you. I think, indeed, we remove it from the operating profit because the operating profit is used internally also for our target-setting process. As you know it, it's part of the management target-setting system and we want to encourage people to constantly think about changing the business, and the target-setting system should not be in the way that people are stopped doing what is right to drive the future. That is really to get more speed and into the organization and gets the people also more looking at opportunities where change could help to a positive future. The 10% RoE target, well, we have not given a list there. That would be, actually, also, a bit unfair to my colleagues in the countries who are, at the moment, not yet on the 10% level because they are all working hard and have given us a lot of high hope that they are getting there. Therefore, we should wait with the bashing until we have 2018 and they missed it.

William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

Okay. And sorry, just to come back in terms of the numbers on the restructuring charge. Should we inevitably assume that, that line item could be increasing because you've said to people it's fine to be investing? Or should we be [indiscernible]?

Dieter F. Wemmer
CFO & Member of Management Board

Yes. That line item should be increased, but I'm not expecting jumps to huge numbers, but certainly growing. I think we had some EUR 100 million in last year. And currently, we see the same level but I think we have now the change and that could be a bit more coming towards the next quarters.

Operator

Our next question is coming from Nick Holmes from Societe Generale.

Nick Holmes
Societe Generale Cross Asset Research

Two questions. The first is I wondered how concerned are you by the EIOPA requirement to disclose Solvency II without the long-term guarantee package. I'm sure you can't give us any sort of ratio of what it would be like. But can you give us any idea of what the ratio sort of range might be? And then secondly, Oliver, just wanted to come back on acquisitions. I know you said nothing has changed. But correct me if I'm wrong, but I think you have indicated in recent interviews that you are looking at large acquisitions. And I think that is a change, is it not? I wondered if you could give us a bit more color on that.

Oliver Bäte
Chairman of Management Board & CEO

Nick, thank you. Oliver here. It came also up this morning. That is actually a misunderstanding based on an interview earlier, where the question was are you not investing or trying to invest and buy something in the U.S.? And then we basically said, "Well, that is very challenging because, in the U.S., the valuations are very high for the market relative to Europe." And if you want to do something in P&C, you would need to go very large, and then I said, "And that's why it's very unlikely." Now that was turned around and we say, "Ah." So since you need to be large, then they're going to do large. So that is a little bit like the deck [ph] of buy and sell, the chart that you know. You say buy and then sell. It's coming out at the end. Cut a long story short, we remain disciplined the way we are and our balance sheet allows us to do both large and smaller. But what we are needing to do is to have transactions that make economic sense and that we can handle. And these criteria have not changed. And then on -- and the other comment that I get, I said earlier, there's lots of speculation driven by people that have low share prices and we always come up as the guy that might be interested. But we'd like to have a nice bride. Okay, so Dieter will talk about long-term guarantee.

Dieter F. Wemmer
CFO & Member of Management Board

Yes, I think, actually, our balance sheet is the best long-term guarantee. I think the EIOPA requirement that I think it's somewhere mid-May, that all legal entities in the Eurozone have to give their full details on their Solvency II balance sheet and assumptions setting is a good step in transparency. I'm really looking forward that there is more transparency in the Solvency II regime, as we currently have. Am I concerned about it? No, because we are not using balance sheet transitional. And the VA, yes, that was part of the long-term guarantee package, but I think it got diminished by EIOPA redrafting of it. Anyway, I think the industry should have got a much better way to handle it because the credit spread we can use under the VA is substantially lower than the credit spread we are experiencing every quarter in our results. So it is really a small recognition of what we achieved and what any insurance company achieves. And the U.S. insurance industry is clearly benefiting from recognizing 100% of their credit spreads. And Europe has to live with the small portion of it. So I think any transparency will help also to drive a fair competition between Europe and the U.S., and I think also a fair transparency between Allianz and its peers.

Nick Holmes
Societe Generale Cross Asset Research

Can I just follow up very, very quickly? First, Dieter, on the long-term guarantee package, are you -- I mean, is there any concern that the transparency will work against both perhaps yourselves but also the industry in lowering ratios to levels where people might get concerned? And the second question, Oliver, sorry to pester you on this, but just very, very quickly, are you saying that you rule out large acquisitions? Or do you not rule out large acquisitions?

Dieter F. Wemmer
CFO & Member of Management Board

Yes, I'm not concerned about our solvency ratio and the transparency. I am looking forward that this is a positive. And in particular, when I consider this very unfortunately paid about the Germany Life insurance industry and I think I'm really looking forward to the transparency and maybe some of you have to adjust their comments.

Oliver Bäte
Chairman of Management Board & CEO

Talking about adjusting comments, so let me repeat. We have no predefined size that we're looking at. We're looking at strategic fit.

Operator

Our next question is coming from Michael Haid from Commerzbank.

