S&P Capital IQ

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Allianz SE DB:ALV

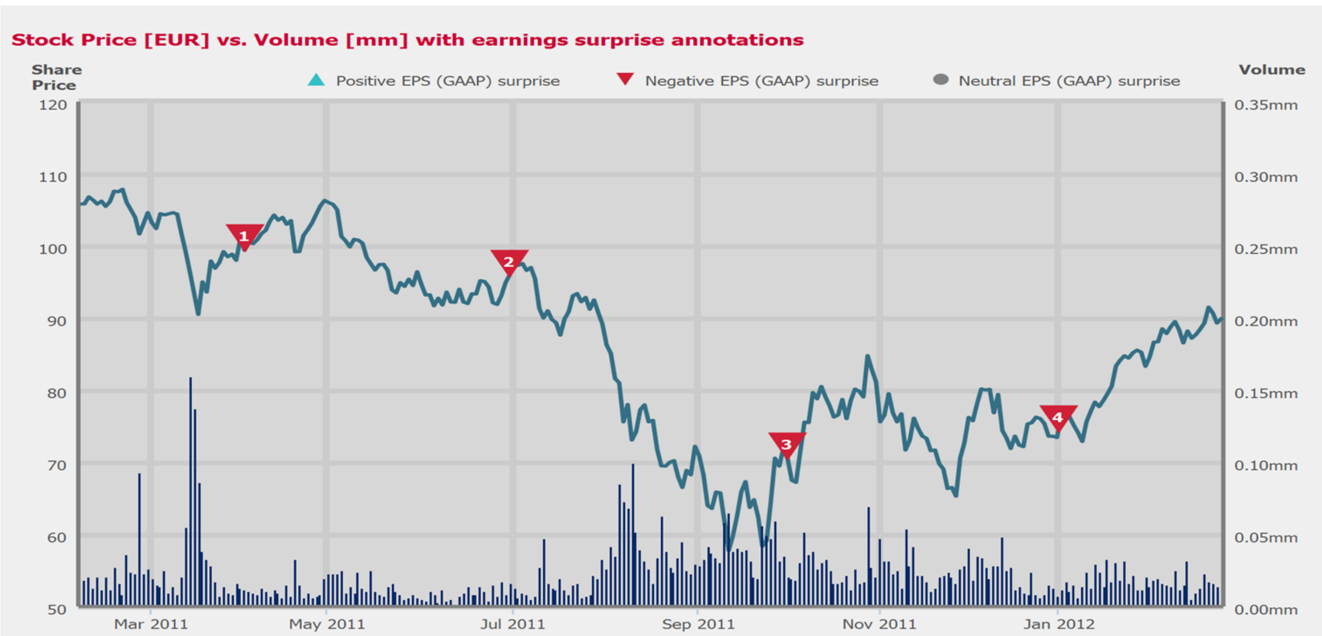
FQ1 2012 Earnings Call Transcripts

Tuesday, May 15, 2012 12:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2012-			-FQ2 2012-	-FY 2012-	-FY 2013-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS (GAAP)	3.00	3.02	▲0.67	2.81	11.53	12.03
Revenue (mm)	30308.33	30053.00	▼(0.84 %)	25089.00	103209.01	104058.49

Currency: EUR
Consensus as of May-15-2012 8:19 AM GMT



- EPS (GAAP) -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2011	1.99	1.88	▼1 (5.53 %)
FQ2 2011	2.57	2.17	▼2 (15.56 %)
FQ3 2011	1.65	0.34	▼3 (79.39 %)
FQ4 2011	2.17	1.06	▼4 (51.15 %)

Call Participants

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Presentation

Operator

Ladies and gentlemen, welcome to the Allianz conference call on the financial results for the first quarter 2012. For your information, this conference is being recorded. At this time, I would like to turn the call over to your host today, Mr. Oliver Schmidt, Head of Investor Relations. Please go ahead, sir.

Oliver Schmidt
Head of Investor Relations

Yes, thanks, Bettina. Well, good afternoon, ladies and gentlemen. Welcome to our conference call for the results of the first quarter 2012. As always, Oliver will present the key facts and figures to you. So without further ado, I hand over directly to him.

Oliver Bäte
Chairman of Management Board & CEO

So good afternoon, everybody. We had a good quarter. I'm going to lead you through the Q1 numbers and I'll enjoy them as long as they are great. Given the environment, we have some tough times ahead. But let's talk about the things that went well in the first quarter. And I will try to hit some of the questions I have seen in the early commentary that came out right up front. The second comment I'd like to make, I'm trying to be brief, but I'd also like the questions to be pointed on the explanations and the economic drivers. We have provided a lot of technical answers in the appendix, particularly on the internal model changes which we have implemented in Q1. Oliver Schmidt will, after this call, be very happy to address any technical items around it, like how come this number moves this and that, because I thinks that's a better use of our time here on this call.

So let's dive into the deck. I'm going to start on Page 3 with the main highlights. Revenue is EUR 30.1 billion, while Life is down but still is the second-best quarter we have had. Operating profit, 40% up to EUR 2.3 billion. Lower NatCat losses have helped but also a very strong performance in Asset Management Life/Health. Net income at EUR 1.4 billion and capital position continues to be very strong while we are doing everything we can to further de-risk it in parallel.

Page 4 gives you the usual overview over the last 9 quarters, gives you a nice feel for the Q1 results.

Page 5 gives you the equity development and the growth in the book capital to EUR 48.2 billion, EUR 7.4 billion (sic) [7.4%] up. Net income plays a role. FX was actually slightly negative, was minus 200. Unrealized gains and losses significantly up, EUR 2.1 billion and a few other items that add up to this number. The stress impact, on the right-hand side, are as usual so I will not spend a lot of time on it.

Page number 6. Therefore, the next, at least 2 years, relevant conglomerate solvency rules show that we have very strong solvency at 183%, going up further. Now we all know it's not sensitive to interest rates so it's a partially interesting perspective from an economic standpoint, but in terms of regulatory capital, we are and will remain extremely strong.

Page number 7 gives you our economic solvency at Solvency II calibration. I spent a lot of time, last year, to prepare you for the changes we have done in Q1. A couple of comments on that. Number one, we have implemented a whole slew of changes that are aimed at trying to bring us, as much as possible, in line with the current Solvency II discussion. We're taking a very close look at is -- what is in the tax that has gone through the econ and have applied it. Second, we did it in the first quarter in order to not create uncertainty about our Q4 numbers, so we have lumped them together in order to prepare ourselves. Last comment, however, we will only know what the real deal is once we have gotten an internal model approval which is a year after the trial log has ended. We're currently planning our approval process to start for the internal model application in the middle of 2013, and that's when we will exactly know what the regulators will approve of or not. Until then, sorry guys, there is still some insecurity.

Now second comment is, a lot of people have said, ooh, that looks great but the markets have been terrible the second quarter. Will that number not have suffered dramatically? I cannot tell you the number as of today but we're getting better on the system side every week. As of May 7, that solvency number still stands at 195, which is really strong.

Last comment before I go into the number, the most important sensitivity remains the combination of low interest rates and equity markets, but with the bund kissing 1.5%, we're already in a very, very difficult situation.

Now let me move to Page number 8, where we have provided you with the transparency around what makes the numbers move between year end and now, the 2 components. The right-hand side shows you the Q1 movement which is typically benign market IFRS earnings. And on the risk capital side, increasing risk exposure and decreasing valuation rates due to lower liquidity premium. I'd also like to point out that liquidity premium have come down significantly, and therefore, those of you that hated this thing in the first place will know that this more reflects what you always thought were the true economics. Factually we had 96 basis points liquidity premium in Q4 and it has come down to 59 basis points as of now. Yes, so it's almost half.

