S&P Capital IQ

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Allianz SE DB:ALV

FQ3 2008 Earnings Call Transcripts

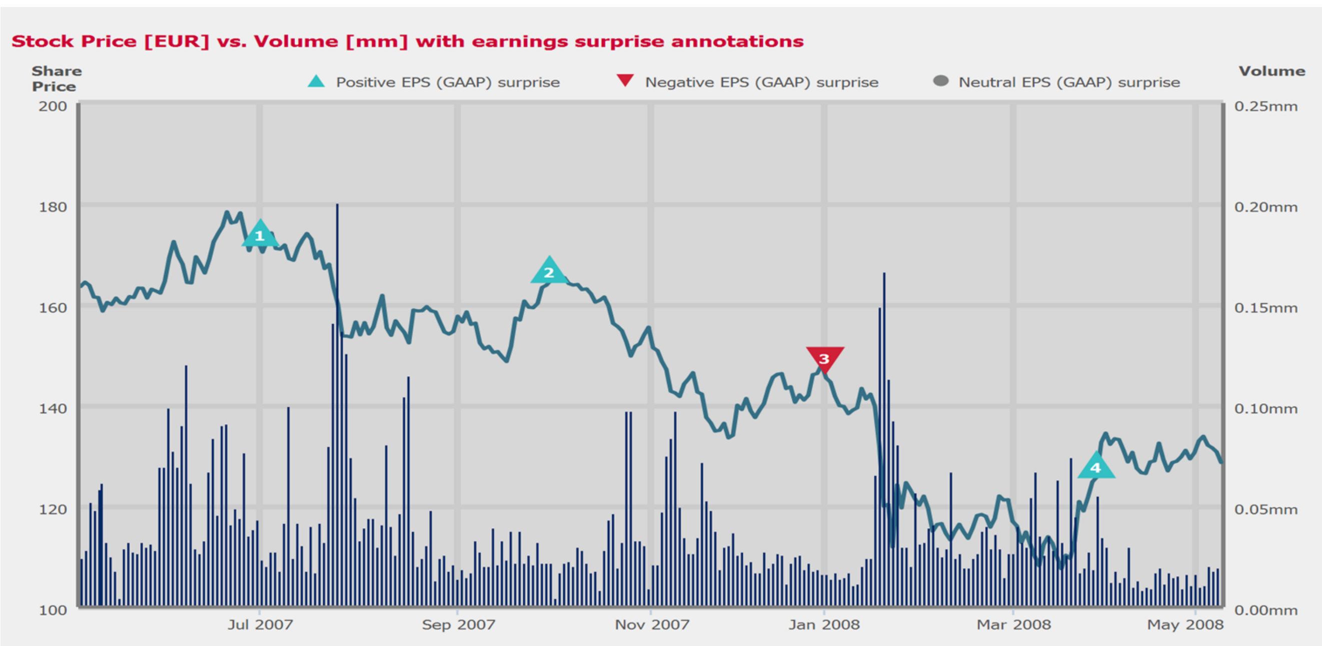
Monday, November 10, 2008 5:00 AM GMT

S&P Capital IQ Estimates

	-FQ2 2008-	-FQ3 2008-		-FY 2008-	-FY 2009-
	CONSENSUS	CONSENSUS	SURPRISE	CONSENSUS	CONSENSUS
EPS (GAAP)	3.09	(8.56)	NM	12.30	15.19
Revenue (mm)	21835.33	21521.25	(2.05 %)	93045.31	94726.27

Currency: EUR

Consensus as of Nov-10-2008 3:02 AM GMT



- EPS (GAAP) -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2007	4.60	4.85	1 5.43 %
FQ3 2007	3.28	4.23	2 28.96 %
FQ4 2007	2.08	1.59	3 (23.56 %)
FQ1 2008	2.37	2.48	4 4.64 %

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Presentation

Oliver Schmidt
Head of Investor Relations

Yes, thanks, Marion. Well, good afternoon, ladies and gentlemen. Welcome to the Allianz conference call. I think due to the magnitude of information we would like to speak about today, including a special section on our investment portfolio, I shouldn't waste any time, so let me hand over to Helmut right away.

