S&P Capital IQ

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Allianz SE DB:ALV

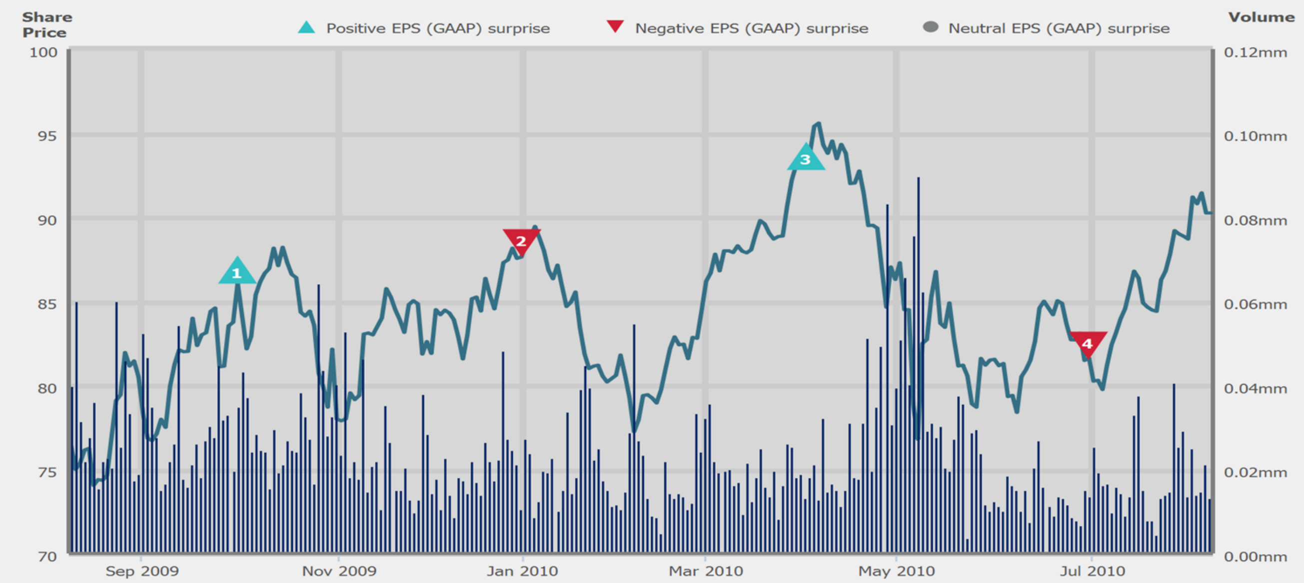
FQ3 2010 Earnings Call Transcripts

Wednesday, November 10, 2010 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2010-			-FQ4 2010-	-FY 2010-	-FY 2011-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS (GAAP)	2.72	2.78	▲1.83	2.54	10.92	11.97
Revenue (mm)	23123.20	24500.00	▲5.95	-	95222.91	95868.16

Currency: EUR
Consensus as of Nov-10-2010 8:25 AM GMT



- EPS (GAAP) -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2009	2.83	2.94	▲1 3.89 %
FQ4 2009	2.65	2.39	▼2 (9.81 %)
FQ1 2010	2.76	3.43	▲3 24.28 %
FQ2 2010	2.50	2.21	▼4 (11.60 %)

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Presentation

Oliver Schmidt
Head of Investor Relations

Ladies and gentlemen, welcome to our conference call about the results for the third quarter 2010. I know you all had a busy day so I'll keep it brief as always, and without further adieu, I'll hand it over directly to our CFO, Oliver Bäte.

Oliver Bäte
Chairman of Management Board & CEO

Good afternoon, everybody. Thanks for joining in the call. We have about 50 people now on the call to discuss the quarter numbers. Sort of learning over the first year, I'll make a quick comment, I'll try to be fairly brief in terms of going through the presentation, minimize reading to you the things that you already seen but commenting up front on some of the important number changes and explanations. I think it's fairly significant. I expect to be through that in about 35 minutes, and then we should have sufficient time for Q&A. Hopefully not just q, but also some a.

Now before I get into that, I wanted to just memorize. I've been the CFO now for 1 year. Now I wanted to thank you for your support, in particular, to my team here. Without them, I would not have been able to do that and Hamud, by the way, is also still around helping out, so thanks a lot. And now let's get into the substance.

Overall messages for the quarter, I think unexpectedly, so when you look from the beginning of the year, this is the third good quarter for Allianz and we hope also for our investors. We've seen double-digit growth to 24.5 billion on the revenue side. Operating profit was 2.1 billion strong, net income stands at 1.3 billion, a little lower relative to prior because of increased tax expense. We'll talk about that, but still a good number and a solid capital position, which we probably discussed in detail today.

When you look at Page 4, the quarterly results overview, I'd like to remind you that at least personally, I don't tend to look at quarter-over-quarter, but how the year accumulates. So let's just reflect for a second on the first nine months of this year. We've accumulated 80.5 billion in revenues, that's a strong 8.6 billion higher than last year. We have accumulated operating profit exceeding 6.1 billion. That's 1 billion over prior, more than 20% up and a net income is at 4 billion already, that's 800 million higher. So again 20% increase over the prior year and that is in a very, very tough economic environment, with depressed interest rates, higher NatCat loads. So from the management perspective, we are for the first nine months significantly happier than some of us would've expected the year to develop.

So that's just as an intro statement looking at nine months number, not just quarter-over-quarter and we'll talk quite some time about what are the effects in the quarter, but I'd like to keep the year into perspective. That also means that for the year, overall, if we continue to have a benign trading environment that is no new NatCat loadings, for example, or exacerbated capital market volatility, we should come out at the upper end of our target range of 7.2 billion in operating plus profits, plus or minus 500 million. So that's just to into statement and so we are positive on the outlook for the year.

Now that supported by a number of factors. Let's move to capital position Page #5 is the development of shareholder equity. Some people apparently have commented during the day. Why is the growth in the equity position not stronger than the 2.5 that you see here. Now you have had in the shareholder equity increase a couple of points positively net income going up and unrealized gains going up, while at the same time we suffered from negative FX effect and as I think was not in some of the valuation spreadsheet that negative FX effect relative to the end of June was EUR 1.4 billion and that has impacted the growth of the shareholder equity.

Now when you look at the solvency ratio relative to the middle of the year, it's down two percentage points and some of the effect I just described do also effect the solvency ratio plus two others, which I'm going to mention. The first one is we have an increase in shareholder equity, driven by higher unrealized gains

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in AFS bonds, which are not included in available funds for solvency purposes. The second point as usual, we do accrue 40% of net income for solvency purposes. We deduct that. And by the way the 40% now 500 million respective time periods and in line with the equity development we have had FX movements decreasing available funds by 1.2 billion. And then we've had some capital requirements due to the very strong business growth that we see in particular in life. So it's a natural development given these factors.

Page #6 gives you the usual equity shocks that we have in the IFRS and to the conglomerate solvency ratio. I think that's self-explanatory so I don't want to spend too much time on it. Let's move on to the group numbers and to revenue growth.

On Page #8, you see the usual split up between total gross i.e. nominal and internal gross, excluding in particular foreign exchange, which had a major influence on the year-over-year comparison. The group overall is 6.5% up on the internal perspective. PNC looks 1.1% down.

Now let me comment and pause here. A significant part of that is due to a loss in volume on our Agri business in the United States accounting for around 97 million. Without that, the portfolio would about to be flat. It accounts to almost 1% of that number. The strong growth in life and health continues at 11.7% on an internal gross basis and Asset Management powers ahead with plus 29%, truly outstanding.

Now Page #9, I will not explain the numbers but basically tell you what you see on this page from an economic standpoint is that we do have quite some volatility in the segment year-over-year. Given the economic environment, that should not come as a surprise. The drivers are -- were similar on interest rate side, sometimes they're very different but the overall picture is a very positive one because in our portfolio we apparently diversified the effects between the segments and overall deliver better performance at this point in time. So I think that's very interesting to look at and that same picture you would see if you would take the nine months numbers.

We'll talk about the various components going forward. Let me just comment on the Corporate and other segments. The loss here decreased to 270 million we had on plan. If you can be on plan, with a negative number for the Corporate segment then we really have to improve. I think we did a couple of things well, relative to prior year.

The first thing is after long deliberations, we have installed an improved foreign exchange hedge that improved the segments not just by 30 million this quarter but has really helped us in the year to take the volatility out in the Corporate segment. And we also have the Banking segment here. Their revenues and interest results increased by 13 million. So also there an improved situation not much more do you need to say about the Corporate segment.

So let's please move to non-operating items. On Page 10, there's just two lines that I would like to talk about as an intro. The first one is realized gains and losses. Here, you see higher realized gains on the debt security side. Two comments here. They basically follow duration lengthening that we've done in some parts of the portfolio and some gains that we have realized relative to the size of the portfolio's very small numbers. We don't want to generate gains to offset sort of the operating profit issues, so this is just a part of normal portfolio rebalancing. And that number, the third quarter was up artificially low. Also now in my mind on a like-for-like basis, that number is about 40 million, 50 million maximum higher than the usually quarter would look like. So nothing in my mind to worry about. All the other components are fairly flat and stable. The one thing we need to explain is other non-operating here and there are two major items driving that. One is the fair value impact out of the valuation of our warrants. In the third quarter of this year, we had a negative development of 29 million. The share price went up at the half, by the way, even more now but the volatility went down. That drives down the value of the warrants. Versus in the third quarter of 2009, we had 92 million of positive developments so the delta is a start 121 million relative to prior, so that's the one effect. The other one is amortization of intangible assets and goodwill, particularly on private equity investments that we've taken down in this quarter. So those two together explained the vast majority of the swing and I think that's the most important thing to recognize the usual explanation of balance of unrealized gains and losses you find in the right-hand side most of that explained by market movements, so I wouldn't want to spend too much time on this issue.