Michael Hermann Haid
Commerzbank AG, Research Division

Three questions. First, on the expense ratio in P&C, which was again very high and you mentioned that it includes some investments. Can you talk a little bit about these investments? And can you also give us kind of a number which may or may not in the future reduce the -- by which the expense ratio may be reduced in the future? Second question, new business generation in Life in Germany was very strong in the fourth quarter. Can you tell us from where it comes from? Is it more single premiums or more recurring premiums business? And is it more new? Also, does it include traditional products? And also, regarding German Life, you mentioned that there was a burden from the policyholder crediting in Germany in the fourth quarter. Can you talk a little bit about that? And last question regarding the ZZR. You just mentioned that this you expect to peak in 2016 and 2017. Do you say that because you assume that the regulation or the legislation is going to change? Or do you -- or can you say that without a change in the legislation regarding ZZR requirements?

Dieter F. Wemmer
CFO & Member of Management Board

That was -- was this a long question 2, or already including question 3?

Michael Hermann Haid
Commerzbank AG, Research Division

It was already question 3.

Dieter F. Wemmer
CFO & Member of Management Board

Okay, yes. Okay, Michael, thank you. Expense ratio, P&C, well, over the whole year, our admin cost ratio moved 10 basis points up. So that is [indiscernible] of EUR 50 billion. Yes, that is still a large number, but it is actually quite a number of projects we are doing for the renewal agenda and that is, whether it is the customer centricity to move up Net Promoter Score, whether it is our digital agenda, there is quite some change or implementing technical excellence. To give you a precise number, I have then really to add up quite a number of details, but it is roughly explaining the 10 basis points up in total. There is -- the new business in Life, and in particular in Germany, we are -- in 4Q, it is roughly half-half between recurring -- well, difficult to say because under the German measurement, it's half-half between recurring premium and single premium. In recognizing the revenues, of course, single premium is very much the dominating part. It is very strongly driven by our new products. Otherwise, we would never get for the whole portfolio the 40% out of capital efficient products. And I think our Page 19 indicates this. We have, in Germany, a higher share in the capital efficient product than overall. That is 42% and only below 20% are actually still traditional products. Yes, you are right with your observation; we have allocated a higher share of the profits in Q4 to the policyholder. Q4 is always a bit a catch-up quarter to average out the whole year and align it also with the statutory result and the real payout to the customers. So therefore, that is always a little bit of catch-up. Therefore, the numbers are not stable over the quarter. And no, my assumption about ZZR peaking is actually more an assumption how the roll-forward of this average interest rate is moving. So it is not assuming any change by law or formula or whatsoever. It is more, I would say, a rough guessing how this impacts moving forward. And that is just a slowing in the decline of the interest rate curve, so nothing else.

Michael Hermann Haid
Commerzbank AG, Research Division

Okay. Regarding the expense ratio in P&C, the 28.7% for 2016, I think it includes more than just the 10 basis points investment into the renewal agenda, right?

Dieter F. Wemmer
CFO & Member of Management Board

So that is commission increase, I said this before. Sorry I did not repeat myself.

Oliver Bäte
Chairman of Management Board & CEO

Michael, Oliver here. Just -- because the underlying question is, are we remaining committed despite the surge to drive down the traditional business? And I just wanted to be very clear: there is just an acceleration, not just a commitment. There's an acceleration of an increase of risk protection, unit-linked and, in particular, capital efficient. And I think your question reflected the fact that in the past, we were very strong in the change in Germany around the retail portfolio; and in the corporate portfolio, we were a little slower. That was not because we don't want to, but the issue is you have ongoing client relationships and contracts with corporations that take a while to change. But the direction is everywhere the same. We're going to more capital-efficient products because it's actually better for consumers. It's not just better for shareholders, it's better for consumers. It gives them more choice, it gives them more yield. So the -- it's actually unabated. And our German colleagues are doing an outstanding job to drive further in the right direction. And that is what we want to see overall. While sort of revenue is still slightly down, as we are moving from the old world to the new world, you already can see in Germany how big the success is. Once you have the right platform of products and services, we will accelerate in the future into the new direction.

Operator

Our next question is coming from Andrew Ritchie from Autonomous.

Andrew James Ritchie
Autonomous Research LLP

Some very quick questions. What funds are driving the inflows at PIMCO? Is it still mostly the -- I think it was the income fund that was the particular flagship success most of last year? And in relation to PIMCO and Asset Management division, what are your sort of base case assumptions for 2017 behind the forecast? I mean, last year, you were willing to give us, I think that you'd said you'd get to breakeven or positive flows by the second half, which you did. What's your kind of working assumption for '17, both in terms of flows and performance fees? One other quick question. I just want to understand. Clearly, the balance sheet is very strong from a Solvency II perspective. Your debt capacity on a Solvency II basis is obviously very, very large. But I suppose, I'm just trying to understand what was the binding constraint on your debt capacity. Is it the IFRS gearing, which is kind of flat year-on-year? And maybe if you'd give us a number as to what you think your debt capacity is? And the final question is, you looked like you've hedged equities more in Q4. Will that have a P&L impact; increase the volatility from associated derivative noise?