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

Well, that was quick, Oliver.

Oliver Schmidt
Head of Investor Relations

Yes.

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

Good afternoon, ladies and gentlemen. It is in fact a pretty large presentation, and I try to focus on the most important things. If you start out with the overall summary, then I think it's fair to say that Q3 was continuous tough environment, but our fundamentals by and large remained strong, with 1.6 billion euros of operating profit, 6.5 billion euros year-to-date with all core segments contributing. And what is really important from my point of view, P&C largely unaffected by the financial market crisis.

Our solvency ratio is at target level. Divestment of Dresdner is on track. We had no accounting changes. There was some reclassification on the Dresdner side, but was absolutely no impact on group's operating profit nor net income, so no accounting changes. And the BaFin which is, as the 6.5 billion euros, are already somewhat short of what we had expected. We will see that by year end, we fall short of our operating profit target of 9 billion euros. And also for 2009, if we do not see a recovery in the equity markets, we cannot confirm the 9 billion-plus euros.

Now I think on the next slide, the only number I would like to point your attention to is net income and respectively, the net loss from discontinued operations, minus 2.5 billion euros. And we come to that in the second, which gives us together with the net income from ongoing operations a year-to-date -- sorry, a net loss for the third quarter of 2 billion euros year-to-date net income including discontinued is at 667 million euros of profit.

Now important, I think, on Page #4, let's talk a little bit about the solvency ratio. Our solvency ratio was 157% is within our target, defined target range. We have, as you are certainly aware, of the BaFin has reconsidered and changed its regulation how to calculate the solvency ratio based on the financial conglomerate. And that would mean that we do eliminate, going forward, unrealized gains and unrealized bonds from the calculation of this ratio, which would put us at a level playing field with our main competitors in Europe. That was, compared to the old measure, improves the solvency ratio by 13 percentage points. And we had also some positive impact from the Dresdner Bank divestment or the anticipated divestment of 9 percentage points. That 9 percentage point is only a snapshot, of course, based at -- on the available market conditions end of September. All things being equal, if we go -- as we go through closing 1 and 2, I would expect another 10 percentage point plus out of this transaction.

Now 2 final remarks on that slide. Even at the end of October where we had -- in the months of October, pretty disastrous equity markets, our solvency ratio would stay at 152%. And in both numbers, 157% and 152%, we had these numbers a net of an accrued dividend of 1.6 billion euros. Now you might ask why exactly 1.6 billion euros? And the answer is this, we try to be somewhat consistent in line with our previous communication regarding dividend policy. What we have accrued for is 40% of the net income of continued operations. Now ultimately with our level of capitalization, we are still comfortably above the necessary threshold for a AA rating. So that all in all, we feel very well positioned based on our own requirements, but also in relative terms compared to the competition.

With that, let's quickly go on to the drivers from a group perspective. Revenues was 21.1, are holding up. They are down minus 0.8 on a like-for-like basis internal growth, and that is basically nothing new. You'll see the impacts in the yellow bubble. Main impact is on the left side, further shortfall in unit-linked production and in particular in countries where unit-linked is distributed by bancassurance, because the banks increasingly try to substitute life products by term deposits and other things in order to bolster their own liquidity positions.

P&C is up 7.8%, but this is specific or specifically related. A good part of that is specifically related to the crop business at Fireman's Fund, which I come to when we talk about P&C. Adjusted for that, our gross would have been 5.2%, and you can rest assured that we are still putting profit first and volume second, i.e., trying to maintain strict underwriting discipline.

I think in the sake of time, I can jump over to Page 7. Make just one remark on Page 8, where you see that nonoperating items and result is hit by impairments of round about 920 million euros. There are 750 million euros of equity impairments, that is slightly above the number of 600 million euros I gave you when we were discussing our Q2 results. But that is by and large a factor that financial institutions have structurally or systematically underperformed. And therefore, we do see a higher number here. There's another 134 million euros of debt impairments, which I come to in the special section when we talk about our own portfolio.