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Page 11, you see development, usual development of net income. There's various definition of what net income is as a service to you. Now the only one line that people have missed I think is, and they couldn't really predict, that is higher income tax. What is driving that normally as you say, we expect a tax rate at around 30. Now that is the year number and that can fluctuate quite a bit between the quarter. So it doesn't do that normally and hasn't done it the last two quarters, but this time it had hit our effective tax rate of 34.3% and there were some less tax-exempt income than in the prior year and we have sort of valuation differences quarter-over-quarter. What I can tell you however, and that's more important for the year, we expect to be within our target range of around 30% and I think that is really important to bear in mind for valuation and forecasting purposes. So that is it on the group level. I'd like to move on to PNC now.

Revenues stand at 10.6 billion. Operating profit up 9% and 1.1 billion combined ratio of 97.1% driven by higher NatCat on the one hand side and on the other hand driven by runoff at 3.4% and we'll probably talk about that as well.

Page 14 shows you usual splits that showed the development of the countries. Let me remind you the column on the far right-hand side is adjusted for FX effect so it doesn't match the numbers in the three preceding columns and you see a number of FX as in the past in markets where we do see pricing pressure or the effects of pricing pressure, we do continue to be very tough on underwriting standards so we have still portfolio decreases. Germany is one. Switzerland now is another one, France and Italy. On the overall portfolio now also on Spain where the markets and trading conditions have deteriorated. While on the other hand, we have areas like South America, the U.K., credit insurance and Australia where we're going very strongly.

One explanation again to the United States this year, the crop volume reduction that is due to changing prices in terms in the Crop business in the U.S. with minus 97 million of predominant role in effective overall portfolio. I think the only additional comments I wanted to make is that what you don't see here because we don't separately show it, we have see very strong growth in the Direct business. We are growing double-digit here. For example, just our Italian business is growing 21% in the first nine months and the total Group Direct business is growing 17%. So there's good news I think and would also need to think about and talk about the price effect relative to the volume effect. We still have negative volume effects, partially driven by continuing cleaning particularly in commercial lines, offset by positive price effects. The total price effects on the year already in the books that we can sort of statistically verify is at least 1.5%. So that's the volume effect.

Now we move on to profitability. Profitability has improved. You see the driver underwriting investments, both up being on the investment side, largely driven by higher Assets under Management. In this segment you see a little bit of that later. Now you wonder why does the combined ratio not improve if underwriting profit improves. That is a technical explanation we have significant part of the Exxon business in Germany in the PNC segment and those changes in underwriting profit do not make it into calculation of the combined ratio, as we have not done that in the past on a like-for-like basis. So that explains the difference.

Now if you move on to Page 16, you see the various development in the countries. Now a couple of points. Germany hugely affected this year by NatCat. Let me give you a couple of numbers. Germany deteriorated 3.4%, which you can easily gather. What were the drivers here? Higher losses from NatCat and weather-related events were amounting already to 5.8%, huge. We also had higher large claims relative to prior year, another 1.1% offset by less negative run of 1.6% and the balance being lower attritional frequency by and large. So that is a big driver.

The other main number to be explained is Eastern Europe. You probably asked about that is 14% up, 14.56% to the process. The couple of effect. One is Hungary, we had introduction of a financial tax, thank you very much, 3.7% hitting our combined ratio. In Russia, we settled a large claim and including the write-down and the provision on cost as a receivable against a one particular reinsurance that drove up the combined ratio 4.8 percentage points. And then we had additional losses to be settled out of that floods in the second quarter driving it up another seven points. So there's a huge impact to the poor colleagues in Eastern Europe and we are bearing with them.

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On the other market, I think we have seen some very positive developments. In particular obviously, we need to note this big swing in credit insurance a highly volatile segment in both directions, used to be a very negative in 2009 and has turned positive now where we are running out and have to runoff the reserves that we were building in the financial crisis.

Let's move on to the underlying drivers of the accident year loss ratio. I think there are couple of interesting developments year to be noted. On the upper left-hand side, you see that for the first time in nine quarter development, we have the accident year loss ratio, excluding NatCat trending below 70%. We've been talking about that the last few quarters, Oliver said it's too early to call it a trend. It looks like the positive trend is indeed stabilizing.

The second effect you have on the right-hand side is for the first time, and a long time, we have a positive price effect that we can actually dissect on the sub-portfolio in the accident year loss ratio of 1.1% lower than the 1.5% that I mentioned to you earlier because we have a different cut off and that significantly out balancing the continuous claims inflation we have now that the nominal claims inflation obviously over the year is 3%. That should be on a quarterly basis much higher than you see. So a number of the particularly around portfolio cleaning, are really showing an affect here.

Now credit insurance, their improvements we continue to show as long as it's volatile as it is, offset by the significant negative NatCat effect and you see that on the lower right-hand side over the last two years, the relative quarter had 1.5% loading. We have recorded, again a quarter of very high NatCat that is 3% and despite that, the overall accident year loss ratio did not go up. It leaves you the runoff position and you can believe that I'm spending a lot of time to understand whether the runoff we see here is natural and I can also only confirm to you that indeed it is.

Now out of the 3.4% you see, 90 basis points alone is credit insurance. Also, excluding credit, you have a much lower number and that is basically supported by runoff out of portfolios that seen very high increases in claims reserves in the economic crisis. So in effect, what you see is that counterbalanced to increasing claims reversed during the crisis and that's why it's normal to see this runoff. So at this point, the underlying runoff for the portfolio at the moment is more around 3% and above the long term average of 2% at a very normal rate.

Now I will not go into the various businesses that we have, but I'd like to turn your attention on the expense development as usual. That's on Page 18. We have on the commissions side increases basically based on nominally based on FX and growth in various markets. The ratio is stable, unfortunately it's not stable on admin and other expenses and the key driver, two folds, beyond the FX is one-offs that we have, not so nice, particularly in Russia. We've talked about that in the U.S. In the last year we had a positive one-off on settling health benefits plan and this year, we have had 17 million extra charges in Switzerland, so that drive those numbers up.

Now unfortunately we also have recurring items that will not go away. In the P/C segment, we have 35 million increasing expense on the bill markets on pensions and we have 20 million as expenses for this financial tax and they are here to stay. Now the good news on the bill market charges that they go away at the group level is something that only affects the PNC level. The group overall, it's neutral. I'm not happy with the admin expenses because you should expect these one-off charges even at the financial crisis and as always, there needs to be more focus on getting admin and other acquisition expenses down and not up.

Now operating investment income, the other major driver of our performance on Page 19. It's basically up 6% to 841 million. Nothing special to be reported basically driven by a high investment base as you can see on Page 20. Asset average base is up 5.9% to 95 billion roughly. The current yields are down, reflecting interest rate declines and stabilizing at the current level. The equity yield is due to some one-offs. They will not be repeated stem from associated enterprises where we have realized gains on PE and real estate participations.

Last slide at PNC. Some that you always look at Page 21 is the pricing trends. Here, we have seen very consistent development, relative to prior quarters. Some markets, the nominal tariff increases actually being higher than anticipated in the middle of the year. I think there were some comments that people

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didn't understand that. I've just added two comments on credit insurance in our last corporate business on the right-hand side.

The credit insurance will have price increases yet a plus 5% this year again, and AGCS, that's the offsetting factor our large Commercial business sees very soft trading environment and given the very large risks around so we are very cautious in underwriting and prepared to let top line go because the price trend for the year is slightly negative and we expect soft market conditions to continue. The various effects despite some of the headlines we've seen losses, large losses have actually been not high enough in order to take sufficient capital out of the market, particularly in the U.S. We continue to have enough excess capital that is chasing business, and we don't want to participate in that for volume.

So these are my introductory comments on PNC. Let's move on to the Life and Health business. And as a starter, a little apology particularly for those of you that have to change your valuation models on the U.S. business. We have restated our easy live numbers and I'll talk about that a little more in detail. And I personally pushed this because what we're doing now much better reflects the true economics on the management levers of our business, the volatility that we've seen in the economic crisis on our U.S. business is totally overstated. The volatility in the underlying business. Now I wanted to solve this and thanks, to our team that was able to get it done.

So revenues in the segment are 16% up to 12.6 billion, very strong numbers. Operating profit up at 655 million operating asset base, up by 4.2 billion to 418 billion the value of new business at 147 million at a new business margin of 1.6% according to our current internal valuation methodologies.

Now if we look at the revenue side, Page 24, just two comments. Number one, we're growing both product segments we're as appropriate where we make the margin. We sell the traditional product relative strong investment-oriented products. We hope to have the right balance between traditional and unit and product. Still we see strong demand for guaranteed business, as the key differentiator for people that are sick and tired to see their equity mutual funds go down all the time.

Now the German Life business is still growing and in this environment, it's flight equality here. We are benefiting from the very strong ratings in the market as have been a number of markets. Now let me explain Italy. Italy has a bonanza in the third quarter of last year. We didn't plan in Italy and still see some strong contribution from Bancassurance even though at a somewhat lower level, and we also see very, very strong growth in Asia Pacific, particularly in markets where we do have good margins. Where we're also growing is Japan. We are watching margins very carefully there.

On the overall value chain the margins are also positive. Now the United States looks very large in terms of year-on-year growth. Let me remind you that last year in the second quarter, we called off the e-product that we successfully reintroduced at very nice margins and the gross at very nice margins is strong this year so that number looks larger relative to prior than it is. We are right above or at plan in 2010. We also have strong sales in fixed index annuities. Our product that is in terms of its growth in line with expectations.

Now let's move to profitability, Page #25. The key change over prior year we've told you last quarter already that the third quarter numbers will not repeat themselves. They were very much driven by positive exceptional impact last year, out of credit spreads narrowing in the U.S. There was 130 million and positive value option movement from equity market gains that were another 66 million so that by and large that explains the large swing. Then we have some changes in the expense results mainly due to one-offs in particular we had a DAC adjustment to be done in Eastern Europe accounted for 24 million, that was the biggest one-off item.

Overall, with 655 million, we're just in the middle of the lower and the higher range we have provided for the year. We typically have told you we have 2.3 billion to 2.8 billion. 2.8 billion would be 700 million to 2.3 billion would be as around 600 million per quarter so we are exactly on target with the third quarter numbers.

