S&P Capital IQ

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Allianz SE DB:ALV

FQ3 2016 Earnings Call Transcripts

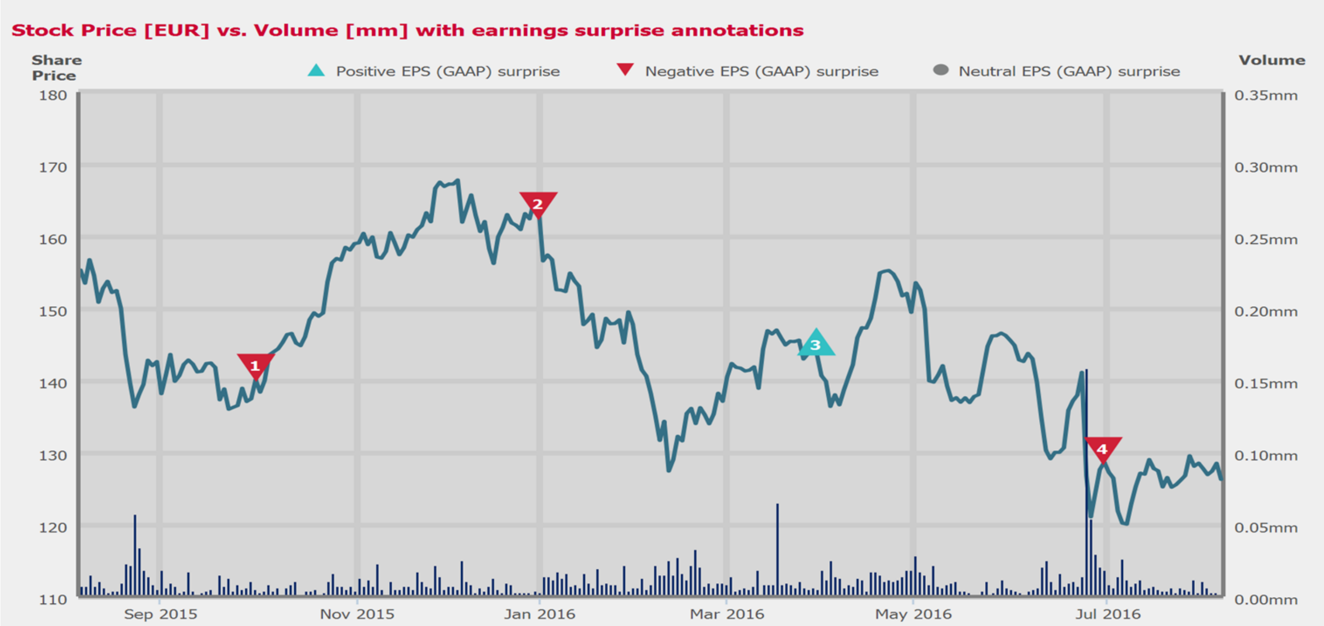
Friday, November 11, 2016 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2016-			-FQ4 2016-	-FY 2016-	-FY 2017-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS (GAAP)	3.53	4.08	▲15.58	3.70	14.41	15.23
Revenue (mm)	26950.00	27700.00	▲2.78	-	125159.50	123808.32

Currency: EUR

Consensus as of Nov-11-2016 10:12 AM GMT



- EPS (GAAP) -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2015	3.49	2.98	▼1 (14.61 %)
FQ4 2015	3.53	3.12	▼2 (11.61 %)
FQ1 2016	3.48	4.70	▲3 35.06 %
FQ2 2016	3.67	2.35	▼4 (35.97 %)

Call Participants

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Presentation

Operator

Ladies and gentlemen, welcome to the Allianz conference call on the financial results for the third quarter 2016. For your information, this conference is being recorded. At this time, I would like to turn the conference over to your host today, Mr. Oliver Schmidt, Head of Investor Relations. Please go ahead, sir.

Oliver Schmidt
Head of Investor Relations

Thank you, Jenic. Yes, good afternoon from my side as well, and welcome to our conference call about the results of the third quarter 2016. There's nothing specific to be added from my side today, so I'd keep it brief and turn it over directly to Dieter.

Dieter F. Wemmer
CFO & Member of Management Board

Yes, thanks every much, Oliver, and also good afternoon to everybody on the call, or good morning, everyone, who dialed in from the states. It's a great pleasure for me to present to you our Q3 results. When we start at introducing the presentation on Page 3, operating profit of EUR 2.9 billion really supported by all areas and, in particular, by the Life and Health segment. And I will then dive into the individual segments later on in the presentation. Shareholders' net income, close to EUR 1.9 billion, 36% up compared to a year ago, a strong evidence of operating performance and also good financial market results. But also, the revenue growth of 0.5% has translated into internal growth, that means adjusted for currency and other effects, 1.7% is pretty good and strong results on an organic growth basis here coming from P&C as well as our Life segment.

But let me first go a little bit deeper into the balance sheet. Increase in shareholders' equity of more than EUR 2 billion, driven by unrealized gains and losses in fixed income and equity, retained earnings, but also consuming actually an increase in our pension liability because the valuation rate for the pension liability is down to 1.3%, which is a clear evidence on how low interest rates in Europe was. And in this low-yield environment, we are defending our Solvency II ratio with 186%, very strongly. And I think that the solvency ratio is really doing well with what you can see then on Page 7, where we have the details in the waterfall the Own fund development and also the development of the risk of required solvency capital.

Own funds is in the end, pretty flat in development. The earnings are consumed by a little bit of market impact and some other changes. And the dividend capital management number, which is a positive, despite that we, of course, have accrued another EUR 0.9 billion for the 50% payout ratio at year-end. It's positively influenced by the high growth of EUR 1.3 billion we raised in August.