Now I think I can also jump over to Page 9 and maybe spend more time on Page 10, where we talk about the Dresdner Bank transaction and how this is accounted for in our financials. Now if you start on the left-hand side, and usually we'll recall the presentation when informed about the deal early September, there is basically 5 components we received in exchange for 100% Dresdner Bank. And that is cash, that's the Asset Manage of Commerzbank, Cominvest. That's approximately 350 million Commerzbank shares. That's a distribution agreement and the trust fund, which -- and this trust fund, as you might remember, provides a certain protection to specified assets of Dresdner.

Now in the middle column, we have the approach, how this consideration or this component has to be evaluated for our financials end of September. And obviously, to start with the easy one, cash is cash. Cominvest is a valuation, a fairness opinion, which translates into 700 million euros. That was no change. Now the most important part is probably Commerzbank shares. Owning 28%, ultimately, in Commerzbank would mean that we have to report Commerzbank at equity. Now, and this is reflected in this approach, because this will be our accounting entry when we receive those Commerzbank shares physically. And reporting at equity means simply, we take 26.8% of the protected net asset value of Commerzbank. Now the net projected net asset value of Commerzbank is a, what they have at the end of September, that's a known number. And b, the capital increases for the completion of step 1 and 2 of this transaction. And as the value for the rights issue we applied, the Commerzbank share, end of September, i.e., the Commerzbank share price, i.e., 10.40 euros per share.

Now then, we have to evaluate the distribution agreement and the trust fund. The distribution agreement is based on the agreed-upon targets with Commerzbank was a certain cushion or buffer, plus the margin we are making traditionally on our Life products through the banking channel. And the trust fund is based on a mark-to-market approach, which was a pretty, yes, also cautions valuation. You see that we have only assigned 100 million euros to this trust fund. So if worse comes to worst and all the assets which are in the trust or covered by the trust would ultimately default, then there's 100 million euros adjustment to this consideration. But there's also some upside if those assets do perform better.

Now what does that mean on our books? So for our books, that's illustrated on the right-hand side in this slide. We have to start out with the carrying value of Dresdner end of September, and that is 9.2 billion euros. And if you compare this to the 7.8 billion euros I've just explained, then the expected loss out of this Dresdner divestment is 1.4 billion euros. We have to be enter this, the net loss of Dresdner from Q3, which is another 1.2 billion euros. And that gets us to the 2.6 billion euros net loss from discontinued operations Q3.

Now let me make a few more remarks on that one. A, you might ask the question, "You told us in August or September that the carrying value of Dresdner is 10.5 billion euros or 10.6 billion euros." Yes, that was true. That was the carrying value end of June. Now we have to adjust this carrying value for the net loss of Q3 of 1.2 billion euros. And there is some highly technical minor adjustments driven by accounting regulations that get us to the 9.2 billion euros carrying value end of September.

Second remark is, and a question obviously on your side is, "How likely is this number to change and what are further, maybe, contribution positive or negative from Dresdner?" Our point #1, in general terms. Whatever the result of Dresdner is going to be in Q4, and going forward in 2009, there is no impact ultimately on our result, because that is now fixed with this anticipated loss from the transaction.

Nevertheless, the 1.4 billion euros still can change because ultimately, it depends at the net -- upon the net asset value of Commerzbank at the time of closing. And that net asset value, obviously, can change for 2 reasons. One is the results of Dresdner from October 1 onwards. And secondly, if the capital increase is done at a different price as I've just explained, namely the 10.4%, but that is most likely only supposed to be a minor change.

Now with that being said, let me move on. I think we can also jump over Page 11. That just gives you the movement analysis of our reported IFRS net equity. And let's go into the groups. P&C, I think as I've mentioned, P&C is largely unaffected by the market crisis. It contributes or continues to be a reliable generator of profits and free cash flow. Now the operating profit is down some 200 million euros on a quarterly basis. That 200 million euros is caused mainly by 2 specific events, which are somewhat related to the financial markets. One is credit insurance, where we currently observe overdue payments. And those are a lead indicator for higher future losses, which we already built into or baked into our resource end of September. And secondly, Fireman's Fund had to absorb losses from the crop business, following a slump in commodity prices at the end of September. Those 2 numbers add up to 160 million euros or 170 million euros, and basically explained the shortfall in the underwriting result, which you can see on the right-hand side.