Now we get to the accounting changes that always cause a lot of fun. Page 26 gives you a description of what the original challenge was and how we have been addressing that. If you go back particularly

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to 2008, you saw a lot of volatility in our earnings, driven by credit spreads changes on the asset side. We've had a portfolio recently of USD $5.2 billion in fair value assets that we've described tightening and widening constantly went up and down. And on the other hand, we had about USD $7.4 billion in fair value liabilities and then however even though they were called fair value, we're not discounted with the appropriate rates but with market risk free rates and that amplified volatility to a high degree. And it did not reflect particularly liability accounting the management levers that we have available to share credit spreads and credit risk changes with the policy holders. That is a misstatement of true economics, which is very important and that's why we wanted to change it. So I have nothing against accounting volatility. I have something against accounting volatility that is not reflecting true economics. So what have we done? We have sold the assets held as fair value and reinvested in them in assets available for sale. Somebody would say what you could've done that earlier that would only taken down some of the volatility. So in itself we were waiting for the right opportunity to deal with the regulators also on the liability side and we introduced successfully now a new accounting policy for the fixed index annuity liabilities. How does this work? The first thing again is all assets backing the fixed index annuity are now held and available-for-sale and the remaining value liabilities are at discounted that didn't earned great that reflects exactly our levers that we have on the management side. So no more unjustified accounting volatility stemming from credit spread and interest rates movements. And I wish to be honest that some of the other accounting methods that we would have would also reflect how economics as good as we probably have it now with FIA.

On Page 27, you see the numbers that some people have asked or what would've been the third quarter number? I don't know what it is because we change the accounting effective July. And also I cannot tell you what the third quarter number would've been. Just to explain, the sale of the fair value assets is not reflected in the restatement the cost of selling them was about two to three basis points of the assets so nothing dramatic to be reported here. So the live restatement here reflects the restatement of the liabilities, which will be a lot more in line with economics going forward.

So that is what I wanted to say maybe one additional comment on, despite all of the volatility, I wanted to remind you we are not speculating on the asset side. The average rating on the portfolio that we've had at AZ Life is a strong AA-. So this is not around, camouflaging credit quality issues to the opposite.

All right, now operating investment income, Page 28. Up 80 basis points to 4.1 billion. Nothing really noteworthy to report. Interest and similar income slightly up with assets up, net harvesting stable and investment expenses also stable. So nothing to be reported. Net flows are still positive and market affects however, sort of out-balance negatively by foreign exchange effects, which were at large 8.3 billion on a comparison basis to the middle of the year. So the decline in U.S. dollar has affected us significantly just the AZ Life liabilities and assets have been contributing with 7 billion here. And also the swing given the dollar decline has been significant.

The total asset base, excluding unit linked is on Page 30. You see the development and the current yields on the equity side. I just want to comment, are below normal because of the goodwill write-off and the developments on the private equity side. That number is usually a little higher and will be higher going forward.

Let's move on to the value of new business. As we compute them to date. This is continues to be the pure theory and see the old methodology as of end year, so you can do the comparison and given obviously that interest rates are down very significantly. It's no wonder that the new business margin has declined and the present value of new business premium is also slightly affected by that. So the value of new business stands at 147, which I think given this environment is a very strong number, and we have not applied any liquidity premium to that yet. Other, I will talk about that later I guess. At the end of the year, we will revisit our MCEV and valuation methodology as we get closer to understanding what the new Solvency II environment is and as we've learned through the crisis, with what valuation methodology actually reflects economics and what is pure theory.

Now Page 32, gives you the split up by region. And again, we are happy to report that in all regions, we are having positive margins. Now again, in Europe, we're seeing because of the strong influence of the guarantees, the declining of new business margin was 2.1%, still good. Asia Pacific actually improved

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because we're selling a lot of business on the unit link side without guarantees that have very attractive margins and the U.S. stands at 50 basis points. Here, the FIA product in October has trended downward with a sudden drop in interest rates and we are repricing it effective November in order to capture better margins. So we are here on the right track as well. So these are my initial messages on life. I expect some more discussion later.

Asset Management, so let's finish the top-down description with the best numbers that we have. Total assets now exceeding 1.4 trillion, third part assets exceeding 1.1 trillion. And again, we had exceptional net inflows. In the first quarter, I said we will probably not see again the quarter with 37 billion net inflows. That was wrong. We have now 40 billion. We have reached a new height and operating profit therefore continues to reach record levels and the cost income ratio is truly outstanding at 58.5%.
Now the Pages 35 and 36 give you both the AuMs and the flows. And Page 37 give you the net fee and commission income. Here I just would like to comment that we are not just growing but the quality of the earnings is also improving, excluding performance fees, excluding to look at performance fees. What do I mean? The third-party AuM margin has increased by 10% to 40 basis points. It's really, really strong. It hovered around 36, but higher share of retail and new products has driven up the margin, so the earnings quality not just the volume is up.

Now on Page 38, you see the various drivers of the improved operating profit. On the operating expenses, profit participation that's well earned, and but also investment in new platform that's influencing the number that in fee and commission income is at par however, by the same amount that the operating profit was in 3 '09. It basically doubled before cost effects.

Fixed income is the key driver. As you can easily tell by looking at Page 39, here, all the net flows come in 32.9% at higher AuM. Performance is 91%, I think most s-managers on the phone would be happy to have that and operating profit is 400 million, very strong numbers.

Equities. Equity people always look at negatively I think that's overdone because we I think are faring relatively well, if I look at the overall market, operating profit for the quarter is 30 million. We should get to 200 million for the year I hope and cost income ratio is also now improving despite a lot of restructuring so I hope we also see better investment performance and then we should continue to improve.

Now last comment on Asset Management and in the presentation before we summarize is something that goes in my mind unnoticed and not reflected in the valuation properly. That is the fact that Asset Management is not just significantly increasing operating profit contribution, but the flow to net income is going very, very strongly because we've been buying out the B shares in hindsight at very good prices. This quarter alone, the contribution of Asset Management to group net income is 22%, 22% and over the three quarters already 16% and the net income contribution has almost doubled. And I think that's very good for us and very good for our shareholders.
So let me summarize. Double-digit revenue growth, strong operating profit, net income at 1.3 billion for the quarter on the nine-month number. We are very, very comfortable on net income. Capital position still solid, so we expect on our outlook that we will reach the upper end of our outlook if there is no undue volatility in the remainder of this quarter. So Allianz shareholders should have a very good year 2010. Thank you very much and now I'm ready to answer your questions.

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Question and Answer

Operator

Today's first question is coming from Michael Huttner of JPMorgan.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

First one, the internal solvency. I just wonder if you could give us a feel for where we are now? The last figure I have is 155% at Q2. And in there, of course you've got the MCEV bridge figure and I wonder maybe you could identify that separately. I think that kind of what you're alluding to talking about the impact of low interest rates. And the other question is the pricing you're talking about in non-life in the various slides whether I take the 1.1% figure or the 1.5% or 2.8%? It seems a lot lower than Zurich reported last week. They have this nice picture in Europe of various price increases and the numbers there range from 2% to I think plus 13% or 15% for U.K. and the average for Europe is around 4%. And I just wondered -- I know you can't comment competitively but I wondered why your numbers shouldn't are not quite higher. I can't get my head around that. The interest of course is trying to guess what the next combined should be?

Oliver Bäte
Chairman of Management Board & CEO

I was hoping the usual question that get to solvency what is the dividend going to be and what you're combined ratio next year. And I can say at all very fair questions. Let me start with the pricing environment. I don't know what the book of Zurich looks like. I think we are cautious. We've expected significant price increases in Europe over the last 2 years and then never came. So I'd rather want to be cautious to see what is a nominal price increases and what makes it into the portfolio after discounts, after lapses that you see when you do price increases on some customers so what does it is really reflected at the end of the day in the portfolio. To be very transparent, I cannot say, tell you that I have this perfect now. But we've improved and this is our best guess of what our portfolio would do. Now we do also have a different portfolio mix, for example, the motor race in the U.K. are strongly going up but we are just a small player in the U.K. market, in terms of motors. So the overall effect on our portfolio is much less than for players that are very large, for example, in motors. So very significantly by market. On the other hand, for example, we underestimated in the beginning of the year the price trend in Italy. We have expected from all of the year around 7% price increase in Italy. They're approaching around 10% now, so we're doing much better than originally anticipated. But I'd like to see that in the portfolio. By the way on Italy, it's the first time that we have in that gross in the PNC portfolio in the last two and half years so it shows you the positive momentum in pricing that is all now making it into the portfolio. As predicted Enrico's team doing a great job there. At it's very heterogeneous across markets of example German motors are still stays soft. The people have apparently too much money to be spent on losing money on motor. So that is now our best estimate on the pricing. So that was the number on the -- these were the numbers on the pricing slide. Now on a combined ratio side, I think it's very important to understand for next year that looking at this year, developments would give you too high a number to anchor your forecast for the next year. I'm actually would return to normal around the NatCat side a much more bullish than taking the 2010 number. We originally planned a 96.5 combined, and we are likely given the NatCat loading to somewhat miss that. But it doesn't mean that I have very strong expectations to make up for that in the next year. So we should get to better levels next year for sure and we're working very hard particularly on the claims side to get a few portfolios improved. Germany must improve significantly. We must improve France, for example. Very, very important and that should give our portfolio a significant boost going forward. And I think that's very important. Now on solvency. Solvency we have a long debate on what we're going to do around that going forward but I think being consistent is the most important thing. Now the other comment I want to make is that when we reported midyear numbers, we always were referring to 2009 numbers because the computations to update all the internal numbers is a lot of work. We didn't do that in every quarter as we now have done the major review of our Solvency II project in the internal capital models, we will adjust that by the end of the year. Until then, we'll provide with the

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numbers that are fully consistent with what we have communicated prior. Our current internal model on the AA confidence, which is 99.7 gives us ratio of approximately 120%. If you used the 50 basis points confidence interval that's being applied for Solvency II, that number jumps to 150. Now that is before any liquidity premium and any yield curve anchoring that we already have in QS 5. If you just take the minimum advice that we've had from SIOPs and the new commission and we do the yield curve anchoring at 30 years and the liquidity premium we are at least at 170%. So what does that mean? What you should be worried about does Allianz have to go raise capital out there in the foreseeable future to support the business? Absolutely not. That is what we're really managing ourselves by. We will review the model and adjust it by the year end in order to a more appropriately to reflect our true economics and obviously the low interest rate environment is driving these numbers up and down by 10%. It's going easily every month. That is also driven by obviously by the MCEV numbers. And let me comment again something that Helmet Perlet in 2008 fourth quarter. It's super important risk management tool that we used to understand the risks in our business. It should not be used to value the business of our life book. I'm very happy to buy life businesses that are basically rated down based on MCEV numbers. So if anybody that is selling life business based on the MCEV numbers, give them my phone number. So just to be very clear on that basis, we feel very comfortable given our capital position at this time.