The capital requirement on the risk side is mainly driven by market impact growth. Swap rates were down another 30%, but also equities up mean more risk consumption of the equities by market value. Credit spreads on BBB bonds was 20 base points down. That created actually a positive impact and not a negative. That means less capital consumption. But the change by EIOPA of the volatility adjuster formula and application has overall reduced our solvency ratio by 2%. That is mainly in the SCR because we are applying the dynamic of VA.

Management action, actually better hedging our investment results. Our interest rate sensitivity has reduced the risk by EUR 0.3 billion. And that is also really what I had forgotten to mention on the previous page that interest rate sensitivity came a little bit down further in the direction of our target. Overall still a very good number. And before the question is being asked, Korea is still fully consolidated and included in the number.

Now let's move to the P&C segment. As I said at the beginning, a strong underlying growth, 3% half price, half of volume. And we are always concerned about that underwriting cycle is getting weaker. Actually, when I look at the list of countries you see here on this Page 9, only Italy and the last couple of business show a negative rate development. All others are in the positive, which is, I think, a very good evidence that the broadly diversified portfolio is on a good track also to deliver our midterm underwriting targets.

And that leads me already to the operating profit of the P&C segment, EUR 1.4 billion operating profit. Based on the group's previous year underwriting results, still a little bit improvement with a 93.5% combined ratio. A little bit better expense ratio, but mainly a better loss ratio driven by a low NatCat. Pretty normal large man-made losses, so actually falling in our long-term average and better related, it's actually, I would say, medium level, not low and not particularly high. So normalized -- or the runoff result, not the normalized. The runoff result is the 3%, a bit below our long-term average of 3.5% in the quarter. But still the 9-month figure is a little bit above our long-term average. So overall, attritional loss ratio very much comparable to 12 months ago and, I think, on a good track for our future development.

Let's then move to the breakdown and to the individual countries. Well, not surprisingly, the combined ratio of the individual countries, in particular the last one, are pretty good. Otherwise, we are not getting to a 93.5% average. Latin America is now, it's the last place, above 100%, although we are seeing also here a movement in the right direction. Profitability, actually, in Latin America, we would have shown a positive operating profit, but we had a one-off booking on an old Life book in runoff we have from more than 10 years ago in Brazil, still a Life book in runoff. This is protection business where we have increased reserves. Otherwise, the operating profit would have been EUR 5 million, EUR 6 million positive. So that means for the quarters to come, also, Latin America could return to a positive. I think that is overall a very good development in the number.

So investment income and P&C. Well, the running interest income falling parallel to the yield environment we are living in, no surprise. But what we show on the net harvesting and other was, a year ago, a negative number driven by FX losses and other derivative losses. So this year, a small positive. So that is actually the swing factor which allows us to have a better total investment income than a year ago. So it was also in this aspect with 10-plus just above normal quarter, but nothing negative.

Turning into the Life business. Our execution of the new business strategy continues to play out very well. When you look at the contribution of the various business classes, we move in the right direction and are able to deliver overall a strong new business margin with 2.8. But not only that we move in mix in the right direction when you look at the little table on the right-hand side, the PVNBP is up by 8%. That means also sales is growing with the right product mix. So I think our Life story continues to be a real success story, and the real success story is also falling down to bottom line. EUR 1,129 million is a very strong operating profit for the quarter. We have a higher investment margin in the quarter and then there is a positive impact from the base risk on the old VA block in our U.S. Life business, plus good growth in our U.S. Life business. So that's the drivers of our operating profit increase. Is EUR 1,129 million a reasonable number to use as basis for future quarters? We would normalize the number more at EUR 950 million. That means the investment margin, which in the number here included, is 98 basis points, we would normalize more to 90. And then we would correct for the base risk and then some other small figures. So overall, it would be EUR 950 million plus in the future yields, whatever you have in growth on the size of liabilities that would, of course, then dynamically develop the figure into the future. So that is the Life results in total.

Page 21, value of new business, EUR 318 million, very much on last year's level because last year, we had even a slightly better new business margin, but that was at a substantially higher interest rate level. So in light of today's interest rate level, I think we are defending the value of new business. That is strongly -- and you can see that, actually, Germany is the main driver of it. The U.S. is fairly low in the third quarter because the fixed indexed annuity business is very sensitive to the 10-year treasury rate. That means when we look at the screens today, we are probably now back to the good new business margin in the 3% category because the U.S. 10-year is back to 3.3%, where in the summer, its low point was at 1.4%, 1.3%. So that makes a huge difference. But on top, we had taken end-of-the-quarter measurement to improve the profitability. So the U.S. would have been even with unchanged interest rates, also show better new business margin in the last quarter. So overall, a broad contribution from many countries and I think overall doing well.

Page 23 is a detailed presentation of the investment margin. I think I gave already the more relevant information. So annualized, EUR 98 million margin in the quarter. And that means 25 basis points for the quarter specifically and normalized for the quarter 2, 3 base points or 3 base points down.

So that leads me to the Asset Management business, which is, I think, completing the positive story of the quarter. PIMCO is reporting for the quarter net inflows of EUR 4.7 billion. The October also ended with a positive number. So I feel that our prediction, we did already almost a year ago, where actually, last year, in the third quarter presentation, I said that we are expecting more positive flows for the second half of '16. And I think that statement is, at the moment, being on track. I can't tell you what will happen at year-end. There is now a big shift in the U.S. also in how the market views future development. So therefore, it would be a bit too naive to say that we can exactly say what is happening. But I think PIMCO is on a good track to have overcome the problems from 3 years ago and are back as a very recognized great platform and asset manager. We have also placed, over the last month, 2 private funds where we have quite some billions of committed dollars to invest, but they will only show up as inflows when the money is being called from the investor.