Also, on a year-to-date basis, with year-to-date, we are at 4,411,000,000 euros. That compares with 4.6 -- 4.65 billion euros for 2007, so a shortfall of roughly 230 million euros. And that, to some extent, is explained by the combined ratio. As we will see in a second, roughly 100 million euros and 150 million euros of investment income.

Now if we move on, on the premium development. Again, you see 7.8% of internal growth. You see the growth drivers on the left-hand side. And as I said, there was special impact based on the crop business in the United States. Just to put this in a different context, on a net basis, Fireman's Fund has grown 2.5% instead of 34.4% on the growth side, and that is almost entirely driven by this crop stuff. I could come to that later on, maybe if there are some questions, how does that work? Basically it works that Fireman's Fund is fronting a good part of this growth business for a Wells Fargo subsidiary, which has no license for many of the U.S. states. So Fireman's Fund is fronting the business, is seeding it to the Wells Fargo subsidiary. And then the Wells Fargo subsidiary is seeding again that business according to the alternate positions to Fireman's Fund and Zurich. Zurich is the other insurance company in this set-up. And that, again, does artificially inflate the gross premiums written of Fireman's Fund.

More importantly, I think if you look at the price development, it's basically unchanged from what I've told you in August. We see across the portfolio a decline of roughly 0.5 percentage point. If you divide this or make a differentiation between the businesses and you see a decline of 1.5% roughly in motor, which is to some extent driven by the bonus-malus system. Whereas, on average, the other businesses are increasing by 1%. From original point of view, the U.S. was minus 3.9% are most affected by price decreases whereas the U.K., France and Australia enjoy already strong rates.

Now on Page 15, our combined ratio for the quarter was 96.2%. That was up about 2.1 percentage points over Q3 2007. And again, specifically driven by the 2 events I've mentioned at Euler Hermes and Fireman's Fund and on top in Q3. And that explains the 116 combined ratio at Fireman's Fund. Fireman's Fund was pretty hardly hit by the hurricane Ike, which caused us more than 130 million euros net. Now apart from that, I think, what you see is a pretty healthy combined ratio in all the other operations. And even on the credit side, we are still below 100%.

On the right-hand side, you see the development of the expense ratio, which is clearly going in the right direction. And you will remember that our mid-term target here is around 25%, and we still stick to that, of course.

Now let's just quickly talk about the outlook for 2009. 2008, on a combined ratio, was year-to-date 49. -- 94.9%, that would mean we need to have a Q4 at around 91% in order to achieve ultimately the 94% target. And I think, or let me put it the other way, frankly, I don't see that this is happening in the current circumstances. I'm talking at our overall experience in 2008. However, I'm rather confident that we will still come in at around or slightly below 95% for the full year.

If you look in more detail at the loss ratio at the next slide, then you see that the loss ratio has gone up. There is a few contradicting or compensating issues. On the positive side, we had lower impact from NatCat, that was about 0.8%. We had lower impact from large claims, 0.4%. And we had lower frequency of round about 1.1%, so that's a positive impact of 2.3%. On the negative side, we have this already-mentioned crop and credit impact was round about 1.6%. And severity, including stronger IBNRs, coming through was about 3.2%, which net-net gets us to the 71.5.

Now on the expense side, Page #17, I think we are pretty much on track. The run rate is now falling by 191 million euros. That is more or less evenly spread over the last three quarters. And I do expect further improvement for the remainder of this year, so our measures are starting to show impact here.

Final remark with respect to P&C, and I've done this slide slightly different as compared to previous years' investment income. And what I'm simply trying to illustrate was the bars here that you can expect basically over the course of the year, round about 1 billion euros of net investment income, which is very stable also based on the quality of our assets under management. And which is providing a predictable, say, 4 billion euros of operating profit or the P&C business. Now you might make your own forecast and adjustment. But if you assume that a combined ratio of say 95% is achievable, that would put you somehow in the range close to 6 billion euros. And I think it's important to understand that this investment income I have just mentioned is not subject to a lot a volatile issues like impairment, et cetera, which are all reported below the line. So that's a pretty stable and predictable number. And basically this 4 billion euros of investment income translates into something like 10% based on net premiums.