Operator

We'll now go to Mr. Spencer Horgan of Deutsche Bank.

Spencer Horgan
Deutsche Bank AG, Research Division

Can I just clarify what you just said in Michael's question. You mentioned the number 120% on your own model. And that's with interest rates as they are at the end of the third quarter no liquidity premium. Is that correct? And if you were to have a liquidity premium could you just give us some sort of sensitivity around that?

Oliver Bäte
Chairman of Management Board & CEO

No, we don't give sensitivity around these numbers. We've never disclosed that and we're not going to start that now. Particularly as we're changing the model at the end of the year anyway right so that gives you an interim view. First one, now normally, we use a beginning of the quarter numbers, not totally true because we recalculate new business margins in the, for example, every week right so it's more of a mix model. That's different to midyear reporting with the way you ask me where we've have an adjusted all the numbers to midyear effect, which we're doing now in order to more appropriately reflects the business and also because our risk infrastructure is much better than it was at the beginning of the year. And so we've improved that quite a bit in order to steer the business on realtime information.

Michael Broom
Berenberg, Research Division

The basic message here is you're going to revamp the model quite significantly and restate it at the start of the year, so we should essentially just wait for that?

Oliver Bäte
Chairman of Management Board & CEO

Yes, what are going to do is obviously look at and that's particularly important for the Life business. How the model should reflect the liability. Let me give you an example. A significant part of MCEV changes that we see happened around cash flow is beyond year 30. So about 50% of some of the MCEV changes have been adding cash flows that occurred long before I and you probably will have retired enjoyed our retirement time. And we need to be careful that we balance these valuation methodologies with cash flow emergence and we are moving and have been moving more and more away looking at cash flow. As we told you last year, at low interest rate levels, we can go 10 years without having to worry about at least not at Allianz, for example, in Germany without having to miss any guaranteed payments to our policyholders. And I think that's what really we should be worried about. What is it on a cash flow basis

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can really pay for the guarantees that out there. On the other hand, that's why MCEV is just a great risk management tool. We need to understand whether underlying economics are in the worst-case scenario but I don't run the company on worst-case scenarios.

Spencer Horgan
Deutsche Bank AG, Research Division

The second question was obviously you're not giving any guidance for next year and having increase this year's guidance. But from I guess what you're saying, you're expecting the non-life business to be substantially better next year and this year. Life I guess could be broadly the same and Asset Management a bit higher so could you expect the operating profit to advance further in 2011 at least or maybe you can you give some qualitative comments around that?

Oliver Bäte
Chairman of Management Board & CEO

Yes, I hope you find me professional to say we are in the middle of our planning processes right now. As of tomorrow, we are on a week of looking at the plans for next year. So already for that reason, it would be imprudent to give you more firm guidance. Now if we do have stable interest rate markets, and I hope the interest rates go up and that was stable but we don't have any major volatility that much higher of level assets under management that we now have in our Asset Management segment should provide also much higher earnings and given that we've bought have a lot of the B. shares, a lot of the values would also flow to shareholders. So that's one point. The other anchor point I give you is can see that you should not look at this year but at the original guidance that we provided for this year what our target is for the PNC segment, so it's better than this year. And on the life and health side, the Assets under Management have increased so I don't know what the gross will be but the earning side would be fairly stable relative to this year where you have a balance between increasing assets on the one hand, on the other hand declining interest rates. Now what I would love for is a slow, but steady increase in interest rates because that should dramatically lift up our share price and that sector.

Operator

We'll now go to Mr. Marc Thiele of UBS.

Marc Thiele
UBS Investment Bank, Research Division

My first question is for the Asset Management unit. We see a big trend down in terms of the B share charges and you have hinted there is very little left. Can you give us a bit of an indication what we should be assuming in the coming quarters and how the impact of the M shares will feed into the numbers? Then the second question is related to life insurance. There's no liquidity premium assumed in the MCEV calculation and do you think that you would be moving that way, Zurich will be moving to that way? Just looking at access sensitivity table, that makes it 2.7 billion in down case given that the Allianz book is smaller. Would it be wrong to assume the potential 2 billion uplift? And then also in life insurance, can you give us an indication of what you intend to do with the German crediting rate at the end of the year and where you see the market is moving?

Oliver Bäte
Chairman of Management Board & CEO

Yes, now, Mark, thanks for the questions, all very good ones. The point is I cannot publish yet what we're going to do on the Life business. What should be clear, the market overall should go down, okay, because that's economics. So the German markets should go down given where interest rates have gone. We led the market or tried to lead the market down last year. We were the only major one to reduce the crediting rates, and we're looking at that very carefully now. We're making a decision here based on sustainability, but I'm not going to give you a specific number, unfortunately at this point in time. Second one was or the first question really was on what happened on the B share expenses. We expect remaining B unit expenses of around 200 million. That is however, assuming an OPEC growth of 0% and it could go up to as much as 440 million if the OPEC growth continues to be 10% plus the year. So it depends a little bit on

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what the OPEC growth is, but is by and large. We have so far acquired around 120,000 of the 150,000 B shares. Now so the vast majority now is out. The other thing, which I wanted to mention is the M shares. Now the M share dynamic is very, very different because we only pay for additional profit growth. While the B shares were originally let me remind you part of the purchasing price. 1.15% of the earnings and I think that's very important. The M units are also held in perpetuity, so there are puts and calls on the M shares just to really make sure and they represent an interest in PIMCO only. I think that's very important. For the detailed cost, they depend on obviously operating profit development and their price thereafter, so I cannot give you the precise number for what the total expenses really are. However, I can tell you relative to total earnings, I wouldn't say tiny but it's very small, less than 30 million.

Marc Thiele
UBS Investment Bank, Research Division

Just a comeback, the 200 million to 440 million, is that a number for 2011? For the full year?

Oliver Bäte
Chairman of Management Board & CEO

No that's on the remainder of the program that theoretically can go until 2016 depending on how many we call or they put because you have a difference between the portfolios as you know and therefore we need to decide every time. That gives us significant option value because we can wait for the business development and what our assessment of the market is and then we can decide whether we call or they then decide whether they put. And as you know, there has been a lot of volatility in the last two years. Now you asked the third question you had is on the MCEV and what the various lift ups are. Let me just remind you just on the solvency ratios. The liquidity premium which happens very late is at least 20 percentage points around solvency so the impact is very significant. The impact is very significant in terms of the changes and we'll calibrate. But it's a fair observation that you say, that the industry as an industry, will move to adopt liquidity premium and some type of it is occurring because it's already in the SIOPs specs, and SIOPs appears to be extremely conservative so that the minimum that I expect you will see going forward, in terms of the positive lift on the MCEV values at least that they use for capitalization. And I would also like to remind you that two different purposes that MCEV is being used for. One is a basis to determine risk capital. That's what we need to pay a lot of attention to it. The other purpose is for valuation, which I do not support because I always have the view that Life business is valued as a runoff portfolio. And, for example, just to give you the specs of the German business, if you look at life books only as a runoff business, you're missing a lot of management levers that you have by taking fresh cash flows to support the inflows. So I find that totally inappropriate as an evaluation technology.

Operator

We'll now go to Mr. James Quin of Citigroup.

James B. Quin
Citigroup Inc, Research Division

The first one is just on the Asset Management cost income ratio. We've had three quarters of very good performance and I guess what we're clearly seeing is that the growth of expenses running far lower than growth of revenue. I was wondering if there's any thing within the current cost income ratio ran about 58% level that you would view as an unsustainable ticket? Second question I have is just on the corporate expenses. And I'm just wondering if you could give us a bit more of a breakdown of exactly what's in here because this obviously it's a very substantial part of your earnings, but I guess it's not internally obvious and we're now expecting what is that 10 billion sort of operating cost, but it's a big number because you continue to be nonrecurring as well?

Oliver Bäte
Chairman of Management Board & CEO

Yes, James, I do agree that this is a very big number, very, very big number and I'm not happy about it. But the Corporate segment again doesn't only contain the cost of our holding. That's been around 400 million for a while, but you have all kinds of other effects here. The treasury in there, that's very

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important. You have now the banking and financial services elements in there. You have the consolidated private equity in there. Oliver Schmidt is going to give you the details of the segment composition, which we do also provide so you have the detail. What is very important from my perspective is we historically have better results because we have very high interest in capital income at the holding level, offsetting our interest income. And given the changes on the capital market, that interest income has trended downwards, while the interest paid has stayed constant because we have basically had long duration liability. Whether that's smart or not I do want to comment on but has tilted the balance towards a negative number recently and again a lot of the gains that we have recorded do not come in operating profit, but they come in net income. So in order to look at the corporate performance, one would really have to look at operating profit and nonoperating profit together because a lot of the positive offsetting effects are recorded in nonoperating. So I don't want to leave you with we have a problem here. I think that's very important. In the interim report you find that on Page 74 and 75. Now we have a lot more detail. Now on the cost income ratio, our Asset Management is fairly important. Indeed what we are seeing here and that's really for the first time this year significant economies of scale because the assets -- the cost of managing the asset is going up at a significantly less up as you said correctly on the way up. And that's very important. And I think that would basically also rattle the industry. You have a lot of asset managers there that are feeling the pain with lots of outflows. They see that fixed cost base remaining now. What is variable however I think a lot of administration outsourced to stage street that is actually AuM-based and then you have the rest of the infrastructure that's basically for AGI flat. So we're benefiting that and the cost is not expected to go up. So at this level of Assets under Management, we should see stable cost income ratios, excluding significant investments in new products that we do. But given the overall level of earnings, that should not distort the picture. Yes? So we will continue to see and we will maintain the high level of Assets under Management a very strong cost income ratio also into next year.