Now the left-hand side shows the major movements, both on AFR and risk capital. And I've seen some comments that said we've taken a lot of positive, but no negatives. That's obviously nonsense. On Page #69, we've provided you -- and I think we're leading disclosure here in the industry -- with what has really moved the impact and what have been the various model changes. All the ratios are as of the end of last year, so you can really go through the numbers, and I'd like to point out that we've done 3 major items to be on the more conservative side. The first one is we have introduced transferability restrictions for the Value of In-force of Life portfolios and also where we have minorities limited that to the risk-bearing capacity. The second one is we have become a lot more conservative given what we're seeing with the Fed rate and with the bund on interest rate modeling. The external calibrations which were too benign -- we've used -- and now use our own statistical time series, again, which are stressing interest rates a lot more than the official data. And then a third one is, we have introduced Life non-market risk modeling in line with Solvency II requirements explicitly modeling, even more conservatively, longevity risk. So we're trying to buffer up and make sure that, particularly on the Life insurance side, we are not just taking the gain, in particular, from yield cost entering at year 20 and then up the swap curve and then moving to the ultimate rate at year 60 or, for example, by the full integration of operational risk model that were so far based on an approach that's more like the S&P standard formulas but does not reflect the things we are doing to improve and run operational risk.

The Asset Management side, last comment, we've also had a charge on that. That was not reflecting our true bottom-up model and I can only applaud our colleagues. I think we have a much better understanding of what it is. And we're not just having one of the best asset management shops, but we also have one of the best risk management shops in asset management and that is reflected here.

So let me move back to Page number 8 and then say what is it. So we had a net decline in interest rate risk modeling, a Life non-market risk, operational risk integration and revised asset management modeling, bringing the number from EUR 26.7 billion to EUR 24.2 billion. And at the same time, we also had a net negative effect out of the decrease to non-transferability and partially offsetting by the euro swap extrapolation from 20 years onwards.

Now before people get too excited and say this is fantastic, now we'll get a lot more dividend out of Allianz, let me please remind you that we have other capital regimes we also need to pay attention to. In particular the credit agencies have the desire to constantly downgrade European sovereigns and the banks sometimes, by the way, arguing that you need to downgrade the one because you just downgraded the other one. And that is putting, obviously, pressure on ratings. Since we are exposed to both financial sector ratings and government ratings, we have had our risk capital relief that we have produced by de-risking about EUR 1 billion in the first quarter, seen offset by charges through higher charges from Standard & Poor's and others due to the downgrade. So we are at net neutral despite significant risk reduction and that will remain somewhat of a boundary condition going forward. So before you get too excited about dividend increases, let's get through the year and see how the euro prices continues to unfold.

Now Page 10, please. Revenues development, a couple of comments here. On an internal growth basis, P&C are both from prices and volume, Life/Health down 5%. I'll talk about it, particularly, due to the situation in Italy where we had very, very slow sales on the bancassurance side. Asset Management continues to power ahead with 8.4% on an internal basis -- notionally, it's actually 13% and very strong inflows after outflows in the first quarter, which also differs from the industry.

Page number 11 shows you that all the business segments are doing well. We have one issue that -- the corporate segment, I need to explain that to you -- that on Page number 12. Two declines, one in the banking side, not Germany banking, it's RGF Banc [ph] where we have a guarantee we provided for the Life Insurance side on Greek government debt. After the exchange we've taken the net hit to the P&L so that the nonrecurring item -- and on the holding treasury side we have about EUR 18 million loan investment income, typically dividend income, from our financial investments and EUR 29 million in technology investments in the first quarter.

Now moving onto nonoperating items. A couple of comments on the realized gains and loss position, net number minus 7 for the quarter. The right-hand side shows you the various components. Two comments here, on the equity side, last year we still had ICBC gains in that we don't have this year and we had some debt changes and realizations in the first quarter, particularly to de-risk. On the impairment side, there is a 125 charge of equities. The vast majority of that EUR 75 million, to be precise, is a write-down on our Spanish bank participation, Banco Popular, who've taken in time and through the market an indifference to all other strategic positions and that position we could not hedge due to the illiquidity in the market or other positions UCI, Commerzbank and others, we are hedging or making sure to reduce that.

Now the other component I'd like to mention is the income from financial assets and liabilities carried at fair value, second to last line. A part -- the vast majority of that is EUR 180 million gain on the sale of the Hartford warrants. Let me remind you the debentures will come in the second quarter and we haven't decided yet, just to preempt the question, what we do with the shares. We're evaluating our option as the year unfolds.

I'd like to close the comments on this page by pointing out that our unrealized gains, both on equity and fixed income, have gone up substantially and we have refrained, as always, from taking extra gains just to make -- produce some earnings.

Now let's move on to the sovereigns. I think this is now the eighth quarter where I have the pleasure to talk about this. Greece is basically irrelevant, Ireland is irrelevant, Portugal is irrelevant. For those that have a question, we've been also continuously selling down whatever we have. EUR 300 million, EUR 400 million on Portugal and Ireland. We've sold Spain further down with the appropriate position. We continue to de-risk where there is market liquidity and we will continue to do so going forward. The unrealized gains position have obviously improved in the first quarter. The second quarter we'll see the reversal of the trend but still significantly better than in Q3 and Q4.

Page 15, net income development. There's still always a question why the effective tax rate is so high. Two comments. We had, again, lower tax exempt income in Q1, and we have trade taxes and prior year taxes that you need to pay -- keep in mind. So for example on the Hartford warrants, we not just had to pay tax on the Hartford sale but also on the dilution payment that we received, I think in 2009, EUR 200 million. We needed to pay extra taxes on -- because, at that time, we were assumed to hold and then convert the warrants. Now that we've sold, that had to be unwound. That tax rate is expected to trend down over the year. We have a plan of around 33.5% for the total year. So these would have been my comments for the group section. Let's please move on to P&C. And there were a couple of questions, in particular, around the accident year loss ratio which I'm going to address in a second.

To start with Page 18, you see, I think overall, a nice picture. Except for Eastern Europe and for Spain, we're growing everywhere, obviously at different rates. In Spain, we all need to acknowledge that there is a very severe recession. But I can tell you, we have the strongest balance sheet there and the strongest franchise, and we will continue to make significant profit in this market. And given our low fixed cost base, we can actually afford to let top line grow -- go and protect the margin. Now in France, we are flat on the quarter. We expect slight growth this year, as for Germany. In both cases however, we're still growing through prices. We also now need to make sure that we grow through -- on the unit side.

A number of other places are growing very nicely, just to explain AGC&S. It is somewhat of a one-off through our ART unit, it's not something you can prorate over the year, it will normalize over the year. And we have a number of markets where we are catching up due to very strong price increases, for example, in Australia. And we have one comment I have to make. On credit insurance, we've actually decreased prices, I mentioned that in the year end call, and it's actually enlarging the market space and attracting customer volumes. So I sometimes see a little bit, how do I say, simplistic analysis let's say. If the prices don't have volume, doesn't go up. It's not true. In the number of markets where we've taken prices down, we see significantly more growth and that's -- wherever we have good margins, that's actually the right thing to do.

Now operating profit, Page number 19. The huge improvement to underwriting and that is obviously driven by very low NatCat. We had EUR 700 million less NatCat than last year, which was terrible. And we have some profitability gains in a number of large markets which we really like, particularly in Italy and France. Now, partially, that's offset by negative runoff from prior NatCat; it was in the footnotes. We have about EUR 80 million additional negative runoff from Thailand. It just took a very, very, very long time to have business disruption claims coming from third-party reinsurance business to the corporate center and that's reflected in the numbers that you see here. That also suppresses the runoff numbers to what you saw in the first quarter.

With that, let me move on, Page 20. Yes, overall, a very, very good picture, except for the United States, where we're still running at around 106% for the year. The question always is, is the U.S. going to be better? I told you at the end of the year, 2012 is the year of restructuring, so the Fireman's Fund numbers will not dramatically improve throughout the year. We have taken significant reserving action. We will continue to do so. The market continues to be tough, particularly in workers compensation and property. So that's it.