AuM, in total, up besides the inflows, good help from the market, as it is a little bit spoil the story. And I should not forget to mention that also Allianz Global Investors had another very good quarter with plus EUR 1.5 billion, which then translates also into a good revenue development overall. Allianz Global Investors growing revenues, baseline, as well as performance fees. And PIMCO are still suffering from the outflows of the last 12 months, but I think we see a pretty stable fee margin. Allianz Global Investors, I should say that the dilution of the fee margin had, of course, something to do with the Rogge acquisition, and then all the changes I explained already in previous quarters on mix and business.

So when we come to the operating profit, a small positive compared to last year, which is a very good development compared to the previous presentations I did. Cost income ratio, a sharp improvement on both sides. PIMCO is 57%. I think that is a very good number. And Allianz Global Investors going to 67.3% and delivering EUR 150 million operating profit is a great step forward to really becoming more and more important in our Asset Management segment.

Now a couple of segments, actually nothing special. Normal, I would say. Noise in the numbers, nothing really to mention. So that we can just have a short look at the net income, EUR 2.9 billion operating profit. Nonoperating items, pretty small, driven by EUR 220 million realized gains, small impairments. So that you end up with EUR 2.8 billion pretax income and 30% taxes, which is the tax rate this quarter without any special element. It is just in both countries where normal tax rates apply. So that we end net with EUR 1.855 billion for the shareholders, which is, I think, a very good number and makes me confident that we can deliver for the year-end an outlook of EUR 10.5 billion operating profit with probably also a good number for net income. When I look at the 2015 net income we delivered for the full year, then our 9-month figure at the moment is 78% of last year's full-year profit. So that means we have good chances for year-end to come out with a nice net income figure.
And here I will stop and open for questions because I think that is probably a better use of our time.

Question and Answer

Operator

[Operator Instructions] Our first question comes from James Shuck from UBS.

James Austin Shuck
UBS Investment Bank, Research Division

Dieter, I had 3 questions, please. Firstly, just from the change in the VA reference portfolio, it's -- you said 2 in the presentation. It's usually one on the actual bridge. It's a much lower kind of impact than one might have expected. If you can just explain a little about the change to the reference portfolio, why it had such a limited impact, particularly to the dynamic elements of the VA. And kind of linked to that, if I compare the sensitivities because you're the first to display the updated sensitivities on the new reference portfolio, and we've seen some big changes going on in terms of the different sensitivities. So in particular, your sensitivities with government bonds has more than doubled, and you're not showing 0 sensitivity to corporate bonds. If you can just explain that bridge to me a little bit. And kind of in the same range, I mean, what does it mean for how you actually manage your Solvency II ratio going forward if kind of overnight, we've had such a big change in the perceived volatility? My second question is a shorter one, just around potential modeling changes to the Solvency II ratio itself. I think in -- earlier this year, you talked about things you could do to refine the treatment of negative rates. So that might have a positive impact. Could you just help quantify your visibility on that going into next year, and then the other things you might be contemplating? And then finally, around the combined ratio in the third quarter, so 93.5% headline. Obviously, there's a low level of NatCat in the period. There's a level of PYD that's broadly in line with where you would want it to be. I know you have large losses. Could you just give an indication of kind of what the normalized underlying level is and how that compares with the below 94% that you're targeting for 2018, please?

Dieter F. Wemmer
CFO & Member of Management Board

Okay, James. So thank you for your questions. Let's first start with the VA reference portfolio. There is, in the update of the reference portfolio, it's one change which you could say is normal procedure, and then there is one change where we are, at the moment, still struggling a bit. But we have applied it. So the first change is, yes, the EIOPA analyze how people are invested and shifted the reference portfolio more to corporate bonds. So less government bonds, more corporate bonds, okay? That's fine. But also, they added in the reference portfolio -- at least that is how we read it, the asset of the unit-linked business, and concluded that this is not interest rate-sensitive, which is correct, but the consequence for the VA is that they reduced implicitly the application ratio by -- well, if you calculate it through, the application ratio falls from 65% to 46%. That is the indirect impact of enlarging the reference portfolio with the unit-linked business, where I am at the moment still struggling why you would at all consider unit-linked. And you are right. The new sensitivities and the big shift came to all of us as a surprise. It's very hard what you can do. You can certainly not adjust your investment portfolio after you have read the paper. However, it is in the end confirming our long-term strategy to go more into corporate credits and reduce government bonds. The sensitivities, you can reach in a way that we are still too long in govies and too short in corporate bonds, and that we need further to balance. That is what the sensitivities say. And whether this -- the volatility adjuster reference portfolio, whether this unit-linked business stated it or not, I don't know yet. But actually, I hope that we can have still a discussion here with all the regulators and more understand what is the idea behind it. Model changes, there will be nothing happening end of the year. I would expect that the model changes is more coming in Q1 '17. And maybe what I should have mentioned on the volatility adjuster, it overall dropped 8 basis points, of which 6 was roughly to market changes in the credit spreads and 2.5 base points is the change coming from the new formula of EIOPA. So when this helps you. So in general, model changes before Q1, nothing. And I would expect that on all the model changes we have applied for, there might be a small positive overall, but not -- that means a few points and nothing too dramatic. The combined ratio, 93.5%, what is our normalized combined ratio? Well, I thought I mentioned that the large losses are included in Q3 are roughly at normal level with some

4%. When you normalize it completely, where would you put it? I think to get to our 94% target in 2018, we have still to go for another, well, around 50 basis points, maybe plus/minus. So -- but I think we are on a good development path that we get to our 94% target.