James B. Quin
Citigroup Inc, Research Division

Just quickly coming back on to the co-percent of cost. I suppose the fact that the interest income has gone down has just exposed this. I suppose it's always there, but I mean is there anything within the current level of cost that you believe to be something that we should not expect? Or is this the current run rate that you -- like it remained a current run rate?

Oliver Bäte
Chairman of Management Board & CEO

Long debate. As the co-percenter guy, we can even have a philosophical debate here. My personal point of view is, on the record, that co-percenter cost should be lower. But what I'm working on here is 400 million annual cost. So if we were to move, you could get maybe 35 million, 40 million out. Is that going to move the needle on the overall valuation? No, it isn't.

James B. Quin
Citigroup Inc, Research Division

I guess the other 500 million I was talking about but -- sorry, I mean it's not about the 400 million owing cost. It's the other EUR 500 million or so that is in there, and whether there's any thing within that you consider to be a non-sustainable item?

Oliver Bäte
Chairman of Management Board & CEO

No, there's a couple of aspects in there. There is, for example, our private equity holdings that we have and that we are consolidating for accounting reasons that are negatively and have been negatively affecting the holding segment on the operating profit. And that needs to go away overtime. So that's one significant item that we have. Then we had to build up cost for some of the alternative asset functions that we have, real estate and others that have been holding cost because we cannot take all of the cost and pass that on to our businesses that has also driven up our cost recently and that should go away. Now on the downside, we are also carrying our pension liabilities on the holding, and depending on what the

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development of the interest rate is over the next two years, we also might see some increasing expenses there. So I cannot give you a full picture on the holding development as of this year now.

Operator

Mr. Andrew Broadfield of Barclays Capital.

Andrew Broadfield

Two questions, please. The first is on the avenue expenses. And it feels a little bit like the Groundhog Day every quarter, seems to be the same comment that you're a little bit disappointed with the avenue expenses in PNC and your predecessor used to say, it felt like every quarter as well. I'm just wondering, is it still -- so it's still a process of chipping away at that and trying to find many areas that you can cut back on, or do you feel that there's a sense that maybe there's an opportunity to do something a little bit more dramatic? That's the first question. The second question I hope I understood this right, but I think you said you he was talking about the U.S. and I think you mentioned that you felt though you were getting very nice margins there. And if I look at the Slide 32, and I look at your new business margins, they're clearly lower than elsewhere in the group still. That's odd. I was just wondering what you consider to be a very nice margins and perhaps you might be able to give us some background on the product characteristics of why the VA has changed dramatically or the main characteristics of the changes are?

Oliver Bäte
Chairman of Management Board & CEO

Yes, now I think on the Life there was a misunderstanding. What I'm talking about very nice margin was related to the VA business that last year was very negative. So that's important to understand. We have a mixture here in the numbers that we disclose between VA and fixed index annuity. And the VA business was basically breakeven in the third quarter. As I told you, we have recognized that already at the end of the second quarter as interest rates suddenly dropped and you reprice that. Now regulation in the U.S. requires you to file these changes and it takes about six to eight weeks to actually get the repricing into the system, and as of the fourth quarter, that business will be up about profitably and sustainably profitable again. So we have always a delay in adjustment in the margins in the U.S. Now what I wanted to say is the Variable Annuity business has a margin of 1.9 percentage points and last year was negative when we have to reprice the product and that is in this environment, which is not easy. So I think the team there has done a very good job so that's the one comment. The other comment I have on cost, if you really want to make me upset you just need to talk to me about cost development at Allianz in the segment because it is really true, it is Groundhog Day. We have a development here I think that is over time has to improve. The issue I think is the underlying cost inflation that we have in the business model. Every year, we record cost inflation that is -- excluding claims, I'm just talking about admin and acquisition overhead cost -- that is outpacing revenue development in this time of the economic and underwriting cycle, and we cannot have that. We're coming out of an industry that is used to grow at least at GDP level. Now, the cost growth is still GDP level, but unfortunately, revenue growth is. And we cannot have that. In other industries, you have productivity plan five years out, say, if revenues stay flat and earnings power has to improve in order to improve productivity not just on the cost but also on capital, productivity has to go up. And I think we have not achieved that mindset nor have we introduced the target systems. We still have businesses that come in with lower revenues a lower number of clients, but increase in cost and we cannot have that, sorry. They have to change going forward and so that is not a question of let me do another cost-cutting exercise. This industry is ripe when some management teams come to you and say, now we're going to let 2,000 people go and it's not going to do something around the underlying inflation. The problem is not the next cost cut. The problem is to get labor cost inflation and non-labor cost inflation finally under control and that's why my focus is on not the next cost-cutting because somebody needs to serve clients and we can certainly save money in overhead. But the cost inflation needs to go out and we need to talk to our social partners to say what do we do here? We cannot have costs go up and salaries go up, if we don't earn more revenues from our clients.

Andrew Broadfield

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So just if I understand that quickly, you're saying your approach or ambition, if you like, is to keep the costs stable and to grow into them as they are now rather than to think about...

Oliver Bäte
Chairman of Management Board & CEO

To be more precise, and I think it's a good analogy. We need to tie cost development precisely to productivity development. That is, if revenues and number of clients don't go up. We cannot have cost go up. And that needs to make it directly into the targets of our management and we're working on that for the next year. As you'll remember, Allianz now has, for the first time, a three-year plan that's very tightly tying in centers to achieving this. So people will be not making money if we don't get that done.

Andrew Broadfield

And so I'll just come back to the last one very quickly. You mentioned that VA is 1.9 percentage points in your business margins. Was that correct?

Oliver Bäte
Chairman of Management Board & CEO

Yes, for the third quarter in the United States.

Andrew Broadfield

And the U.S. as a whole was 0.5%. So was that interest rate and the fixed annuities that you were referring to that struck that down then?

Oliver Bäte
Chairman of Management Board & CEO

Of course, as I said before. 10 basis points is basically what I said on the quarter and how we are repricing that. I cannot tell you at what the expected new business margin for the fourth quarter is even though we do weekly members. We can probably dig them out and I can follow-up on that question to tell you what they're currently are because we have the best pricing.

Operator

We'll now go to Fabrizio Croce of Kepler [Capital].

Fabrizio Croce
Kepler Capital Markets, Research Division

Actually, I'm looking perhaps first a statement about your idea to go to nine-month result. I think this is really a great start, will be a great start and the quality seal, actually. I think that a quarterly figure distorts a lot of reality and put a very bad light on the sector. And so it would help actually. So first as a comment. And then, two questions, please. First one is again around expenses. I mean, I shared your indignation about your cost base, which is definitely too high and here the question is if you share also the figure about how big the cost of it around is currently? I come to the conclusion of between 1 billion to 1.5 billion of cost overrun, which should be mitigated. And here the question is, could it happen in the way that you suggested by simply a debt cost revenues or would not be some more drastic measure necessary at the beginning? And afterwards of course your course will be the perfect one. And second question is about the Asset Management. I mean, the figures are really gorgeous, but I mean I have a confession that competition is not sleeping and so what I'm not understanding or probably and simply I have a confession I'm missing it is, what are you doing so far better than anyone else? I mean although they're also very good name, very good brands and Asset Management but you seem to outsize everyone and the question is, has it to do with condition? Has it to do or is it really -- I'm missing simply the point. So if you could spend a couple of words there?

Oliver Bäte
Chairman of Management Board & CEO

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Yes, I'm very happy to do some advertising for our friends at PIMCO. Let's talk about the issue however. I wanted to just give you, of course you mentioned the nine-month number. We also have on the expenses in the reporting a major issue because when you look at the cash portion of the cost and even in PNC, you have significant amounts of deck movements. We therefore have moved to a nine-month perspective and also at looking at the cost and I think that's very important to understand that. And in the past, used to have three quarter numbers, quarter-over-quarter numbers, which in my mind don't make any sense. So unfortunately, the picture you see on Page 18 is exactly what it is and that it takes care of a lot of the deck ups and downs that we used to have. I just wanted to mention and reiterate one point. The cost inflation is also not just related to revenues, but also to a number of clients. What you also find in this industry that people kid themselves by trying to get to price increases through and then price themselves out of the market. So you should not give management too many incentives to just ratcheting prices up beyond what a sustainable level is. So you also need to tie the incentives to client number development. You cannot continuously lose clients and then allow people to increase cost. So both has to happen and we're in the process of making sure that it gets into the target of people and we enforce it. And then the savings, where do you take out the money? There are many, many areas where we still suffer from too much complexity either to a large number of products, tariff generations, IT systems. I mean there's lots of opportunity. Unfortunately, once you have the complexity, it takes a lot of time to finally, get it out. So guys are working on this. Not we are lazy, but in the environment that we are in, the downside from losing volume is much faster than you can get the cost savings through, and that's also a reality that we need to face. Now on the Asset Management side, I'm just quoting the Wall Street Journal I think from a few weeks back, I think we had more net inflows into PIMCO than we had order flows and the U.S. equity asset management industry in all of this year. So due to the huge success of our friend, PIMCO, that have just relentlessly focused on performance. Now obviously having a lot of support by the market as interest rates are at the lowest point that I can imagine. The current treasury bond prices indicate implicitly 24 years of inflation below one percentage point. This also tells you that it's probably not sustainable and we are seeing the build up of a new bubble. So in terms of just to give you a balanced perspective why the guys are doing a fantastic job, we also need to be conservative in terms of what can happen going forward. If interest rates suddenly rise, you would probably also see assets moving in a different way. So we've also sort of participated in a boom that has helped us. Now on the other hand, in times of high volatility, people do look for records and PIMCO has now 30 years of strong performance behind them. And despite some outflows that we also see when you go back to the pages significant in the last quarter of 2008, when they called the Lehman crisis the wrong way, they have been basically overall continuously doing and going ever stronger. So fixed income was never the focus of many of our competitors in doing an assigned business and the core of our capabilities also, by the way, strategically because it complements our strength in the Life Insurance. We have invested into PIMCO because fixed income is a core part of our capabilities, so something we really need and now we're benefiting from. That's what it is. We need to strengthen the equity side. I think there's some more work to be done and we hope that business that was in 2007 doing really well will, in terms of if asset allocations change, we'll also benefit. So we have some hedge built into the portfolio there as well.