In a number of other places, Germany, France, Italy, particularly Italy, we have fantastic profitability. If you compare that to our competitors, we're probably 5 to 6 points, at least, better than everybody else. Spain, outstanding results as we have them in AGC&S, the U.K. credit insurance. And Australia is still not as good as I think it's going to be once the price increases come through. So the underlying momentum is good.

Now some people scratch their head and say, Ollie, I can't believe that. So recall on Page 21, your underlying accident year loss ratio has trended up, so can you give me an explanation how I get to reconcile these 2 items?

It's very simple. We have a statistical outlier in here because the accident year loss ratio for the first quarter is heavily impacted by weather-related claims in France and in Germany, a total of about EUR 85 million to EUR 90 million, that comes through tap water. Last year we also had that but in Germany it was in the second quarter, not in the first quarter. On top of that, we have effects from the U.S. you saw and that lifts this number by more than 1 percentage point relative to what we've seen before. So the underlying, at least from my personal point of view, is actually much better than the number looks on this page. And we expect some further improvement throughout the year.

Page number 22, expense ratio stable, that's what it is. Actually, the underlying trend is favorable, particularly in our largest 4 market. We've taken about 30- to 40-basis points trend improvement. But again it's the first quarter, and before people relax too much on the expenses, I better shut up and move on to the next slide.

Now average asset base is up to EUR 99 billion, helps us to support the investment income in the low yield environment. Our colleagues are doing a great job to get the right yield despite the challenges in the market. And you also see that on page 24 when you look at the interest and similar income. Now for those just talking expenses, that this -- the investment expenses are up, that's also a glitch, because we've changed some classifications on the investment expenses in Australia. So no worries about that, that's a transfer.

Now page 25 has changed because we want to give you an appropriate picture on what the price effects have been. Now in the past we always used to have 2 columns -- actual rate change on renewals and then planned pricing. We've eliminated the second, also for compliance reasons, and secondly, going forward, you need to bear with us, we've indicated it with a price trend arrow on the market.

Now we've had about 2%, on average, and some commentators have said that's actually a very low number. I don't know what statistics you look at, but I can tell you ours do fully reflect all discounts, and more importantly, the impact of bonus-malus in motor insurance. Many of our competitors publish gross numbers that is before bonus-malus. So before you get excited about people that tell you they're increasing prices by 5%, please read the footnotes.

Second comment, that while the pricing momentum is positive, we are balancing 2 items. One is the exposure units, i.e. one is the wording, and the other one is the price. We will work, this year, both on getting further pricing throughout the year but also optimizing our risk profile. For example, the experience in Germany with our new products show that we're not just getting better pricing but better risk selection, which will also affect the claims ratio going forward. So the selection items and tariffing remains hugely important for us and we're pushing that as well. Last comment, that even though it's my own slide, Page 25, I would like to comment on the arrow in Italy. If I really listen to what I'm hearing from the marketplace, there is pressure building on the pricing, so we might see less pricing strength than this arrow here indicated. It's probably more going to be flattening out as you see in the text on the right-hand side. And in non-motor, we still have fierce competition. I actually don't know why people do that. Particularly in commercial lines, we don't have the rates we need to have, so we'll continue to cull risks that are improperly priced. Again, in many other places, prices are improving.

Now let me continue to comment on the credit side. We have some weakening in rates but we are operating, if I may remind you, at combined ratios below 80%. So we are very comfortable to expand the marketplace and you see that in our gross numbers. This would have -- would be my comments for P&C.

In the interest of time, let me move on to Life and Health. EUR 13.7 billion on the revenue side, operating asset base growing further, operating profit at a solid EUR 800 million, value of new business currently standing at EUR 200 million and a new business margin of 1.9%.

Now the revenue side is depicted on Page 28, and there are a couple of comments. Number one, you see the significant reduction in Italy, and that is reflecting lower sales, particularly on the bancassurance side. Now we had a very, very bad start in January, and as of the end of February, the numbers have been continuously improving. So the trend will revert itself. While we were about 45% below plan in the end of the quarter, we're catching up with now 30% below plan, and we expect to get towards plan through the remainder of the year as the funding situation of the banking partners is actually improving and we're getting a better grip on the right products to sell.

Asia Pacific is the other area where I need to comment. With the closure of our Japanese business, significant top line disappeared. That's one item. And we have almost irrational competition in Taiwan in the bancassurance side and therefore we are very cautious to underwrite. This means a lot of products with debt and incentives that are problematic, I think, from a customer value standpoint. So we remain on the sideline. And somebody wrote we had strong growth in the U.S., it's not what my number say. In the U.S. we're basically flat, slightly up on VA, but that's a last call before repricing on our old product, about EUR 79 million -- excuse me, was plus EUR 54 million on the VA side and we have FIA minus EUR 64 million.

Now -- and we are really trying to monitor margins here and reprice and I will comment to that in a second. If you look at the overall structure, the capital strength that we have placed positive on the traditional business side which we carefully grow but we are moving, particularly from single premium to a recurring premium, to increase persistency which helps new business margins despite the fact of lower spread earnings. On the investment-oriented product, that's more difficult to do, and we'd rather let top line go than sell as a negative margin.

So with that, I'd like you to move to 29 where you see the development of the present value of new business premiums, which is at a good level of EUR 11.5 billion, and a lower new business margin. Now on the margin, for full transparency, you also know I don't want to kid anybody, this is beginning of period numbers. With the decline of interest rates, the new business margin would also be compressed in the second quarter, and that we need to really watch. And we have a number of measures into place to make sure we sell only profitable product.

When you look at Page 30, you see the mix of the various markets and the new business margins that we were having in the various segments. You see the lowest number in the United States. That actually is the mix between VA, that has been trending before repricing at about 0, and good margins on the FIA. After repricing, we will get to new business margins for the U.S. segment of 1% to 1.25%. And we are targeting, overall, to grow the Life business more, the traditional Life business, which has 2% to 3% margin. So we're also adapting the product mix.

In terms of the low interest rate, obviously, Germany will be trending down in the second quarter and we'll have to see where that ends up. A number of measures are in place to improve the profitability there further. Again, Germany has been the market where we've moved more strongly from single premium to recurring premium business.

Page 31 gives you the flows. I mentioned Italy, I think with that, most of the things I said, I expect better net flow numbers for the total year than the first quarter would indicate, in particular, because we expect the Italian situation to improve throughout the year. The same should be expected for Asia.

Operating profit, Page 32. Here you see the real improvements, particularly on the investment side. And I would like to comment quickly on the expenses in technical, both look negative. They stem from -- particularly, from adjustments we've done in Germany Life, EUR 10 million from changes in the policy holder allocation for the technical side, and Germany, another EUR 7 million negative 2 up, like in France. These are one-off effects that I don't expect to come back throughout the year. So then the question is, what should we expect for the technical result over the year. We will remain with a target of EUR 800 million to EUR 900 million throughout this year, assuming we don't see major changes and lapse behavior, which will affect this and the expense result. Expenses, I expect to be flat over the year at 0. Now the asset base grows further and the current yield stays at a good level, in terms of the equity that you see here, as we have already a positive contribution from our investment in infrastructure. As you may remember, we are investing significant amounts and the first large one we did into Gassled, that's the Norwegian gas pipe, is already contributing, upon arrival, I really love that, with EUR 60 million and that has had a positive effect in the first quarter.

Page 34 gives you the overview of the operating investment income and there were some questions around what happened here. It is, as you can see, in the harvesting side and we had higher realized gain of around EUR 360 million, particularly on the equity side. And I've to actually compliment our investment managers because at the end of the first quarter we locked in gains through the hedges that we have implemented, both particularly in the U.S. and especially Germany, and made sure that we keep the gain for our policy holders and shareholders and don't lose them with the next market dive. So that is behind the number, not an unusual, an extra one-off item, that somebody would normally expect.