James Austin Shuck
UBS Investment Bank, Research Division

And just on the point about how you manage the Solvency II ratio. I mean, obviously, the sensitivities don't change so much, because you have a target level for your capital. I mean, what does that mean for actually how you address that volatility?

Dieter F. Wemmer
CFO & Member of Management Board

Yes. We will further see how we can shorten certainly the spread sensitivities. That is what we have to look at. And obviously, what is showing up more and more is this overfocus on Solvency II on credit spread development. It's probably not the right approach for long-term investors.

Operator

We will now take our next question from Farooq Hanif from Credit Suisse.

Farooq Hanif
Crédit Suisse AG, Research Division

Three questions, also, actually. First one, if you take out performance fee with Asset Management, then your cost income ratio is still down. So there's a real good nominal reduction. But Q3 tends to be kind of obviously very much lower than Q4. So just wanted to get your sense of the path of cost now and what you're targeting and how quickly you'll get there. Second question is on the performance fees. You gave some kind of guidance about private funds and private equity-related business that have performance fees coming. I was wondering if you could give us another sort of bit of outlook on what you think is special that's going to come in the next couple of years? And lastly, could you comment on the Italian pricing, where it was weak in P&C? Just what you're seeing in terms of pricing in motor and non-motor?

Dieter F. Wemmer
CFO & Member of Management Board

Okay. So let's start with the Italian pricing, it's still in motor that from our perspective, slightly softening. But the speed of softening is going down, and it might go a little bit better. In the non-motor business, we don't see any negative price trends. I think it is a little bit up, but nothing very special. Also, in commercial, I think we are holding up. It's more the motor liability business, which is still under pressure. And I think that is pretty much in line with also the result presentation of the 2 large peers, which also came out yesterday and today. So that means when you add the 3 up, you have some 80% of the motor market in Italy. I think we are holding up in profitability still quite well. And I assume that we will see, sooner or later, the turning point also for Italian rates, and then people need to turn it back to higher rates. Taking out the performance fees, we have still an improvement of the cost income ratio year-over-year. Actually still some 3.8%, if we are not mistaken. So that is a good number. I cannot give you a performance fee outlook for '17, but you should really consider that it's from the closed funds, but it's also from a very normal institutional mandate. And PIMCO has actually also a sizeable hedge fund business, which we should not forget, which also lifts on performance fees. What can I say about 2017? Well, November 1, that means a week -- a good week ago, and Manny Roman joins as CEO. He is, at the moment, well, I would say, putting his office in place and really trying to understand PIMCO's business in all details. And I think it is fair when you give him some days or months actually to learn how the business works and then comes with a proposal, where do we have the best opportunity from our current strong position to get even stronger. Did I cover everything, Farooq?

Farooq Hanif
Crédit Suisse AG, Research Division

Yes, you did.

Operator

We will now take our next question from Paul De'Ath from RBC.

Paul De'Ath
RBC Capital Markets, LLC, Research Division

A couple of questions, if I can. Firstly, just looking at the Department of Labor changes, a couple of points here. Firstly, has anything changed on your view in terms of the impact on the Life business changes? Also, do you see any impact on PIMCO from the upcoming changes? And on the, as I read earlier today, do you think that the new president might well cancel them? And therefore, it's all been a somewhat fruitless exercise? And that's kind of question one. And then the second point, just looking at the Life business, and you're guiding again to the, I guess, ongoing normalized level of investment margin at 90 basis points for the year. And going forward, given that the shift to new types of business has been so strong and the investment margin on that business is broadly double, what it is on the traditional savings business, do you see any opportunity for that to grow over time? Or do you think the underlying lower investment return environment is going to counteract that 90 basis points as kind of an ongoing target?

Dieter F. Wemmer
CFO & Member of Management Board

Thank you, Paul. Actually, it's good that you asked the question about the investment margin. Obviously, I did not say precisely enough. I'm not guiding to an average new business investment margin of 90 base points for the full year. I am guiding to the 90 base points as expected number for a quarter. But what we have in the bank, we have in the bank. That is quite a different statement. So it's my expectation for a new quarter, without knowing anything, would be that we make the 90 base points and then we see, end of the quarter, whether the volatility allows us to be a little bit higher or a little bit lower. That is how I want it to be interpreted. So DOL, yes, that is a mystery. And the mystery is certainly not getting easier with the recent developments in the U.S. First, in Asset Management and Life, we are fully working on being prepared when the DOL rule starts. However, we are still all a little bit struggling with the interpretation. And when you look at the large broker dealer networks in the states, well-known brand names, they have taken opposite directions, actually, how they view this with the VA. That shows you that there is still a lot of uncertainty around how to go for it. So that it's how its bet at Life working? Do we have to do -- can you only do fee business? And any first-year commissions are being seen as not good enough as at Life, so there are different interpretations at the moment, and there is a lot of uncertainty around it, where we assume it would be clarified over the next months. Now that the Republicans in control in all 3 key positions, so to speak, Congress, Senate and President, yes, there is now, I think, the possibility that things are changing. And when I look at the stock market the last 2 days, the market seems to know more about it. But as an industry representative, I would say too early to say, and let's wait what is going to happen.

Operator

We will now take our next question from Thomas Seidl from Bernstein.

Thomas Seidl
Sanford C. Bernstein & Co., LLC., Research Division

First question is on Life. Quite impressed. You grew the share of Life business above 10% from 34% to 75%. When I look at Western Europe, it's particularly interesting. You have flat operating income, but the RoE for the segment rises from 7.9% to 10.6% quarter-on-quarter. So I'm assuming they have also done some capital action to ease the RoE. And I just wonder if you could give some color here, what exactly you have done to get this strong RoE improvement in Western Europe and in France, in particular, where RoE doubled. Second question, could you give us an update on the Asian Life disposals? It has been a bit quiet on that one. We have heard peers have sold Korean Life businesses. So where are we here on the process? Can we still expect a close in Q4? And finally, I think EUR 2.5 billion is what you have in the M&A budget. You basically said this morning that cost is the biggest hurdle to do M&A. Korea, the price level doesn't change for the rest of the year. What keeps you basically from being -- announcing the buyback that is indirect consequence of not doing M&A?