Dieter F. Wemmer
CFO & Member of Management Board

Andrew, I start with PIMCO fund inflows. Yes, well, you can look at it from various angles. I think what is good in Q4 is that we have actually seen good net inflows in the U.S. And it is still the old funds. Therefore, I think somebody asked me early this morning that total return fund continues to see outflows. Yes, correct. But it is, clearly, outrun by the newer product categories. And that is, also, when you look at customer groups, we see the stronger inflows in separate accounts. So that is a bit how I would characterize it in total, so various things. To give an outlook for the year, well, certainly, we assume that the current situation continues. Active credit, I believe has really a good outlook. Volatility in the markets, yes, slightly raising underlying rates. More steepness in the interest rate curve, I think that are all good points for an active credit manager. So I think PIMCO is well positioned for the current environment. Your question on what is really limiting our leverage; in general, we are still fairly conservatively leveraged. We are not going to the maximum with our current rating. The bottleneck is Moody's calculation and requirement for our current rating under Solvency II, indeed, we have substantially more room to go forward. There is this interesting Tier 3 rule, which will really allow us to leverage up a bit. Under S&P, I think our capital position, I did not mention this earlier, is very strong. And also the financial leverage would be less binding than Moody's. You had another question, Andrew?

Andrew James Ritchie
Autonomous Research LLP

Did you hedge equities in Q4? The equity sensitivity went down, and was there -- is there an earnings impact from that going forward?

Dieter F. Wemmer
CFO & Member of Management Board

I'm glad to pass this on to my new colleague.

Günther Thallinger
Member of Management Board

Yes, it is indeed the case that we manage our equity exposure, of course, to also optimize our overall capitalization under Solvency II. And you'll see this in the sensitivities, and we believe we can do this very well with the know-how that we have internally with AGI, but also at companies like AZ Life in the U.S. And yes, I believe this is basically the answer to whether we hedge or we don't. Yes, we do.

Dieter F. Wemmer
CFO & Member of Management Board

Let's say if -- yes, I'm just getting the -- let's say cost was also a question there. Look, if we now are going to really illustrate what kind of fee load we have on these structures, we really start to make those very transparent. We actually believe that we have a little bit of a competitive edge on that side, and therefore, we are not going to explain that, sorry.

Operator

The next question is coming from Rötger Franz from Societe Generale.

Rötger Franz
Societe Generale Cross Asset Research

I have 2 little questions. First of all, last year, you disclosed the risk capital breakdown by risk category in your presentation. And I no longer see that in this year's presentation. So my question is, how actually -- has this changed in 2016 especially in the context of the Korean -- sale of the Korean Life business? So can you give us a bit of more detail how this risk profile has changed over the last year? And second, just a bit of follow-up to Andrew's question in terms of leverage. I understand that Moody's is a binding constraint for your leverage. I also see that you increased your sub debt over the last 2 years or 3 years quite significantly, also when you take into account that you called EUR 1.4 billion of sub debts today, which is already refinanced, issued EUR 1 billion in January. Do you have kind of a specific target range that you aim for?

Dieter F. Wemmer
CFO & Member of Management Board

Yes, I think, overall, the target range, as I said, is driven by the Moody's constraint. Otherwise, we don't have a specific target range. But when we can use this in a different form, we would also do. At the moment, we had the feeling that buying something more at this favorable market condition is a great long-term deal. So therefore, we did this very opportunistically. The risk capital breakdown will be, for sure, published in our annual report, as every year. So that document is being published soon and I would ask you for the patience to do the specific reading there. Or when you need to do it faster, call our Investor Relations team and you'll get it earlier.

Operator

[Operator Instructions] Our next question is coming from Adina Ranzinger [ph] from Deutsche Bank.

Unknown Analyst

Two questions, please. Going back to the M&A topics, you highlighted that you are looking at opportunities in P&C. Would you consider a composite business? And the second question is, when you are considering the size, how important for you to maintain your current rating and stable outlook?

Oliver Bäte
Chairman of Management Board & CEO

Dieter has given you so many good answers, so.