MCEV development on Page 35. Nothing unusual this quarter. Nothing to write home about. The net free surplus number is significantly down, and we need to move on to the Asset Management sector because I expect there will be some technical items on MCEV anyway, so why spend a lot of time on it. Let's talk about Asset Management.

Now Asset Management, very important, we have implemented the organizational change to Allianz Asset Management and are now reporting PIMCO and AGI. We've also used the opportunity to be honest to clean up some of the reporting, because as we dug in, we found a few assets under management that were actually assets under administration. That's about EUR 50 billion that we have sorted out and that's important for you to understand as you interpret the historical development.

You see the movement on Page 38 and I've provided you with quite a few back-ups in the back to understand what it is. Most important message, no impact on P&L. Therefore, no restatement of historic

AuM figures as shown. It also had no effect on the Asset Management from shifts due to the new structure. Internal growth of total AuM versus end of period December is therefore, in adjusted numbers, around 5%.

Now if we move on to the net flow numbers on Page 39, you see a very strong EUR 23.5 billion in the first quarter. And Page 40 does reflect very high earnings despite the low level of performance fees at this point in time out of other net fee and commission income. I'd also like to point out, whenever people say you get bigger, your margins get smaller. That's not true, the margins have also improved, now, to a record of 41.7 basis points on the third-party assets. Thank you very much.

Now moving to operating profit in Page 41, shows you the driver directly into earnings. The operating expenses reflect, again, the management expenses and the compensation that is fully variable against the earnings. Now the interesting facts come beyond that on Page 42 and 43, where you see the numbers for PIMCO and for AGI. We've highlighted with light blue the new setup numbers that include the total AuMs, the total net flows and the operating profit. Now for those of you that think that the decline in service, we have provided you in the appendix all the data you need on the third-party flows. I'll give you some example when we go to AGI. So you see both in the details of the numbers on total AuM on net third-party flows. We, however, believe the total picture is the right one to look at.

Now let me move from PIMCO, which has stellar numbers, to AGI. And just to give you an example on how you can recalculate, if you want, the third-party number, the total net flows, look at a minus EUR 800 million. The third-party number is EUR 1.6 billion, a positive. So we have a very strong quarter despite some issues and the Allianz flows that we have had in this segment turned it into negative. So the third-party flows were actually positive. Right-hand side, the operating profit. We are targeting, after restructuring, a cost income ratio of below 70% and the number in the first quarter is reflecting some restructuring cost that will go away over time.

So Asset Management, overall, a very good story. Good development in both pillars despite the restructuring.
With that being said, I'd like to summarize the numbers for the first quarter. A very good start, good revenues; operating profit up, supported, of course, by lower NatCat; net income EUR 1.4 billion, up almost 60%; strong balance sheet. So we maintain our outlook at 8.2 plus or minus 500. And with that, I'm ready to take your questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Michael Huttner, JPMorgan.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Just a couple of questions. The first one, can you talk a little bit about pricing in German motor? You've got these wonderful rate rises for the Germany as a whole but in term of motor, I'd be really interested. And the other question is the -- can you give an idea of what is the underlying run rate for Life as a whole? I know you explained that there's about EUR 300 million of gains, but I'm never quite sure how much of that I should attribute to policy holders. I'm coming to a number of about EUR 600 million, but I don't know.

Oliver Bäte
Chairman of Management Board & CEO

So these were the couple. Michael, the pricing in Germany, we have motor up on the retail side, 3.7% and on the commercial side, 3.2%, and various other items. And that's the year-to-date rate on renewals. We'll see further effect throughout the year as we hiked up the rate in the beginning of the year. So it's bringing the combined ratio significantly down. It will, however, remain above 100%, significantly, this year still, because we're coming from a very high level. However, overall, it will have a very significant positive impact on our combined ratio. Now I'm not quite sure I understood the question on the Life Insurance side. I would like to remind you of the operating profit outlook that we have provided. That, by and large, gives anywhere between EUR 600 million and EUR 700 million operating profit per quarter. So this one was a rather high level which we believe will revert to the numbers that I mentioned to you earlier. But I think, in this interest rate environment, it's actually very strong.

Operator

We will now take a question from Andy Broadfield of Barclays.

Andrew Broadfield
Barclays PLC, Research Division

Two questions please. One, I think Italy was -- there was a few questions asked at various stages of its distress there on the P&C side, what your strategy would be there. And I think you felt that there was good opportunity for organic growth there, which doesn't yet seem to be happening. Is that just a consequence of what you talked a little bit about earlier on the challenges there? If you can just give a bit more color as to why you haven't made more progress there yet or whether that's to come or whether it's unlikely in the current climate? And the second question, just on the VAs. Just be helpful to understand a little bit better your -- the practical implications when you say that you've been writing VAs at a margin of 0, I think, for a couple of quarters, it should have been dragging down the U.S. new business margins for a while now. Just why that takes so long to turn that through and what the practical implications are.

Oliver Bäte
Chairman of Management Board & CEO

Yes. Andy, now let me start with Italy. We are really pushing hard now to grow the units. And after we've really achieved a position where we have the best reserve position and the best profitability in the marketplace. Since we have been fairly aggressive in addressing the agencies that were underperforming, it takes quite a while to remotivate them, particularly in the present environment to give us more top line. But I expect units to improve through the course of this year. The distribution forces do not react as quickly as management would often like it to be. The second thing is there's also been a lot of insecurity in the marketplace and amongst clients, in what to do given the distress with FonSAI which I hope will also clear up over the course of the year. So we remain optimistic around growing the top line in Italy in P&C

this year. Now on the VA side, as we said, we very carefully looked at the results, particularly of the fourth quarter. Where not only the in-force business was producing the expected losses but even the business that we wrote after 2009 recorded a loss. And then, very quickly, moved to reprice a number of features, get writer fees up, reduce fund choices and so on. And the issue is that, as you may know, all of these changes need to be filed with regulators in the U.S. That takes about 8 to 10 weeks at a minimum. So the repricing will happen effective in May and that's why we have some of the last call effects in March that you see in the numbers. The market will remain extremely tough given the very, very low level, particularly on the long end and significant volatility, and therefore, the high cost of hedging the writers. Now we are looking at this extremely carefully and trying to write only the volumes we need to write to support our franchise, but there will be no growth driver here. I personally expect, however, over the course of the year, and that's -- it's somewhat of a bet, the situation to improve significantly. So the 1% to 1.2% new business margin is what we absolutely have to see. Now, by the way, also for economic reasons, our cost of capital is at around 90 basis points to 1 percentage point. So that's the margins we have to see across the portfolio.

Andrew Broadfield
Barclays PLC, Research Division

And there's no other operational techniques to slow the distribution down in that interim period where you're seeking to file changes?

Oliver Bäte
Chairman of Management Board & CEO

No, it's very difficult to do because you typically have last call effects through your distributors in every channel, particularly in broker-dealers. But if you compare what we do, relative to what others do, we are actually -- let me say this carefully, strongly advanced in managing the distribution down. And another thing that we are doing, in addition, that is actually supporting the changes that are happening on the FIA side -- if you have another minute, even though I wanted to give you the short answer -- because we are, with the necessity to register FIAs with registered reps, we are successfully convincing the more sophisticated sales forces to sell FIA and traditional life products in addition to VA. This takes a while and we support that transition to the minimum needed with VA.

Operator

Our next question comes from Mr. Hocking of Morgan Stanley.

Jonathan Michael Hocking
Morgan Stanley, Research Division

Could I just ask 2 questions on Solvency II, please? What is the ultimate forward rate you're using for the curve in Germany on the Life side? And can you just comment a little bit on what the most uncertain areas are, from your point of view, the right standing based on the standard form and also in your negotiations of and on the internal model?

Oliver Bäte
Chairman of Management Board & CEO

I haven't received -- to be honest, I haven't really fully understood the second part of your question. The only thing I understood what the ultimate forward rate, which is 4.2%, so that much I can answer, off the cuff.