Dieter F. Wemmer
CFO & Member of Management Board

Look, well, thank you for the questions, Thomas. Yes, I think our -- let's start with the Life RoE improvement. We have a nice increase in France and the operating profit and net income. And also, the RoE, it's stronger. We are working with every country, as I explained last time, to get ready for the sustainable 10% RoE target by 2018. Some will be a bit earlier. Some will be, I think, only in '18. So therefore, it should not surprise you that the numbers are getting better because we are really continuously working with all the markets on this traction. So there is a mixture, and I can only repeat what I said last time. There is certainly capital actions being taken, but also improvement of the underlying operating results. And both, together, should then for the whole Western European portfolio going up in the right direction. Korea closing, yes, fourth quarter is our anticipation. Besides formalities, that means the regulators say yes and giving a green light. There is nothing else open. I think both parties have done everything what the regulator asked for and have delivered everything. And all documents are clean and in good shape. So we can now only wait for their official approval. And yes, with the M&A budget, the latest day is when we announce our year-end results. Then you will know when and how we have dealt with the M&A budget. But I can only tell you, we are completely sticking to our promise. That means that it's M&A or share buyback, not used for anything else.

Thomas Seidl
Sanford C. Bernstein & Co., LLC., Research Division

If we don't hear by year-end about M&A, we basically can conclude the buyback is coming?

Dieter F. Wemmer
CFO & Member of Management Board

Yes, with the one version, yes.

Thomas Seidl
Sanford C. Bernstein & Co., LLC., Research Division

And then on the RoE, sorry, one follow-up question here. With this lower equity consumption in France, why do we not see more benefit on the economic capital side? I would have expected that if you get France more capital-efficient, you get some impact on group capital, but it's not visible here.

Dieter F. Wemmer
CFO & Member of Management Board

I think for this, we need to change even more. That it's also in the doing and making that it's not been completed in '16. That will happen more in '17 and '18. But it is a very good question and good observation.

Thomas Seidl
Sanford C. Bernstein & Co., LLC., Research Division

Okay. That means the capital impact is yet to come?

Dieter F. Wemmer
CFO & Member of Management Board

Further on, yes.

Operator

We will now take our next question from Vinit Malhotra from Mediobanca.

Vinit Malhotra

Just one question on PIMCO, please, Dieter. So is it a fair assumption that the institutional mandates are now sort of under control and it's possible that we assume that the pressure on that side of the outflows has now abated and is expected to remain like this? So just some more color, please, would help there.

And second, just one very quick clarification sort of. Thanks for clarifying again on the VA change by EIOPA. Is it a fair understanding then that EIOPA is now able to direct the industry's asset allocation? Because it should've been the other way around. But it seems that with you moving and EIOPA controlling so much through its VA reference portfolio, is it a fair understanding that they are now controlling where assets go? Or it's too much of a statement here? Just want your thoughts.

Dieter F. Wemmer
CFO & Member of Management Board

Okay, Vinit. And let's start with EIOPA. Well, in the end, it is a mutual process because the reference portfolio they have used is really from the market data they collected in Europe. So that more seems that in the market data that our portfolio had obviously still a bit more government bonds than the average, which actually still surprised me a bit. But I think I have to accept this when this is an EIOPA statistic. On PIMCO, yes, we have fairly stable inflows on all the funds and strategies that people like, and that has -- really is on a good level quite over some quarters now. I think the institutional decisions are, yes, under control, is maybe not a good point when you are in a client service business. We are servicing clients and not controlling them, but some of these mandates got also canceled because the people just needed cash. And can I predict who needs cash? That is very difficult to say. And therefore, we feel comfortable. And in general, the acceptance of the existing clients and the satisfaction with what PIMCO is doing is high. And that gives us, I think, the confidence that today's development in the third quarter was not only by chance.

Vinit Malhotra

Sure. And Dieter, can I just -- the reinvestment rate in P&C, for example, went down 30 bps in the third quarter versus second quarter. Is that somehow linked to this portfolio change from -- you had to do for a while for?

Dieter F. Wemmer
CFO & Member of Management Board

It's 10 basis points underlying 20 credits, pretty much how the market moved in the quarter.

Operator

[Operator Instructions] We will now take our next question from William Hawkins from KBW.

William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

Dieter, just a small numbers on Slide 7, the roll forward of own funds. The EUR 1.1 billion from the Life business, could you just try to help me understand the breakdown of that figure? In the past, you've guided that the in-force runoff is about EUR 900 million. And if I were to add EUR 400 million or so for pretax new business, that would imply some negative operating variances. But it may be that the EUR 900 million is the wrong starting point for in-force runoff. Could you just give us a bit of color about how that EUR 1.1 billion breaks down, please?

Dieter F. Wemmer
CFO & Member of Management Board

Yes. So Will, thank you. The expected business contribution is this quarter only EUR 600 million or a bit more. So with EUR 400 million new business value, you get to EUR 1.1 billion. But that is obviously for you already easy to see. The EUR 600 million has actually some small variance still included. I think we assumed before that we would probably see more ongoing contribution also from a positive experience that might have been a little bit too optimistic when we said EUR 800 million. But I think we will see the next quarter where are we again. That number is maybe a little bit weaker this quarter despite all the positive numbers we have in the overall results. And it will also not be fully stable.