Fabrizio Croce
Kepler Capital Markets, Research Division

And about the figure 1 billion to 1.5 billion, is this a figure on which we could agree in terms of cost on your, have on your debt currently?

Oliver Bäte
Chairman of Management Board & CEO

There are various ways on how you look at that.

Fabrizio Croce
Kepler Capital Markets, Research Division

Even higher?

Oliver Bäte
Chairman of Management Board & CEO

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It's a lot.

Fabrizio Croce
Kepler Capital Markets, Research Division

So my figure is a lot, or is the figure which you are working is bigger?

Oliver Bäte
Chairman of Management Board & CEO

You pick your number.

Operator

We'll now go to Mr. Paul Goodhind of Red Partner (sic) [Redburn Partners].

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

One is on the Life business. By first you find in several rates of return a bit more helpful, the new business family on the REMCB [ph] (36:04 audio3), not a figure that you tend to give in the past, but I think it's of interest. Are you able to give any guidance for what you think the IRR is on the cash you've invested in new business during the course of 2010? I might be particularly interested in how that figure looks if you seem flat equity markets, because history has told over the last 10 years, a market can go down as well as up for long periods, and it be good to know how sensitive the IRR would be to that assumption. Question two is on your favorite topic of the dividend. And in particular, if we can just talk conceptually what payout ratio should Allianz seek to attain over the next year or so. In the past, perhaps not you but maybe it's Helmut [Perlet] who said that you want to pay a compassionate dividend. I guess your peers, depending how you define them, are paying out half their earnings or more dividends at the moment. it includes buybacks as well. But you're much more cash-generative because we have to manage the business. So what's the answer to that sort of in medium-term aspiration on the payout? And then if we bring in Solvency II, did I detect that you were fairly a little bit more positive than you were on the Q2 conference call in terms of how that was looking for you?

Oliver Bäte
Chairman of Management Board & CEO

Let me start with the last one. The positive is always dependent on where you stand. I'm still concerned about charges that we are seeing for long-duration Life business with guarantees. And it's a fundamental question for which we don't have any time here. And I think there's still too much -- there are too many capital charges that can affect this business model severely going forward, so we need to come to more reasonable terms there. The other thing is we have business models that have credit spread income. However, that is where the risk is significantly shared with policyholders and the risk models do not appropriately capture the management levers. So we're also getting overcharged in terms of capital in that business model. Looks less attractive than it truly is for us, at least as we believe it. And I think that's very important to understand. So Solvency II, I think, on the P&C side is generally fine. It's not fine on Life business, as I said, that have the characteristics that are described, and we need to work very hard. Now I expect that there are other technical aspects. So for example, what types of yield curves do we use? For example, if you're sitting in Italy and you're supposed to use a so-called European yield curve, that's priced off the German bond, then you basically discount your liabilities at the bond, but you discount your assets with the credit spread of the Italian government, thank you very much. If I were the Italian government, as long as we have one there, then I'd be very upset. So I expect significant technical changes that will improve the capitalization of the Life business going forward. Overall, I think Allianz should come out of this process positively. Now, there's another aspect to be borne into mind that has not been addressed appropriately. That is the capitalization of group solvency. There's lots of debates still going on about fungibility of local capital on the Standalone business. All our business, not all of business, but the vast majority of the businesses look fantastic on the capitalization. But due to some of the funny rules that we've at least seen as being discussed from SIOPs that would then change as you add them up to the group level. We cannot accept that. And often it's by the way based on different accounting

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standards, which would violate the European constitution. So we expect changes there. Overall, we should come to a reasonable outcome, otherwise the industry will suffer significantly, which to be honest, economically, we cannot afford in Europe. Now beyond the sort of high-level statement, let's move on to your more concrete steering question. We do not steer our business on an IRR basis across the portfolio, but we do that in the U.S. particularly on our Fixed Indexed Annuity business because, as I said before, the new business margin is an ineffective steering tool there on a standalone basis. There we look at IR and we are pricing our business in the U.S. for the FX index annuities around 12% to 12.5% IRR, which gives us a solid margin. So there we use it and, by the way, we have a weekly check on those IRR numbers. I can unfortunately not give them for the rest of the portfolio, but I can also tell you we are recalibrating our Life steering mechanics at this point in time, in light of not just MCEV and new business modules, but also to get a much stronger focus on cash flow going forward. And by the way, funnily enough, traditional accounting gives you much better insight into cash flow than you get from MCEV.

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

And on the dividend?

Oliver Bäte
Chairman of Management Board & CEO

Dividend, that's my favorite. The good news for you is that we stay consistent and the consistency is that we are prepared to pay out 40% of the net income. And I would stay on that. I'm sorry to say, for those of you that we're hoping for surprise today, because we still are not clear on cash flow developments going forward. And the other one is, you're always mentioning the other competitors. I cannot talk about their economics but one thing I can tell you is that we need to make sure that we have enough money for reinvestments in the house. We're not accumulating any excess cash. I can tell you that. We have no incentives, neither in my incentives nor Michael's to accumulate excess cash. So everything that is distributable and cannot be profitably reinvested will be paid back. We're also not, let me reiterate that, holding cash for any major acquisitions. We've tested the market this year with the sale of two of our Swiss participations, you saw that. The prices that we achieved are very high. That means people are still asking very high prices, including ourselves. So at the moment, it pays to be a seller rather than be a buyer. So the timing for acquisitions is not perfect. So we're keeping our powder dry on those fronts. We'd like to come through this very difficult economic environment financially sound. And others might make different short-term-oriented decisions, we are not doing that. The interest rates are so low that we need to be extremely cautious in terms of overall income relative to our fixed cost base. That's not just the interest structure cost, the cost of their guarantees, and we to watch ourselves. These are abnormal conditions at least with interest rates hovering between 2%, 2.5%. Everything else would be funny. Let me remind you, in difference to banks that make money whenever the yield curve is steep, we depend on the absolute level of interest rate in order to make money. By the way, that's why I believe when interest rates will go up, and I hope they don't go up with a spike but slowly, but steadily you see a huge uplift in earnings and then we are ready to provide you with more dividends.

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

Sounds like a tactical cut answer. So you're not saying that you don't think you should be paying a higher payout ratio. You're saying that for the time being, there are uncertainties that constrain you from doing that. But conceptually, you are weren't disagreeing with my question or were you?

Oliver Bäte
Chairman of Management Board & CEO

No, I'm not disagreeing.

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

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Because on the low bond yield, some of you said that you don't notice it in Germany for 10 years. So the cash flow impact that you're talking about is way out in the future. So it doesn't really test you in terms of cash flow so for quite some time. So I guess I'm just a little bit confused as to why that would limit your dividend today.

Oliver Bäte
Chairman of Management Board & CEO

Yes, because some people we talked about solvency earlier. I have a rational behavior, a rational belief structure assumption in terms of regulation. Now you see some irrational regulation on some markets. If that happens, I don't want to go out and do a cash call. So we are very, very, very cautious on the environment. And it doesn't mean we are overly cautious but I don't think it's prudent to try to drive up the share price short term in order to look good at the expense of the longer-term future. I just don't run and don't want to run a company for the next 24 months. I want to run it for a long, long time. That does not show up in short-term dividend cash flows. I do apologize.

Operator

We'll now go to Mr. Nick Holt [ph] (45:04 audio3) from Nomura.

Analyst

First one is on the Life side. Can you explain that the real world position with the European new business that you're writing where the new business margins have fallen due to low interest rates? I'm really trying to get a better feel for the true position. I mean we've all discussed how MCEV is sort of artificial. And my question is really, are you writing business with lower spreads, or is this lower margin just a function of higher cost guarantees, that sort of thing? Second question is on the PNC. I wondered if you could update from the outlook's German motor is seems that the mutual by HUK-Coburg are pretty reluctant to increase pricing. And I wondered if you see any hope at all for some sort of improvement in the competitive environment?

Oliver Bäte
Chairman of Management Board & CEO

Of course, let me start with the latter question and then I will try to give some time to our team here to collect the numbers because that's a very interesting question, what is really driven by capital requirements versus the minor. I think it's very good one. The answer should be positive from our perspective because again the capital charges are what is really driving that relative to the business. Now let me start with the German motor. First, good news is the share of the Motor business the overall P&C business has been constantly declining. That's good news. However, it's still significant in the portfolio. I don't expect the overall market to improve significantly in the short term. So there's no relief and that's also very clear, management has understood that, that hoping for an improvement by the market to lift you up would not make the day. But we have significant levers ourselves in the portfolio that we have to pull. My estimate that improving claims management in our P&C business in Germany should improve the combined ratio around 3%. So we have, if you want to say so, a 3% improvement margin just on our own account and we need to make sure that we pull these levers and we expect the new management team, that's why we put it in there, to dramatically improve the management of our claims. So again the market would not help us, but we have to help ourselves. And I think we can do it and we have to do it. Now on the business in Germany, we're still digging up the numbers. So if you allow me to take the next question, I'll get back to you in about three minutes. Is that okay?

Analyst

Yes, of course.

Operator

We'll be now moving to Mr. Michael Haid of Cheuvreux.

Michael Hermann Haid

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CA Cheuvreux, Research Division

The value of new business in Life, 147 million, and the new business margin of 1.6%, of course due to the low interest rate environment. You mentioned this is good in this environment. What do you think is a sustainable figure going forward for this environment? I think it should be higher than 1.6%. And in the past, I think you were going for much higher, but in a different interest rate environment of course for a much higher margin. Second question, the underlying run-off currently, the P&C business is 3%. How long do you expect this higher run-off to persist? And the last question is, on the B-units. If I am right, then you repurchased some B-units also in the third quarter and as we looking into the valuation of these B-units over the year and of course it has -- the value of one B-units has increased a lot over the years, how is one B-units valued at this time?