Jonathan Michael Hocking
Morgan Stanley, Research Division

Yes, the second part was about where you think the most uncertain areas are in the current draft.

Oliver Bäte
Chairman of Management Board & CEO

Okay. Now the most uncertain area is what, if any, will be the substitutions for the liquidity premium that was introduced with QIS 4 and QIS 5 as a counter effect to the high volatility and as a reflection of the illiquidity of our liabilities. Remember, the purpose that insurance has in society is not just to transfer risk from an individual into a community of risks but also provide illiquid liabilities that you can then invest for the long run and ignore short-term volatility. Unfortunately, Solvency II, because it's modeled on stupid Basel II principles, have failed to get that appropriately in. The industry tried to do that with the liquidity premium that has been not so successful. And now the question, what will be the substitute, because our liabilities, just to take P&C as an example, are indeed ill-equipped and therefore a full mark-to-market modeling of the liabilities is not appropriate. We, at this point, do not know whether and how there will be a CCP. We have a joint industry position. We have particularly said we need predictability, i.e. it needs to be formula-based and not based on some whim of some bureaucrat sitting in some agency somewhere, and the second thing is we need to appropriately reflect -- and that's in the matching adjustment, and that's not an add-on, but either/or -- the illiquidity of our liabilities that, again, is most easy to answer for all P&C liabilities. You might remember that very few clients burn their houses on purpose in order to get cash from an insurer or drive their cars into the wall. And on the Life insurance side, we have large amounts of products that have factual prevention of surrenders and therefore do not need to be worried much about spread movements. This is unclear what will going to happen and this is the most important thing that needs to get reconciled. To be honest, even though I'm trying to see a [indiscernible] I can't tell you where this is going to come out.

Jonathan Michael Hocking
Morgan Stanley, Research Division

Just to clarify. On Slide 69, one of the reconciling items, it mentions the mitigating effect of the counter-cyclical premium, so you're giving yourself the benefit of the CCP even though it's contingent at the moment?

Oliver Bäte
Chairman of Management Board & CEO

What we have done is to do, outside of Europe, we have not applied it to the European books. We've only applied it to Korea and the U.S. and it is not a double whammy of what most people do. If you want any technical details, please talk to Ollie Schmidt. Going forward, he will explain you how we have been applying it.

Operator

We will now take a question from Paul Goodhind of Redburn.

Paul F. Goodhind
Redburn (Europe) Limited, Research Division

Two questions please. On the U.S. non-Life business, you talked about further reserve additions in the quarter. Could you quantify how large they were? And I guess it's the usual suspects, in terms of lines of business, but maybe you'd give us some detail on that. And the expense reduction program I think is -- the core part of the improvement plan there, over the long-term. How's that going? And on the pricing, thank you for making that important point about the pricing that you give being net of bonus-malus. What would be interesting would be to give the figure, gross of that effect, so we can see what the difference is and then perhaps compare you more easily with some competitors.

Oliver Bäte
Chairman of Management Board & CEO

Number one, we don't disclose individual line of business reserve additions. What I can tell you is that workers compensation in the U.S. remains an issue because medical inflation, particularly in the state of California, is trending significantly above long-term averages. We haven't done dramatic reserve increases in the first quarter. We're just bringing the accident year loss ratio up as we're taking higher loss picks as expected. And I cannot exclude that further reserve reviews throughout the year might require reserve additions. However, no firm numbers have been determined. We need to look at the reserve reviews in the second quarter and the third quarter to look at that. My overall point is, some have been betting on the U.S. numbers to be dramatically improving throughout 2012. I'd like to remind you of what I said at the end of 2011, the U.S. will remain a challenge for all of 2012. Now in terms of the gross of bonus-malus, I actually do not know. We'll try to look that up and I will get back to you on that because we have different bonus-malus crediting rates across the various countries. And we have made it a good, I think, practice to exclude them for quite a while. I just happened to find that out because we have new colleagues on the board and some of them coming from other companies where they have other practices.

Operator

We will now take a 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, on your net price increase of 2%, I'm just wondering how that compares to claim inflation. In other words, as we look out a year or 2 years, can we hope that the price increases are enough that they, alone, should be driving a better combined ratio or is it the case that you're really just kind of breaking even with respect to claim inflation? And then secondly, PIMCO had a very good quarter. Nevertheless, the incentive payments were also low in the quarter. Dare we hope that we're getting towards the end of the unit expenses being high? Maybe you just tell us what the schedule is for incentive payments going forward over the next year or so.

Oliver Bäte
Chairman of Management Board & CEO

Yes. In order to understand the net effect of claims inflation and pricing, if you take the dynamics of the last 4 quarters, we had about 10 to 20 basis points net productivity gains of prices over the -- only this quarter because of the tap water claims and a few others, this number is somewhat distorted, yes, so -- if you take the average. The second thing is while we can always compute when we set the reserves and the prices with 3%, we are also structurally changing the portfolio. In my estimate, we have about a continuation of this 10 to 20 basis points productivity improvement over the next 4 to 5 quarters; however, with oscillation around that number. So to summarize, we should see a positive effect of prices made of claims movement. That's, at least, what is in our plans. Let's see that our operators deliver that. Now on the 3 units, we have about 200 million remaining costs to come and the cash outflow, because we have been reserving for some of them already is around 700 million. So Brian, that's a small number relative to the cash earnings that we're getting, yes? So it's really true, we're coming to the end of the story. Now the program still runs in 2016 but the numbers are going to get less and less and less relevant.

Brian Shea
BofA Merrill Lynch, Research Division

Sorry to be so pedestrian about this but for 2012, any suggestion of what we should put into our models for the units for 2012?

Oliver Bäte
Chairman of Management Board & CEO

A very small amount, I don't know. Let me just remind you what the drivers of operating profit growth, which in the first quarter was below what we historically had, that's why we had a lower multiple. Remember, we have 2 types of multiples that kick in. So I don't know what the number is but somebody will soon tell me. We have, I just got them from our chief accountant, around 190 million for the September quarter. Units, 191, so the unit matters here. To be honest, Brian, I seem to be mentally absent and the reason why it is totally irrelevant. Totally irrelevant, yes.

Oliver Schmidt
Head of Investor Relations

But happy to follow up on this, Brian.

Oliver Bäte
Chairman of Management Board & CEO

It's not a material number anymore and I think it is really the important news, as I said. There's not much you need to model around that.

Operator

Our next question comes from Michael Haid of MainFirst Bank.

Michael Hermann Haid
MainFirst Bank AG, Research Division

Two questions, first on Fireman's Fund. I would like to get a better understanding of what's going on. You mentioned there are some reserve additions. Should we expect that these reserve additions are coming through every quarter? Why don't you do it in one hit if they are expected anyway? And can you give us also a restructuring -- an update on the restructuring measures that you have taken? How do they work, how do they perform? Second, on the risk result in Life/Health insurance, which has come under pressure in this first quarter. Can you give us the reasons for this? Of course, I understand that you have a huge portfolio here, but maybe there are some reasons. And also, do recently written contracts offer higher risk results or is there competition which drives down the risk results going forward?