Operator

We will now take our next question from Michael Huttner from JPMorgan.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Great numbers. Really great numbers. You must be very happy. Just really the question I have is, is there anything really which worries you a little bit because everything seems so good. But in a detailed manner, the U.S. NAIC proposal, pricing in German motor, I don't know how do you see this developing, particularly versus claims? And the U.S. NAIC, I suppose the bigger question is, what would the solvency look like at year-end given what we know today? So interest rates, potentially Korea, accretion of earnings? Why didn't you raise your target guidance? So EUR 8 billion at 9 months, the run rate looks like 2.7. So we'd be at 10.7. There looks to be a few good luck factors coming from performance fees at PIMCO. So yes, so I was just wondering a little bit. And what -- I supposed it's a question that my colleagues -- competitors asked, but -- I'm getting very slow these days. The issue -- when we met with one of your colleagues in Germany at the end of June, he explained that Allianz Leben profit's coming down, which means the dividend coming from Allianz Leben will also come down. And -- but then, with the fantastic new numbers on the new products, there's obviously going to be -- the old business decline will be offset by this new stuff. And I just wondered if you can give a feel for when Allianz Leben profits might grow again, thanks to all this new business. Sorry if it's too many questions.

Dieter F. Wemmer
CFO & Member of Management Board

Yes. Michael, indeed, that is a long list of questions. So let me start in the order you asked it. So NAIC proposal, we look at -- we elect to it all the testing we have done on the current portfolio exchanges. Our capital requirement in the year is almost 0. It's really a rounding, I will say. So therefore, we are relaxed. I certainly think it would get a fairer comparison between your fixed indexed annuity writer and the VA writer. And any fair comparison across the market, I'm always appreciating, and it would certainly be good for the fixed indexed annuity specialists. So my vote's yes. Well, actually, the share price are still too low. And why did we not change the guidance? Well, probably, we are more a humble German company. So I think that the EUR 10.5 billion, it's a pretty good number. Some of your colleagues questioned over the summer whether we would make it. I think we are well set and can reconfirm our EUR 10.5 billion outlook. And that is what we want to do. German rates in motor, yes, the increases are not as strong anymore as they were. But still, I think very sustainable figures, in particular a good combined ratio. And in the German Life business, I think we have tested and verified that we can keep in our German Life business the margin, the profit margin very stable. And hence, the profit overall will grow with the underlying business. That means that the reserves grow some maybe 4%, 5% a year, then the profit would, at stable margin, do the same.

Operator

[Operator Instructions] We will now take our next question from Sami Taipalus from Berenberg.

Sami Taipalus
Berenberg, Research Division

The first one really just is on the P&C pricing, it's got a nice uptick, about 1 percentage point in Q3 versus Q2. And I'm wondering if you could just give a little bit of detail of where that came from? And I think, at Q2, you said pricing is running roughly in line with claims inflation. Do you think pricing is running ahead of claims inflation now? So that's the first question. Second question's a bit more philosophical in the Solvency II ratio. You've taken a number of actions over the last few quarters, as the ratios kind of approached the 180 range to -- I suppose to keep the ratio up. I wonder, if you would have taken these actions, had you not had the adverse market movement that you've had, and whether your -- effectively, your target range is influencing your investment decisions and hedging decisions there. And I'm obviously not talking about the Korea sale here, but more about hedges and the various tweaks you've made to the investment portfolios.

Dieter F. Wemmer
CFO & Member of Management Board

Thank you, Sami. Yes, I think in general, I would still -- well, outside Italy, seeing P&C pricing is in line with inflation, there are some positive aspects, I think, that is certainly Spain. There is Australia, and maybe in some pockets also the U.K., where I would make a different point that it is actually getting better. So overall, a little bit more positive picture. The quarter-over-quarter comparison are a bit tricky because you are not reviewing every quarter the same business. The mixes in each quarter are very specific. It depends on which markets have strong renewal dates in the summer or year-end or after 9 months. So therefore, you have really quite a mixture, and I would not look at the roll forward from Q2 to Q3. In the end, you have only, we do the Q3 comparison. There we can say that it's roughly the same mix as the year ago because that renews then according to local market prices. So that conclusion is a bit more difficult. But I would say, in general, it looks a little bit better than when we discussed the same question 6 months ago. The Solvency II management action, I think we would have taken some of them without the market movement because it's just a better use of risk capital. Otherwise, we are always trying also to allow risk-taking to make money. So we are not derisking just for the derisking as a dynamic movement backwards and forwards, because in the end, the capital has to work and to give returns. So therefore, we will be obviously dynamic in our management action. Some of them, which clearly improve things and not harm returns, we would do anyway. And we will do some of them going forward. But on asset allocation, we are flexible.

Sami Taipalus
Berenberg, Research Division

Okay, great. So does that mean that if the market movement sort of went your way, we should expect some of the actions that you've taken to unwind and go the other way?

Dieter F. Wemmer
CFO & Member of Management Board

Yes. Well, we, for example, always look at our equity exposure, how we run it. That is constantly being updated. It's certainly not a stable number that is on one hand, the equity portfolio, but on the other hand, we move puts. We use also futures either to expand risk or to reduce risk. That is just depending on the specific situation. For sure, at the moment, when we look at euro swap 20, as some almost 50 base points higher than beginning of the quarter. We have seen an unbelievable volatility in interest rates in the last 2 weeks.

Operator

We will now take our next question from Jon Hocking from Morgan Stanley.

Jonathan Michael Hocking
Morgan Stanley, Research Division

I've got 2 questions, please. First, on inflation, I wonder whether you could -- what level of general assumption you've got baked into your P&C reserves in the sort of big geographic buckets? And whether your view about inflation is changing from a pricing of new business perspective? [indiscernible] indicates which way you're driving the growth on the outflows.