Oliver Bäte
Chairman of Management Board & CEO

Michael, we're looking up sort of the individual numbers. Let me talk to you a little bit about the new business margin development first. It's a very interesting question because it really depends on what the interest rate level is. When we were coming from around 4% long-term rate, the target was 3%. That's what we said. Now we are at half of that, and we are have sort of consecutively seen the margin go down to half of the long-term margin. This is what you expect now. Now, I don't expect rates to go down much further. That's one observation. But obviously do not sort of build our plans only on hopes of the CFO. So we have a few other plans in place. And that is dependent on the interest rate development. The one thing we're doing in environments where we cannot get the appropriate margins on the spread perspective, we're going pushing unit-linked products much more strongly. So Taiwan is an example where we're doing this very successfully. We have had an historical book with negative spreads. A lot of people have left. We were lucky to have a very small book, and we are now being one of a few remaining players and we're selling very profitable unit-linked products with some guarantees in this market at very high margins. So we're also pushing alternative products in an environment where we believe sustainably we cannot make money on guarantees. Now that's in my mind a temporary strategy because our value proposition to clients is to actually provide capital and interest rate guaranteed that have to be economically viable however. And obviously, the challenge that you have on low interest rate environment is that you cannot adjust the cost base down as quickly as you can typically particularly on distribution cost as you can bring down, as the interest rates will bring down margins. So you also have a point when margins turn negative, have just stopped writing business. And, for example, in the Netherlands that I described here, this is a typical market where we don't want to really grow anymore because of the margins in the market or in some parts of [indiscernible] (51:14 audio3) business, we're letting volume go. We're not in the business of writing volume just for the sake of volume. Now that being said, you obviously depends on what the distribution structure is. It is easier to be done if you have brokers, a large number of brokers that are not dependent on the business that you write with them, versus if you have a sales force that depends on you funding it. So I cannot go into all of the details, but I wanted to assure you that we have very good plans into place, depending what the rate levels are and what the profitability are to put a break on new business if it doesn't produce appropriate returns. And I think that's very important to be understood. Now the other thing is we have -- the answer also differs from country to country, among other things. For example, in Germany, we are in some areas closer to the guarantees and therefore we run very conservative asset allocations on the smaller share of the UA business that might change. So for example, in Germany, we push very, very hard personal disability products with very good margins in addition to the additional product to get, on average, a higher margin out of the products here. So the risk components are expected to go up going forward in order to provide stability in earnings and to provide higher profitability on top of what we're getting out of the traditional business. So sorry for the lengthy answer and I think that's very clear. So I'm still waiting for the answer on the B-unit value.

Michael Hermann Haid
CA Cheuvreux, Research Division

With respect to the other margin, 1.6%, but do you -- I think you assume that this margin is probably the low and you try to improve it going forward.

Oliver Bäte

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Chairman of Management Board & CEO

So Michael, sorry, repeating, I'm still trying to get a number here, while the people are very -- because you specifically asked, just let me repeat your earlier question, what the B-unit value at this point is, as you correctly said it is significantly up because it's tied to development of op ed and operating profitability was up and I'm still waiting for my colleagues to get that value so it's going to come in a second. So please repeat your third question.

Michael Hermann Haid
CA Cheuvreux, Research Division

The third question was regarding the runoff profit 3%, which you said they are, for the time being, possible. But presumably the more long-term, you probably go back to the 2% runoff profit in to the P&C.

Oliver Bäte
Chairman of Management Board & CEO

The issue, if you think about it carefully, was Helmut have said in the past, if you carefully listen to him and said, that our reserving policy does imply a normal minimum runoff of 2%. Now on top of that, what you see in this crisis now that we increased the reserve significantly in the recessionary environment. And some of those increase in reserves now come back as runoff. And that's why the runoff is now higher and we've done a bottom up analysis on looking at where the runoff is coming from and how this is likely to develop. There's always fluctuations in there and that level is at least 3% for the time being. This is the consistency.

Michael Hermann Haid
CA Cheuvreux, Research Division

And looking at the level of reserves, so we can basically expect that this is going on for maybe one or another, so maybe two years that we could expect 3% instead of 2%?

Oliver Bäte
Chairman of Management Board & CEO

Yes, I think that is something we can sort of assume with some ups and downs. I'm still waiting for -- the guys are calculating. We still don't have a precise number for the B-units. It's always good that you guys wake us up. Again, I would give you that number during the course of our call.

Michael Hermann Haid
CA Cheuvreux, Research Division

And do you expect the last B-units to be rebought in 2016? Or do you think you can close this book earlier?

Oliver Bäte
Chairman of Management Board & CEO

Yes, I think we expect them to be bought out earlier. 2016 is just sort of the end of the buy-out period as we had agreed then. We have been buying them out at a higher rate. We have a number anywhere between EUR 43 per B-unit that we are running on 30 into 40 unit. I don't think it's going to help you much by the way on the valuation.

Company Speaker

Mike, look, why don't we pull up on this later, okay?

Michael Hermann Haid
CA Cheuvreux, Research Division

Okay.

Operator

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We'll now go to Julia Raffle [ph] (56:03 audio3) who is autonomous.

Analyst

I just want to ask you firstly if you can please clarify whether the 120% economic solvency compares with the 143% at the end of June as opposed to the on in C5?

Oliver Bäte
Chairman of Management Board & CEO

Yes Julia, you are always on the details. The answer is yes.

Analyst

And then can you confirm the 120 is taking the PTSD as per the end of September? And are you already adjusting for the pension deficit or that is the only piece that is not comparable with the full year figures?

Oliver Bäte
Chairman of Management Board & CEO

No, what I said earlier, because the question we already had, is that we have a mixed year. Some of the beginning of quarter numbers, but for the U.S. business we do basically an update on the new business margins weekly so you basically have a middle-of-quarter number. So it's a mixed number up, but it doesn't reflect end-of-quarter numbers.

Analyst

And then on that, I mean can you give us a sense of what the off-balance sheet PTSD was on your calculation as per the end of September? On my number, I assume we are two very marginal figures as per the end of September, but it would be great if you could share the numbers.

Oliver Bäte
Chairman of Management Board & CEO

Yes, Julia we don't disclose this number, but I confirm your statement, it's a very marginal number.

Analyst

And my final question, on the slide where you show your year-to-date pricing, so Slide 21, the impact on renewals. You're now showing 2.1 and if I remember correctly, it was 2.2 at the end of June. So is it fair to say or I accept that things haven't changed that much, but from a direction perspective, you are probably slightly more cautious on pricing now than you were three months ago, is that fair?

Oliver Bäte
Chairman of Management Board & CEO

No, the dynamics are just, Julia, that we get obviously smarter as we grow older. At least some of us and over the year you see sort of the real of pricing coming. So that's the updated figure. This is not changed much as exactly as you say. Across the portfolio, we had some shifts. Again, as I said before, for example, the pricing strength improvement in Italy was much better than expected and in other markets, it has been less strong. So it reflects the usual adoptions in the portfolio and gives you the portfolio mix as described. Also, I'd like to do add, because of data quality issues, AGCS is not yet in the sample. That's why I provided you with additional information on the site. There, the rate development is expected to be softer. So in that respect you can say it's a little less positive than the overall portfolio was being looked at the middle of the year because I know no better what is going to happen. On the other hand, we have no price increases on the Reinsurance side. That should also help profitability going forward. Now the question that we have from Michael on the B-units appears to be finally answered. So the value is EUR 30,000 per B-unit. That's at least a common consensus of my experts around the table. Thank you very much, team.

Analyst

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Just one final question on Fixed Annuity. Am I right that as part of the changing accounting, you move from a economic view like FIS 159 [ph] (59:56 audio3) to a more book value accounting type like FIS 97 [ph] (1:00:02 audio3) for U.S. GAAP. And therefore, the only time where this doesn't show the underlying economics of the business is if the return falls below the interest rate floor or guarantee. Is that correct?

Oliver Bäte
Chairman of Management Board & CEO

No, it's not correct because the first statement was that it's not economic. The opposite is true. And I would like to really clean up that description. Economic has appeared to be what is mark-to-market with the Bloomberg swap curve. That's not economic, that's baloney. So first obvious statement, because this really gets on my feet. Second one is the issue in Life business is that you have in the product, particularly in FIA, management levers to reduce crediting rates and we have a very low guarantee level of sometimes be around 1.5% sometimes even below that. That is not reflected in the valuation of the liabilities.
That was getting on my nerves, as long as I was looking at this business. And we've been working for quite a while to find a solution. Now the earned rate description, as we've used it here, gives you a best approximation. Unfortunately there is no perfect solution of the management levers and the crediting rate adjustments and the way we can share credit spread developments with the policyholders, that at least according to our economics is out there in the market. So the statement that it's not or less economic is unfortunately or fortunately not true. I think it reflects economics much better than it did before.

Analyst

No, I mean I just said that you move from a market value principle to a book value principle. I say it reflects the economics assuming that your earn rate will always be higher than the guarantee rate?

Oliver Bäte
Chairman of Management Board & CEO

Sorry I don't understand the question. Maybe we can pick this off off-line. And we have quite a few people here that spend with me the time on doing the valuations and the description of the business. Very important to actually go to the product level and look at what we are promising to consumers, how it really works. It's a fixed income return with an upside on the market development. And I think we have now much better-modeled economics than we've done that before. This is not about locking in returns. Okay? But I'm happy to spend the time even personally because it's a very important issue.

Operator

We'll now go to Mr. William Hawkins of KBW.

Analyst

It seems to me that what you've done with your fixed-indexed annuities clearly contradicts the standard and the guidance from the IASB with regards to your assets and your liabilities, respectively, at very least reclassifying to AFS. In that context, are you deliberately trying to send a message to the IASB? Because it seems to me what you've done is shift to a much more U.S. GAAP standard for this part of the business. And then secondly, would it be wise or not to assume that something behind this change is effectively thinking about a corporate outcome for the fixed-index annuity, a trade sale or whatever?