Oliver Bäte
Chairman of Management Board & CEO

Now the first thing I'd like to mention is that this is statistical noise. Sorry to disappoint you, but there is no extrapolation of the first quarter that makes any sense for the annual result. We had a number of true-ups we've done in Germany and 1 or 2 countries that had a negative effect here. I expect a more positive development throughout the year. As mentioned earlier, we should get to the EUR 800 million to EUR 850 million minimum risk result for the year. So that's what you should bear in mind. And there's going to be volatility around that as we do update. And the risk results are not coming down, we're actually incentivizing, taking better risk results going forward. And there will be more incentives in the portfolio and for our sales forces to sell risk products. However, let's be very careful. In the 25 years that we've seen in the industry whenever interest rates were low, people were piling into disability and other health products to just 5 years later wake up and be saddled with huge losses. So what looks like a good new business margin now turn out to be a significant headache later, yes? Now second comment I have on the Fireman's Fund. We have already done a huge reserve addition exercise last year. I was personally involved with Oskar Buchauer, our new chief actuary. We've done everything that the data at that point in time indicated. Now in the meantime, the U.S. market, in some areas, has actually further deteriorated. And we're doing our reviews as we speak and in the second quarter you will have more information to come. How is the restructuring proceeding? We have 2 items. Number one is addressing the cost base. Our loss ratio in the U.S. is actually fairly good, but the issue is scale and a very significant cost base. The costs have come down significantly, already, in the first quarter and we have cost-reduction plans in place for the remainder of the year. So far they are working as planned. The other one we must take rate, particularly on the property side in commercial lines. And where we can take rate, we need to let the risks go. The U.S. market is still not where it needs to be, but there are first signs of rate strengthening in property. The liability lines are more of a problem still, not just workers compensation. And there, we are separating ourselves with a number of segments that are not producing the appropriate returns. I'm very confident -- I met with my colleague, Gary Bhojwani, yesterday -- that Gary and team are doing exactly the right things to fix the ship.

Michael Hermann Haid
MainFirst Bank AG, Research Division

So is it fair to assume that Fireman's Fund result will be in the second quarter, worse than what you expect for the third and fourth quarter?

Oliver Bäte
Chairman of Management Board & CEO

I don't know about the timing, yes? But the combined ratio for the year will stay above 100%.

Operator

William Hawkins of KBW will ask our next question.

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

Two questions, please. First of all my favorite one on Slide 35, where you've got your MCEV. Could you tell us how much of the MCEV is not recognized on the IFRS balance sheet?

Oliver Bäte
Chairman of Management Board & CEO

Yes, I've been waiting for that.

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

And then secondly, while I've got my nerd hat on. On Slide 42, I'm just interested, when you're showing your 3-year out-performance, as you flagged, there's been an adjustment to how you calculate it. And that kind of implies that the 3-year out-performance in PIMCO has improved, so that 96%. At the end of last year, the data on a like-for-like basis was showing a deterioration. And so I'm just wondering, is there a genuine improvement going on or is it just that the numbers have changed and can you just like give us a like-for-like.

Oliver Bäte
Chairman of Management Board & CEO

Yes, the asset there is a genuine improvement because we had a V, yes? It was down and then come back up because our master, Bill Gross, really found the recipe again. So it's back up and it's a genuine improvement. Second, the number of the shareholder value not accounted for in IFRS equity -- I'm sorry for the last call, I just didn't understand the question, but that was my fault -- has moved from EUR 1.677 billion in the first quarter of '11 to EUR 2.645 billion in the first quarter of '12.

Operator

Our next question comes from Jean-Francois Tremblay of RBC.

Jean-Francois Tremblay
RBC Capital Markets, LLC, Research Division

I have 2 questions, please. First of all, on the Life business. You alluded during your comment, Oliver, to a number of initiatives you're taking to protect new business margins in the second quarter. Studying the call, you talked about what you're doing on your U.S. VA book. Is there anything else you're doing to prevent this further pressure on the new business margin? And then the second question, on the P&C business. So you recorded price increases of 3.8% in the quarter in France, one of the markets with the strongest rate momentum. How sustainable do you think these rate movements are going to be in the French market?

Oliver Bäte
Chairman of Management Board & CEO

Okay. Let me start with the second, I don't know. I only know what the facts are and that we are trying to take rates, particularly, on the commercial line side. We'll have to see how the market reacts. Currently, it has been supportive. So from what I know for the second quarter, we have some more positive momentum, but I cannot predict anything for 3 and 4. Second, on the Life business, the laws of physics will hold, gentlemen, right? So people that tell you that this interest rate environment, new business margins can be protected in a way that they will not come down, that's unrealistic. With the record low interest rate, particularly in Germany and the U.S., we will see some further decline. Now what are we doing? The first one is, in Germany, to give you a couple of examples, to make sure that we have the right mix between single premium and recurring premium, we have been deemphasizing single premiums, particularly in the corporate side, and moving to recurring premiums, also because competitors are willing to price risks at different prices than we price them. The corporate clients are more sensitive to the lock-in bonuses. That gives me the second point. In Germany you can decide whether you lock in bonuses on an annual basis or you move it to the final bonus account. Moving it to the final bonus account has 2 advantages. You can claim them back. And secondly, they count as risk capital. That is not highly appreciated by large corporate clients but makes huge impact in terms of profitability. We're rather foregoing price elastic corporate money and protecting our capital and our margin. That gives you 2 examples of what we do. In France, for example, we are pushing very hard, the health side and the businesses that we do understand there relative to plain vanilla business. So we're doing a number of things, across markets, to protect the margin as much as possible. But again, you know me, I don't give you the baloney thing. The margins will come down in the second quarter relative to what we have seen.

Operator

We will now take a question from Atanasio Pantarrotas of Cheuvreux.

Atanasio Pantarrotas
CA Cheuvreux, Research Division

I have just one follow-up question, the Life business. My question was very similar to the former one. I saw the sensitivity table of your Life TV [ph] at the end of 2011 and your German new business value should go down by 84% in the case of 50-basis point decline of interest rates. Now my question is, is this possible that you will gear up to some premiums in order to defend your margin in the future? So like it reducing materially your single premium? The second question is on dividends. You mentioned early before the presentation that it's too early to pay, to increase the dividend, given the uncertainty. But let's assume that the Solvency II final framework will be quite favorable for the industry. Do you think that you could revise, therefore, your payout ratio of roughly 40% as used in the past?

Oliver Bäte
Chairman of Management Board & CEO

Yes. I would like to reiterate a couple of points on the dividends. Let's start with that. Number one, in normal years, we have always said we have about a 40% distribution because we believe we can invest the money profitably. That might change between segments, i.e. more in P&C and Asset Management versus less on Life, depending on what the interest rate environment is. And more in markets where we can take strong margins like Eastern Europe, for example, than mature markets. And people have every incentive to produce positive margins. We don't give any credit. And actually, if people want to sell business at new business margins of 0 or below, they need explicit permission from the corporate center to actually do sell. Just to be very clear, right? And there will still be consequences if people are selling at negative margins. So I think this is really important. The other thing is that it's always the beginning of period number, you need to think through what that means as it moves over the quarter. That's why I said some of those numbers will go down. And yes, as you see in our top line, we are prepared to let top line go in order to protect the bottom line. We'd rather be fully transparent as opposed to having super-optimistic assumptions. Now the other thing I'd also like to say, in terms of new business margins, just to put a little bit of salt on the whole cake here, I see a lot of new business margins that are consistent with the MCEV framework but have very interesting policyholder behavior assumptions baked into that you, as an investor, cannot really challenge. So whether that's less assumptions and all kinds of other things, we try to be extremely conservative on those and don't try to have businesses that look good, having high new business margin, but assume 40% to 50% lapse ratios that either create a problem if they don't come for shareholders, and if they come, create a issue from a regulatory standpoint. So just as an industry observer, I would like to say that we need to strike the right balance between customer benefits and shareholder benefits, and we do not want to sell products that are ripping off clients, just to put it bluntly. Now let's move -- and then you had another question, I think dividends. I think we've addressed for now. Again, let's see how the year goes through. And a final reminder, we have Germany, we have the Supervisory Board deciding what the dividend proposal is.

Operator

Our next question comes from Nick Holmes of Nomura.

Nick Holmes
Nomura Securities Co. Ltd., Research Division

I just had a couple of questions. First is coming back to U.S. Life and the big decrease in the margin. I wondered, can you tell us how much is due to the variable annuities and how much to other products. And then can you also say again what exactly it is that you've changed in the repricing of the products? And then second question is looking at economic solvency. I wondered whether the rather high sensitivity to interest rates excludes the use of the RfB? And I ask the question just because I'd have thought the RfB, as a capital buffer, would be much more effective in neutralizing interest rate risk.