Dieter F. Wemmer
CFO & Member of Management Board

I think, it's -- certainly, the rating, we clearly want to maintain. We are selling a AA security to our customers. It is important for our large industrial customers on the P&C side. But personally, it should be much more important for the retail customers who trust us, our money, for their pension years. Because there, you need to be sure that you get your money back with return 50 years from now and that people should be really focused that they have a high quality and highly-rated balance sheet, which helps in their -- for their old age provisioning. So yes, the composite M&A question is a very obvious one. Sure, when you find something interesting in P&C and Europe, there are most likely a Life balance sheet coming along with it. Yes, from our strategy and business interest, we have enough Life balance sheet in Europe. We can cover every part of Europe with all Life products and we don't need more Life balance sheets. But if the overall deal is attractive, then you have to take it or you will not get the P&C part. So it has to be taken into the overall calculation, and then you'll decide whether the mix and the price makes it or doesn't make it. It is a rational commercial decision that is less than a strategic decision.

Unknown Analyst

Very good. So you are basically saying, whatever M&A opportunities you are going for, you want to maintain your rating with a stable outlook. Is -- just to confirm, with stable outlook.

Dieter F. Wemmer
CFO & Member of Management Board

Yes. I think an acquisition which destroys our rating, that's -- the question is what value are creating with this. I wouldn't see this as compelling.

Operator

The next question is coming from Michael Huttner from JP Morgan.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

I was still typing my question. So one was just these little points again. The -- you said U.S. basis, first it made some money and I just wondered how much. And on the FFIC, you said the item which was a cost this year and might not be going forward, the IT, and I just wanted a figure for that. And then in terms of general philosophy on capital management, this kind of more flexible 50 bps envelope that you can review every year and not every 3 years, any idea that you would like, let me put in the extreme, compete with Munich Re in terms of being a big cash return company with a kind of EUR 1 billion annual buyback and a huge dividend? Or is the idea instead that you would have the nice dividend that we see at the moment backed by high RoEs; in other words, high ROEs, meaning more earnings growth. So is the capital management designed to return cash? Or is it designed to increase your ROE? And linked to that, I still don't understand why the RoE actually went down from last year to this year when everything else seemed good.

Dieter F. Wemmer
CFO & Member of Management Board

Well, Michael, the swing in the U.S. basis risk is some EUR 155 million and it is roughly also the profit from the basis. No, that is the swing. It was -- it is still -- it was a year ago a small loss, and this year it is a profit. So why is the RoE down? Well, our net income is 4% up. And very simple, our average equity is more than 4% up, driven also by changes in FX, and for example, the boost in the equity markets at year-end, which is a nice problem to have, created EUR 1 billion more after tax, after policyholders' share in unrealized gains in equity. And as we are calculating our RoE, excluding unrealized gains and bond, so that's -- the bond movement doesn't play a role for our disclosed RoE, but obviously the unrealized gains in the other investment classes, also the unrealized gains in our real estate portfolio, went slightly up with a further increase in real estate pricing. So actually, it all went up for good reasons. As I said before, I really see this as a luxury problem and not as a drama, which we cannot manage.

Oliver Bäte
Chairman of Management Board & CEO

And, Michael, the answer on capital management is a cyclical one, not a fundamental -- so you're implying that we want to put ourselves in runoff?

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Yes.

Oliver Bäte
Chairman of Management Board & CEO

Yes, yes. Thanks a lot. We would like to grow the business organically and unorganically. And -- but since we do not want to have capital sitting idle and accumulating it over 3 years so that, over time, RoE and capital returns deteriorate. We want to give ourselves more flexibility. Other one is the signaling function, because quite a few investors were getting itchy at the end. And so it's "Is the share buyback coming? Is it not coming?@So we want to remove the uncertainty around that. Not having fewer handcuffs and straitjackets is helping our ability to manage. The discipline will come from the targets, let me repeat that. We have given ourselves in November, the RoE target and the EPS targets, and they'll make sure that management is incentivized to keep capital efficiency very high.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

But on the RoE targets, I mean, the EPS you had there, or the calculate you're getting there, that's also my little questions and stuff. The RoE target, as you say, it's a luxury problem. But it seems to be drifting further away. Anyway, it's just a remark. I'm sure it's a luxury problem and [indiscernible] dealing with it.

Oliver Bäte
Chairman of Management Board & CEO

But, Michael, the -- we have given you some sensitivity initially that the share buyback already is adding a significant boost to...

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

50 bps. Yes, yes, of course.

Oliver Bäte
Chairman of Management Board & CEO

All right. And then to RoE as well. Now we have to always say, when are the shares really bought? When are they really nullified as ever, but we'll get a double bang for the buck on that.

Dieter F. Wemmer
CFO & Member of Management Board

All right. [indiscernible] We are now ready to the second round of question. I think for the sake of everybody, we should come to an end and close this conference call for now. Again, let me remind you there will be more opportunities to ask questions next week at our analyst meetings. So with this, we say goodbye to everybody. Thank you for having joined our call, and we wish you a very nice weekend. Thank you.

Oliver Bäte

Chairman of Management Board & CEO

Thank you for support, guys. Keep on buying our shares.

Günther Thallinger
Member of Management Board

Thank you. Bye.

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