Oliver Bäte
Chairman of Management Board & CEO

No. The last one I can clearly say, no, we actually believe it's a very nice business. As I said before, the IRR is about 12% and we really like it, it's actually a winning product. A few years ago people said this product will die. The opposite has been true. I think there is a couple of points that I'd like to say. I'm sorry to screw up your valuation model. So as an underline, the issue is let me comment on IFRS 4 Phase II. The exposure draft that we received from the IASB is fully consistent historically with their approach to so-called fair value. That's a Marxist approach because it's a little bit like whoever wants unfair values. Now the problem is, what is economics? And the more we move to the volatility and discounting stable liabilities with market rates, I spent my time on forecasting the next quarter profit. Does this anything to

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do with underlying economics, no, it's total nonsense. In fact, if you want to estimate cash flows returning to sharers, the worst thing that you can do, it's the worst thing that you can do. So not just Allianz, the total industry is against the exposure drat that is out there. So that's the first observation, and we need to stop trying to try to account for our business that has very clear economics by basically making it volatile in a way that does not reflect the underlying economics. But there might be some various views, but it's very clear. So we're not sending a subtle message. They're just based on the AZ Life, they see a bold form has been very clear in terms of its guidance back to the IASB. We don't want the exposure draft as it stands right now. There have to be significant improvements in the various options that we do that. We want to at least a level playing field with the banks. Just think about IFRS 9 introduced a trading and bank book approach for the banks. We're the only guys that are dumb enough to let ourselves to be the liabilities being constantly discounted with varying rates. It doesn't make any economic sense, I'm very sorry. The second thing is if we do that, we at least have to have a stable discounting rate for our liabilities. If we cannot use the cost approach and that has to reflect the underlying economics of the liabilities, very, very clearly. Now, that is very important to understand. Now the U.S. business and the way we've accounted for that has nothing to do however, with the IFRS 4. We did the deliberations and the design long before the exposure draft was out. We agreed with KPMG on having this approach and got it approved. It's fully consistent with accounting principles and got that signed off long time. I think it's very important the earned rate, and that I would like to put in as a caveat, is only a suitable proxy when the minimum interest rate guarantee is not significant. I also want to point out that, clearly, if you have high guaranteed interest rates, one would have to use a different discounting rate. So we are not trying to camouflage economics or the value of options to the opposite but where the product economics are better reflected, like in this case, we use earned rate for discounting.

Analyst

I hear what you say. I don't want to bore my colleagues but I was also thinking on the asset side switching to available-for-sale is something which is no longer allowed under IFRS 9. But it might be better to take this offline.

Oliver Bäte
Chairman of Management Board & CEO

It is also interesting one. Bockart [ph] (1:07:11 audio3) is always, our head of financial reporting, like me goes on that. We have not endorsed IFRS 9 in Europe for very good reasons -- for very, very good reasons. And I think and I hope it stays that way until we have resolved IFRS 4 Phase II, because we need to solve the issue of how we account for the assets in tandem with the liabilities, and that's my final observation on accounting. Our business model integrates the values of our assets and liabilities. The traditional view that I learned in business school that you try to value all assets and liabilities separately then you put them together miraculously on the balance sheet might make sense for somebody that produces paper or whatever, but it doesn't make sense for insurance companies. We have an integrated relationship between assets and liabilities and they need to be reflected in accounting. I think it's very good points, but we just have a different view from some of the other guys.

Operator

[Operator Instructions] We'll now go to Mr. James Shuck of Jefferies.

James Austin Shuck
Jefferies LLC, Research Division

I was interested in what you were saying about managing the Life business for cash flow. Obviously, I mean Paul's point on the IRR, there are many companies kind of looking at payback period and IRRs. You mentioned that you might be changing sort of how you look at some of your individual territories and I was just interested kind of which are the kind of territories that are sucking up capital? Which are the products that are taking a long time to payback periods? And what are your kind of early conclusions with respect to shifting your outlook in certain territories? I'm also kind of keen to know when you want to be in a position to actually tell us how your overall group cash flow fits together, and kind of territorially how you actually build that up to get to the great pitch at the cash flow level? That was my first question.

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One other question which is, as I think about the distribution networks. Because if I think about your distribution and the number of the territories, you're funding through kind of proprietary distribution networks and I'm interested to know kind of how you're managing the absolute level of kind of fixed costs within those distribution networks. Because obviously top line is under pressure to some extent and we've seen that on the P&C side and that's been one driver of the admin cost, which has sort of refused to come down, if you like. Can you just sort of shed some light on how you view the fixed costs and what your capacity is actually in the individual territories? I'm particularly interested in the continental European countries, Italy, France and Germany, please?

Oliver Bäte
Chairman of Management Board & CEO

Yes, both strategic and important question. Let me start with the latter one. The share of Broker business in the P&C segment is it's constantly rising. So its not just proprietary networks that will continue to dominate, but their share relative to other distribution and hopefully also to direct is going down, but it's a very fair observation. By the way, the fixed cost is not just staying high on proprietary distribution. Also, brokers in this crisis have tried to sort of manage the economics that are much tighter and much more dependent on upline and ours often and protect them. So the cries are for overriders and for-support payments have been very, very significant and our regulators are paying a lot of attention to that now. Again, and I think for the right reasons. So that's the first observation. It's not just proprietary channels. But it's true that the interesting outcome of the financial crisis analysis is that in some of the proprietary networks, the worst of both worlds, they are flexible on the upside, but they're fixed on the downside. And it's actually the opposite of what you would normally want. You wouldn't want fail advantages like you have that in the direct business on the way up, so the margin is declining cost. And on the downside, you want to be protected. Therefore, we have to restructure the incentive system. Now on the other hand, it's very difficult over a short period of time to drive the structural cost of agency forces down because the support mechanisms are very, very large. So often, you really need to work on productivity, so the key changes that I see coming as you saw it on the banks 10 years ago is that agency productivity has to dramatically improve in this type of environment, particularly if they want to play a role going forward in retail P&C distribution, and we're working very hard on that. For example, single-product clients will get central support in order to get cross-selling up and we're focusing the agents more on multi-product clients in order to get the economics right. So the mix between direct distribution in the nontraditional way, i.e. supporting the networks and taking care of the clients, and then the physical distribution focusing on high-value clients will continue and that should lead us to bring down the marginal cost of supporting clients also in the proprietary channels going forward. It's a very, very tough job because many of the agents, Italy is the most prominent example, they behave like brokers but they cost as much as our interim models, so we have very little control over the short term and it takes considerable time to change the model. So I think it's a very fair observation. The other thing is that I'd like to see the cost and relationship to the risk costs. I think the key advantage of our proprietary networks is to drive down cost in two important areas on the risk side. The first thing is that the average lapse ratios are significantly lower in our proprietary networks historically than they have been in non-proprietary networks that has a very positive impact on our economics on the one hand. And the second one is the impact can even be higher on having a lower loss ratios. However, for that to be the case going forward, we need to tie the incentives much more closely to the loss development in the portfolio and get a much better handle on claims steering the proprietary networks, and that's a second priority for us over the next few years. So that's on the distribution. Now on the cash flow development, we have a project running in Allianz in order to not just top down but bottom up gets much clearer on cash flow and P&C and in Life, and cash flow development. So, for example, when you look at our MCEV disclosure, there you have a number that cause free surplus. And when I arrived here my first question was, is that free surplus really free? In reality, free doesn't really mean distributable. So we are working on really understanding how much of the capital after regulatory constraints can really be upstreamed and returned it to the holding and then on to shareholders and how much is really tied up. Now your question was what our areas of concern, and it's actually not an issue that is only related to geographies. It's mostly related in the life side to distribution margins. What is most problematic for my personal vantage point is to buy bank distribution against huge upfront cost on the Life side, then pay huge commissions against the so-called MCEV of that business that's going to come in 30 years. And some of the accounting models, and that's no offense to Julia or

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Will, that you see from life companies that have very strong in Asia show you earnings that you will never see as value at least in my small view of world. Why? The assumptions that you have that support the so-called value and earnings are based on high lapses that might or might not come. Regulators might look at the products and say, how can you make money from just clients lapsing? There are around -- how long will I keep the asset in the insurance companies? So that some assumptions says I have the asset for 10 years but there are sales incentives to churn the assets after five. So a lot of things that shareholders will pay for when you buy the franchise and you pay the banking distribution based on some assumptions and hopes to keep the assets and asset returns over very long periods of time that I'm very cautious about. So we are looking at really the cash flow, what are you paying and when am I getting my capital back? When I will have my distribution cost earned back and when I really will have earned the appropriate return on my cash flow? And a lot of the bank distribution models in fast-growing markets without proprietary distribution gives me the shivers. So we're really, really looking at that carefully just as one example of how we're doing it. Unfortunately, capital markets, and I'm not blaming anybody on this call, I'm not acknowledging and analyzing these trends. A lot of people getting benefit for bank insurance growth that looks very dubious to me in true economic returns.

James Austin Shuck
Jefferies LLC, Research Division

Is this something that you'll be able to present more clearly on sort of next year?

Oliver Bäte
Chairman of Management Board & CEO

The question is whether I'm able and whether we can disclose that yet, i.e. how stable are the numbers? We have a plan to get the definitions and the run calculations done by sometime by the end of the year. I'm not sure I can do that for year in closing for 2010, to be honest. But it's a very, very high priority for us because it directly will drive capital allocation. So sorry for the timing and I think it's a decisive point by the way on M&A already today. A lot of the Life books that we get offered on a real cash flow basis, taking into account the things that I just mentioned, look a lot less attractive than based on published earnings. And we have a very careful COO who always tells me, Ollie, there's a lot of earnings in Life, but maybe not so much value.

Operator

As we have no further questions, I'd like to turn the conference back to the organizers for any additional or closing remarks.

Oliver Bäte
Chairman of Management Board & CEO

Guys, I think we had a lot of time today, but I'm happy to field any further questions because I tried to save it at the front end, so there's some time left if you want to spend it.

Michael Diekmann
Chairman of Supervisory Board

Well, and if not, we say thank you to everybody. Thanks for joining us and we wish you a nice and pleasant remaining afternoon.

Oliver Bäte
Chairman of Management Board & CEO

Thanks for your support, very good discussion. As always, see you next time.

Michael Diekmann
Chairman of Supervisory Board
Good bye.

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