Oliver Bäte
Chairman of Management Board & CEO

While the guys are looking up the details for what the repricing measures are, I think this was a host of things, Nick, that was done on VA. So for example, increasing writer fees, limiting fund choices, I think there's a whole slew of things.

Nick Holmes
Nomura Securities Co. Ltd., Research Division

Right. Did you take your guarantee rate down, for example?

Oliver Bäte
Chairman of Management Board & CEO

Yes. And we have done some adjustments in terms of roll-up rate and so on and so forth. I'll give you the details in a second while the team is looking it up. So you can compare to what others have done, I think, with the background. I'm more comfortable with the choices because, again, I don't want to bank on behavioral assumptions being more benign than really hedging results and others. Now on the RfB use in Germany. RfB generally is an accounting construct and the interest rate sensitivity is based on an economic view. Now we do have the ability to use the fee policyholder funds to, of course, support times of low interest rates. And by the way, it also supports new business stream as this is available for funding. And it's really, really important to understand that this gives us a huge competitive advantage in the industry. The second thing that is also coming in on local GAAP accounting is the additional low interest rate reserve, which is hitting a lot of competitors with huge amounts as the numbers come down, because we can fund them not just through superior investment income but also the way the resource are being used and allocated to policyholder funds. So it's not just a general observation on interest rate risk, but in particular it helps us to produce more attractive returns to our policyholders relative to what the competition can do. Now on your specific question on the U.S., what the new business margins have been in comparison, separated out between VA and the fixed indexed annuity, which are the 2 largest line. The fourth quarter numbers, as a reminder, were 84 basis points on the VA and 1.9% of the fixed indexed annuity for a total of 1.6%. In the first quarter the VA number, as said earlier, trended towards 0, the FIA at 1.08%, for a total of 80 basis points and that's why we instituted the repricing to bring the total back to 1.25% as of May. We have 2 or 3 major items that were implemented to limit the choice to less volatile funds, to increase the writer fees and to, in particular, increase the guarantee fees. And by the way, not just on new business but also on the in-force. I hope that helps.

Nick Holmes
Nomura Securities Co. Ltd., Research Division

Just very quickly on the RfB, just to clarify, it is not used as a risk mitigant in your interest rate sensitivity in your economic solvency?

Oliver Bäte
Chairman of Management Board & CEO

No. It is indeed used.

Nick Holmes
Nomura Securities Co. Ltd., Research Division

It is indeed. Okay, so it is used, right. But the sensitivity does seem to be very high considering that you've got all of that RfB, EUR 14 billion or whatever it is. But that's how the numbers work out?

Oliver Bäte
Chairman of Management Board & CEO

Yes. And the business -- given the duration GAAP that we have historically had, that's how the numbers move because of the very high convexity. Now just to address that we have put a program into place to lengthen the duration. A part, by the way, of the increase we had on the Italian [indiscernible] is coming from that duration lengthening program that will reduce the mathematical sensitivity of the number. Now some people were saying, well, you're taking more credit risk on that. We're taking more credit spread risk, I don't think default risk. And because of our strong RfB position, this is by the way another aspect, we can afford to take that risk without having to worry and still get the economic benefit of slowly but surely closing the duration gap. Yes, now, by the way, were you referring to the shock, Nick, because I'm really trying to answer your question precisely. You're referring to the shock scenarios? If you're referring to the shock scenarios, I'd just like you to be reminded of the fact that we don't anchor the rates in the shock scenarios.

Nick Holmes
Nomura Securities Co. Ltd., Research Division

Yes, that's exactly what I was thinking of, the interest rates moving down by 100 basis points, which...

Oliver Bäte
Chairman of Management Board & CEO

And we don't really anchor it. So the anchoring effect is not in there because we want to provide a more honest perspective. Thank you for asking that, and Tom, thank you for making that point. We would understate the risk effect if we were then sort of in parallel, then it would not be a stretch, right? Doesn't make any sense. So whether you believe me or not, we're really trying to provide a fairly pure economic view on what the stress scenarios are.

Nick Holmes
Nomura Securities Co. Ltd., Research Division

Okay, yes. So the full effect, then, of a capital cushion is not really included? Not fully included?

Oliver Bäte
Chairman of Management Board & CEO

Yes, because the question is do you have a short-term shock or do you have a longer-term decline? What most people are worried about is not the short-term shock but the longer-term decline and the Japanese scenario and then the question is whether rates will come back. And we had the argument in the past and I'd like to reiterate that we need to worry about the next 10 to 15 years and what happens to interest rates maybe 20 years, but worrying about cash flow that will happen one time long debt and my children will be retired. At first we believe from how do I manage the book, at least in terms of modeling, less relevant to make sure that we have the cash flow to support the guarantees. And maybe let me reiterate that I have everybody on board and despite trying to give short answers, the key thing is, in a 1.5% interest rate scenario that we are in, do we ever have a problem in Germany to honor our guarantees? And the answer is never. Okay? With addition -- going to [indiscernible], never. Just to get it out of the system.

Operator

We would now like to take a question from Christian Massic [ph] of Serbia Client Research [ph].

Unknown Analyst

It's Christian Massic [ph] from Serbia Client Research [ph]. Thank you for letting me ask that question. It quite nicely melts into the previous question. So, yes, how do you rate to the current low interest rate environment, especially in German Life? So would it be fair to assume that you further improve -- increase your loan portfolio, loan investment mortgage investments? And so what to model, yes, new investment yield kind of? Yes, that would be really great to know.

Oliver Bäte
Chairman of Management Board & CEO

So we're doing quite a few things and you might have observed that. Number one, the first thing that is very important is what do we not do. That is buying bunds by and large, yes. Because we really believe that a bubble has been built there quite significantly like in U.S. And then it's very important to understand what are we investing at, what are the yields that we're earning on new money and they're significantly above what we need for the guarantees. On the Life side, that's 3.5%, and that is what we are looking for. And the second thing is we are trying to find the right mix. We are really looking at expanding the covered bonds on the corporate side and then some by some EPS, we're expanding the real estate side and in particular like to do more on infrastructure. And on the lending side, we confine ourselves, by and large, to real estate lending, which by the way we have about 40 years in history of doing. Now people are saying why haven't you done it in the last 10 years, now why are you back. Let me give you maybe an interesting answer. When we were doing the lending, the banks had about the same leverage in their balance sheet as we had, 1 to 10. And then they moved from a level to 1 to 10 where they still are today to 1 to 30. And because of spreads seemingly disappearing, they had applied very low cost of capital. Even then, they lowered prices on the lending even further because some of the large banks that were less cross-subsidized the lending and made the money on the investment banking piece. Now that was before 2008. What we now see is de-leveraging, so cost of capital from the capital amounts going up, cost of capital for banks going up dramatically. And that's very, very important, no more cross-subsidies of credit businesses. Now clients don't find that to be very attractive but at the same time, we need to acknowledge that credit pricing was far below where it needed to be. And where now rates are appropriate, relative to the risk and the equity capital that we economically need to apply, we go back in and find more rational competition today than we saw in the past. On top of that, you have de-leveraging, even of some good assets in the banking side, as banks have to repair their balance sheet and not just get more capital and get more liquidity, since we are ideally positioned, with our long-duration liabilities particularly on the Life side, we're very happy to do long-term lending if the appropriate returns are there and the appropriate securities. Sorry for the longer-winded answer, but that's why we are looking at it again, not because it's new but we now find more appropriate conditions to do the lending. I actually expect more to come because, initially, we've now seen over the last year a lot of higher sale assets with problematic risk return profiles and we're not in the, how do I say that, unsure [ph] fund business, that's for others to do. We want really good assets at the appropriate prices with nice duration and we haven't seen too much of that yet. I believe with further de-leveraging on the banking side having to happen there will be more supply of good assets for us to take a look at. I hope that answers your question.