Dieter F. Wemmer
CFO & Member of Management Board

Jon, could you repeat your last question because you are cutting in and off. Your microphone was not really...

Jonathan Michael Hocking
Morgan Stanley, Research Division

Yes, sorry, so the second question was around PIMCO. So I just wondered if you could give us a little bit of color about the types of products that are driving the inflows and also the residual outflows?

Dieter F. Wemmer
CFO & Member of Management Board

Okay. So your inflation question, we are analyzing in each market and each line of business the average past 5-year inflation, and then we do the adjustments for step changes in the market more to the conservative side when we see upswing. When it goes down, we probably stick to our slower-moving 5-year average number. So that is how we handle it. Therefore, to say what general inflation is baked in, it's very formulaic and very precise on each business. As you know, when a line of business is driven by medical inflation, then you get to different numbers than what [indiscernible] is looking at when he is calculating the inflation for Europe. When he would use medical inflation, we would be at a different interest rate level. We had -- very clearly, at PIMCO, the shift in products is continuing. And it's not new. I think since I reported here as CFO my first quarter in 2013, we spoke about already that the old core products of PIMCO around Total Return Funds are losing in importance and all the other products, income, global credit, et cetera, are growing in importance. And that trend actually continues. We had more than EUR 7 billion net inflows in this -- in newer product generation. And around the Total Return Funds type of strategies, we still have outflows. But that is not surprising. And we had also a positive on the mutual fund side. And I think it's also geographically very mixed, where we are probably still stronger in Asia and Europe and less in the U.S.

Jonathan Michael Hocking
Morgan Stanley, Research Division

Can I just ask a follow-up? And I know it's very early days, but if the curve steepness we've seen in the U.S. over the last few days persists, do you think that product mix is going to continue? Would you expect to see different products come to prominence?

Dieter F. Wemmer
CFO & Member of Management Board

Well, that is in the end, now the crystal ball question. I think that it's much too early to make any statement about it. But it seems from a macro view that interest rates -- the long end of interest rates are going more up, and inflation could return in the U.S. faster. Actually, when you look at the spread curve between 10-year and 2-year treasury, that means, look, how steep is the interest rate curve. That is clearly widening already over the last 2 months, that is not an effect from this Tuesday. It's already a trend for now more than 2 months that the curve is steepening. That had certainly accelerated in the last days. So that means people are seeing a recovery of the long-term rates. What impact does this have on all the Asset Management products? I believe as an active fixed income player, we are very well positioned to service the needs of our U.S. customers and elsewhere very well.

Operator

[Operator Instructions] We will now take our next question from Andrew Ritchie from Autonomous.

Andrew James Ritchie
Autonomous Research LLP

Just 2 quick questions. First of all, could you just clarify what it was when you changed the modeling of the new business value of capital-efficient, guaranteed products. The margin went up there. You're citing a model change for Germany. What are the sort of features that you've modeled better or re-appreciated that drove that? The second question, in the second quarter, Dieter, you've kind of expressed the view that to hit your targets in non-Life, you may have to look a bit more at expenses and efficiency because you were seeing a bit more margin erosion than maybe you thought. I mean, it sounds like there's been a complete sea change on that in Q3. You're now much more confident. Is that a fair comment? I mean, I'm struggling to see why pricing's really picked up. I know you mentioned a few markets where pricing is harder, but those are markets that are also seeing the most inflation. So maybe just clarify is there a real sea change? Or is it just a normalization and maybe you were a bit too pessimistic in Q2?

Dieter F. Wemmer
CFO & Member of Management Board

Well, Andrew, let me start with the combined ratio question. I still think, and that is unchanged, that the expense ratio needs to improve and support the development, even when now the rate changes are a bit more helpful than we thought. I'm not sure that it's stable enough that you can fully rely on it for the year 2018. And when it doesn't work out with the rate changes, you cannot start in July 2018 to work on your expenses to make a target. So therefore, what I said before, what we are doing operationally is completely unchanged. So we have to work on the expense ratio, and that is clearly a must-do. So the new business margin change, yes, very simple. We had in our model, which was also approved by the regulator for the Solvency II model, which we also -- as we run everything integrated, new business margin and everything, we have not modeled in our new business margin the reset option on the annuity phase. So we have, in the end, modeled our new products in the German old system like the traditional products. And the shortened duration and the reset of the guarantee and conversion interest rate at annuity phase was left out, and that makes a huge difference that moves in the end the new business margin for the whole German new business from 2.8 to 4.2, because this new business makes now in retail 90% of the whole.

Andrew James Ritchie
Autonomous Research LLP

I thought you already -- that was one of the reasons why it was more profitable already because of the change and the nature of the guarantee. But I hadn't realized...

Dieter F. Wemmer
CFO & Member of Management Board

Yes. Well, it was already more profitable because it had lower guarantees. That was in the model, but not this more complicated reset option, which was not in the old system foreseen. And that is pretty complex to get it into the model, and then to get approval with the BaFin is not yet there. So actually, we are disclosing for the new business margin something which we have not yet in the Solvency II calculation included because the BaFin and other regulators in Europe approval is still missing.

Operator

We will now take our next question from Nick Holmes from Societe Generale.

Nick Holmes
Societe Generale Cross Asset Research

I had a couple of questions on Life. Just first of all, returning to DOL, I noticed that your hybrid variable annuity products were selling extremely strongly. I wondered if you could give us a bit more color on what these are. Are these sort of DOL-friendly? Are they fee-based? What sort of guarantees are you offering, stuff like that? And then secondly, also on Life, I noticed you took some pretty big DAC true-ups, positive true-ups in the U.S. and France, I think. I wondered if you could basically just give us bit more color. What's going on?