Unknown Analyst

Yes, one follow-up afterward. So you wouldn't rule out -- or you look at, yes, portfolios which are on the markets, let's say for example, from Eurohypo or stuff like that and if pricing would be correct, you would consider buying that?

Oliver Bäte
Chairman of Management Board & CEO

I wouldn't comment on any specific...

Unknown Analyst

Yes, sure, sure. Just -- it was an example.

Oliver Bäte

Chairman of Management Board & CEO

We look at portfolios -- to be honest, again, we haven't found appropriately priced risk on the in-force because the in-force book of banks often is mid-priced. And it's very tough for a bank to sell a mispriced credit book because they would then have to give us money on top. That hasn't happened yet, it might happen. We'd rather look for new business that is appropriately priced.

Operator

Our next question comes from Thomas Sidel [ph] of Stanford Bank [ph].

Unknown Analyst

Two questions, on the Non-Life side again. I think you led us through the premium and the rate change per country. And I think it looks like, in Germany and France, I guess continues to lose market share. And I think I heard you saying that you expect some change. I wonder what type of actions you have planned and what timetable you are looking at here. And the other question on Non-Life was on the assets backing the liabilities, Slide 23. Given the shorter duration compared with Life side shouldn't we expect a bit more of a decline on the fixed interest income?

Oliver Bäte
Chairman of Management Board & CEO

Yes, let me answer the last question. The current yield on the P&C side indeed is around 3%, i.e. lower than what we see on the Life side. And that's the first question, and again, we are being impacted here by what we see. I personally believe we should go longer in the duration because of the stability of the cash flow. That's not quite consistent with what Solvency II says, but it's more consistent with economic thinking, because of the stability that we indeed have. And we have done some of duration lengthening there in order to get some yield pickup. Now to the more specific question, what do we do in Germany and France in order to avoid losing market share. Now there's the one view is on the custom, i.e. the number of risk unit, and there you are correct, we are taking positive pricing momentum to be precise. In the first quarter we had around EUR 130 million price benefit in Germany and don't know exactly the number, 80 million to 90 million customer volume loss. I think it's 99 million that the volume impact, so we have the prices that outperforming the volume effect and we need to do 2 things. Number one, and we have been successfully doing that, we need to diversify the channel architecture. We are now going, very strongly, in the direct [indiscernible] and through our online agents, which is called AAOS, both doing very well in addition to bringing up productivity on the agency side. And what we're currently seeing is that productivity on P&C, overall, is picking up. On top of that, also in commercial lines, through the broker channel. And that's, by and large, what we have to do in France, too, even though there the online market is much more in infant stage than it is in Germany. On top of that, I'd like you to understand that we are strongly working on strengthening our automotive distribution. We have formed the global Automotive unit, significant part of the new business in Germany, the fewer new car sales are going through car dealers, Allianz is the leading provider there, and we've been very strong in improving not just volumes, but also profitability by restructuring the portfolios. For example, the 2 retail business is fairly profitable. We have been losing money in the past on the car dealer coverages that we've either repriced or discontinued. So pushing that through and we're doing that also in France with international corporation. Germany, by the way, it's not just Volkswagen, it's Daimler and a number of other brands. We are doing the same thing across other markets. The last item is product redesign. In Germany we've done MeinAuto, our car, which is a model of product that is fairly consistent, by the way, can over time be consistently replicated between and across different technology platforms that allows clients, together with their advisers or by themselves to plug-and-play. So the base cover is fully competitive with the low-price competition and the modular approach allows clients to pick and choose their additional coverages, which by the way also reduces admin cost for us and brings more margin for the carrier. So that's what I'd like to say. I'm fairly comfortable that we will succeed here. Given the overall poor state, however, in terms of profitability in motor in Germany, to really come through, we need to see again more rational competition. Now with late rates, interest rates that is, being at an ultralow level, I hope some rational behavior finally also makes it into the German market, and the signs are positive. The same for France, where we've seen significant pricing action as discussed. So that would be my answer.

Operator

Our final question today will come from Giulia Raffo of Autonomous Research.

Giulia Raffo
Autonomous Research LLP

I have a few questions. First, on capital. Am I right? It's impossible to get your economic solvency based on the old 99.97 confidence level?

Oliver Bäte
Chairman of Management Board & CEO

Yes, it's impossible.

Giulia Raffo
Autonomous Research LLP

Okay, and then a follow-up just on capital. Based on your 99.5, is it possible to have a sense for how much is the impact of the liquidity premium in the solvency ratio? Then my second question is on your...

Oliver Bäte
Chairman of Management Board & CEO

Can I answer that, yes? If we take the worst case, we take out the liquidity premium and the yield from anchoring the lesser, which by the way makes no sense whatsoever, it would be around 150. By the way, the liquidity premium, Guilia, I mentioned that in the beginning, has come down very significantly from 96-point something to 50-something, so that means almost half. So the benefit of that is actually very less significant than it was in the past. Okay?

Giulia Raffo
Autonomous Research LLP

Yes. Is it possible to have that in isolation? So from 202 instead of going all the way to 150 just as indeed...

Oliver Bäte
Chairman of Management Board & CEO

Yes. And Ollie Schmidt will give that number to you, if you may, after the call. I'm always using the worst case in saying...

Giulia Raffo
Autonomous Research LLP

My second question is on your banking exposure. If I read your interim statement correctly, you slightly reduced your banking debt exposure. But within that, you increased by about EUR 1 billion your Tier 1 exposure. Can you just confirm that and can you give us a sense of what type of Tier 1, geography-wise, did you buy? And then my final question is on the pricing slide. There is a foot...

Oliver Bäte
Chairman of Management Board & CEO

Can I answer? It's not an investment but a fair value increase.

Giulia Raffo
Autonomous Research LLP

Okay. So it's just simply a mark-to-market movement?

Oliver Bäte
Chairman of Management Board & CEO

Yes, no additional investment in the bank. Otherwise, I would be panicking around here.

Giulia Raffo
Autonomous Research LLP

Yes. That's why I found the 2 a bit in contrast so I just wanted to get clarification. And my final question is on your pricing slide. In the footnote you seem to say that the 2% exclude the AGC&S and I think, before, you used to include your AGC&S. You...

Oliver Bäte
Chairman of Management Board & CEO

No, we never had that in. I'm actually trying to get -- we actually didn't have the actual rate change on renewals in the past and that's why we always showed it on the right-hand side. We had both the credit insurance side, Giulia, and AGC&S next to the table. We know because we have comparable data on the actual rate change and renewals moved it in here and that's really important because that explains the comparison to the old numbers. So actually, the quality of the numbers has improved not decreased.

Giulia Raffo
Autonomous Research LLP

It's a more conservative deal price, you can argue?

Oliver Bäte
Chairman of Management Board & CEO

Yes.

Giulia Raffo
Autonomous Research LLP

Okay. And I just wanted to clarify, because the full year slide was basically saying that the price renewal impact was including credit. But I didn't appreciate that AGC&S was excluded so...

Oliver Bäte
Chairman of Management Board & CEO

Yes. And it's very important because, again, the credit is negative, so it brings the averages down. And in AGC&S, we have a very heterogeneous picture across the globe, that's why we provided you with additional information. The total, if you exclude AGC&S and credit, is 2.4. And let me differentiate even retail from commercial, the retail side is trending more towards 3% and that's strong, less than 2% of commercial. This is by the way where we need to see the biggest pickup. I'm always amazed how slowly commercial markets move but they have to move. Okay?

Now Ollie Schmidt was very strict. Ollie, this is really it -- do I need to finish?

Oliver Schmidt
Head of Investor Relations

Yes. If you have more questions, please call the team. But I think we should close the call for now. Thanks for joining us.

Oliver Bäte
Chairman of Management Board & CEO

Now you know who is really in charge. With that, goodbye. And if you have more questions, give us a shout. All the best.

Oliver Schmidt
Head of Investor Relations

Thanks, bye-bye.

Operator
That will conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.