Dieter F. Wemmer
CFO & Member of Management Board

Yes. Thank you, Nick. The true-up in the U.S. is just a consequence of the normal formulas when the base was positive. That means when you adjust the ratio between past and future earnings, you adjust formulaic, the DAC that is the normal true-up. In France, similar and then I think also in Germany, we have DAC true-ups. But that is, in the end, the formula depending on the profits. In the U.S., we are developing DOL-friendly hybrids for next, but they are not yet in place. What it's doing more is the index-based VA business. And that is certainly growing slowly. And you can, of course, call this also DOL-friendly because when you have a passive fund at the underlying in your variable annuity products, then, of course, the best interest advice has one hurdle less to pass. That is quite obvious.

Nick Holmes
Societe Generale Cross Asset Research

Right, that's very interesting. Can I just ask, on the DAC true-up, is the positive variance policyholder behavior assumptions or would it be market performance? And I'm just wondering what's actually driving the positive outcome against your assumptions.

Dieter F. Wemmer
CFO & Member of Management Board

No. Look, you have -- what I said, the DAC level which we keep is determined by the ratio for a policy, what profit will emerge in the future, what profit emerged already in the past. So that's in the end a ratio. Future profits divided by past profits for a single policy or a single group of policies, and then you compare this with the DAC to be amortized in the future versus the past, and that ratio is the same. So that is very simple how DAC works in the Life insurance industry. And as the profit scheme is not stable, you have in the end 2 moving parts here, which are then being aligned. And usually, we are not doing this every quarter. So we are usually doing this on 4 quarters rolling because otherwise, everybody would constantly recalculate everything. And the third quarter is where most of our OEs do this calculation. And then it can come from everything. I think here in the VA book in the U.S. that is market-driven, that was positive base, was development by and large, but then it can also be changes and less assumption, mortality, whatever. But it is mainly just the actual development which is the driver and not assumption changes about the future.

Nick Holmes
Societe Generale Cross Asset Research

Yes. That's very clear. So the mix of markets and better policyholder behavior...

Dieter F. Wemmer
CFO & Member of Management Board

Or not at all, yes, because we just had less profit now and more in the future. Or the other way around, it's very different.

Operator

We will now take our next question from James Shuck from UBS.

James Austin Shuck
UBS Investment Bank, Research Division

So sorry, Dieter, but I just want to return to the sensitivity on the credit spreads, in particular between the 2 periods, because the change in the reference portfolio actually reduced the weighting of corporate credit in the reference portfolio. And all other things being equal, that should lower the benefit that you get from the dynamic volatility adjuster. So I'm struggling to see why, in Q2, you show for a 180-point reduction -- or, I'm sorry, increase in credit spreads that had a 10-point impact on your Solvency II ratio. Why, with less of a benefit, you would now show 0 impact from wider credit spreads?

Dieter F. Wemmer
CFO & Member of Management Board

No. The share of corporate got bigger. So that means you are actually getting, relative to our portfolio, more on corporate. The VA reference portfolio, the share on government bonds did sell more, and on corporates less. And that shifted the combination.

James Austin Shuck
UBS Investment Bank, Research Division

My understanding is that the government, we can take this offline if you like, but the government went from 38 to 27, and the other went from 48 to 44. So I don't see why there would be a benefit to you and the sensitivity. But maybe we take it offline. It's probably better.

Dieter F. Wemmer
CFO & Member of Management Board

Yes, maybe we take it offline.

Operator

[Operator Instructions] We will now take our next question from Nicola Delaparma from BNP Paribas.

Nicola Delaparma

My first question is on the motor business across Europe, because in the last few quarters in the U.S., the focus has been on the increased repair costs on one side and some pickup in the frequency that is moving quicker than the actual traffic. So I just wanted to get your views on whether you're seeing anything similar across the European, by and large, not specifically in one country or when it's not really a topic on the European side, even though it may be temporary anyway. And the second question is a follow-up on Andrew's question regarding model change around the reset option for the German annuity products. You mentioned that it's not yet included in Solvency. Can you quantify what the benefit would be of including that calculation in Solvency? Or is that too early?

Dieter F. Wemmer
CFO & Member of Management Board

Okay. So on the motor business across Europe, the repair situation in the U.S. is not visible. The movement in motor claims in Europe is very much dependent on bodily injuries. There was a table changes within Spain this year. Then also, in Germany, when we see movement at all, it's much more bodily injuries. There is certainly an upcoming question for the whole industry, is how much bodily injuries are we seeing in future based on smartphone use during driving. That is not a joke. That is certainly a question because we have seen over years, due to the technical progress in the cars that bodily injuries are going down in frequency. That is coming to a stop. We still see it in the expensive cars. So when you look at cars EUR 50,000, EUR 60,000 and more, there is still a reduction in large claims. However, when you look at the less expensive cars, then there is really the question, what drives increases in frequency? And then I would say, playing with the toys during driving, is certainly a very serious topic. So on the model changes, there is -- we will probably see some positive impact and also a little bit better interest rate sensitivity from the new model. The new model contains more changes than just the mapping the new products correctly. So the new business value is certainly supported. That means you have also a more positive development in own funds. But the new model will certainly support it, that over the long run, our reduced solvency over consumed solvency by new business in Germany will improve further. That means that the 5-year and 10-year outlook is much stronger. Also, in solvency terms, of course, that assumes then always that interest rates stay stable over the whole time. So I think that was your 2 questions.

Operator

[Operator Instructions]

Oliver Schmidt
Head of Investor Relations

Okay. Thank you very much, and I wish you all a great rest of the Friday and a great weekend. Thank you for listening in.

Dieter F. Wemmer
CFO & Member of Management Board

Thank you from my side as well. Bye-bye.

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