Now with that, let's move on to Life. And you have seen that number market conditions take a toll on the Life business. And that is by and large ought, of course, by a lower investment results. And if we come to the explanation in a little detail, if we simply look at the profit development, then operating profit is down 75%, which of course looks ugly at a first glance. It looks ugly at a second glance as well but slightly better, because you might remember that 2007 there was a 170 million euros reserve true-up in Korea. So that on a like-for-like basis, the starting point is rather 700 million euros. Or put it the other way around on the right-hand side, adjusted for this one-off in 2007, the technical result would be basically flat. So the main impact is investment result where we talk in a second about, it's 385 million euros lower. There is only 35 million euros left. And we a have reduction in the expense ratio, which is basically a mixture of 2 or 3 components. Point #1 is, that obviously based on market development, we have a lower asset -- we have a lower base of assets under management and that of course, translates into lower asset management fees. On the other side with the reduction of the overall premium that is less expense loading to cover the fixed costs of the total Life segment.

Ultimately, there is also some reallocation on the French side of expenses from which used to be formerly in the holding, with AGF holding in the P&C segment and now in the Life Health segment. So that all in all gets us to the 218 million euros. I think I can quickly jump over Page 21, because I think you have by and large familiar with the development. The only remark I would like to make is that our traditional business is still nicely growing at 5% internal growth. That's the dark blue part of the column, the IFRS premiums, and mainly driven by Germany and Switzerland and some other countries. And what you see is those countries are hit hardest where we have, where we sell unit-linked products by our bancassurance channels that's in Italy, that's in Asia Pacific. And also in the United States, our variable annuity production is down in line with the U.S. market.

Against this background, we see basically the same effect when we look at new business values. Of course, the present value of new business premiums is strongly affected than just the gross premiums written on a statutory basis, because the statutory numbers still benefit from an ongoing basis of recurring premiums from the in-force business, which is not true on the new business premium consideration. Therefore, the value is down roughly 15.6%, and the value of new business on an internal basis is down by 17% or -- but the margin is pretty stable. It's down 10 basis points to 2.6%. And you see the distribution across the most important countries and operations on the right-hand side.

Maybe if we have a look, a quick look at the margin space on more a product or lock approach, then the margins in our traditional business continue to be very strong. We have 3.7% as opposed to 3.6% last year. But we see a reduction in unit-linked and equity-linked business. Unit-linked is down to 1.2 versus 1.9 last year. And equity-linked, this equity index is down to 1.4 versus 2.3 last year. The flows, I think, still look okay. We had 4.1 billion euros for the quarter and we had 11.4 billion euros year-to-date.

Now let's finally look at the investment income. What you see here, like in P&C, that on average, we are generating some 3.2 billion euros, 3.3 billion euros of current investment income -- interest income and dividends per quarter. Now what you also see in the line other is, while we had a positive contribution of 325 million euros from our listing in Q3 2007, that very number is now down to 1.2 billion euros minus. So that is a difference of 1.5 billion euros. And that of course drives the reduction of the investment income we have seen on the first slide in the Life Health business.

If you simply take this 1.5 billion euros of minor other investment income and you apply some 30% rate on that one, then you basically have the explanation for the shortfall in our investment income. You can take this the other way around and say, we have 3.3 billion euros of current investment income in the third quarter. We basically need around, for our non-unit-linked business, we need around 2 billion euros per quarter to meet all guarantees and constructive obligations of guarantees. Well, that would leave us with 1.3 billion euros of excess interest income of guarantees, which basically then are shared between the policyholder and the shareholders, say anywhere in the range of 30% plus/minus. Now against this 1.3 billion euros, we have to deduct the 1.2 billion euros minus other, which leaves us with 130% or 35% of that 100 is the 35 million investment result you see on the first page in the Life segment.

But having said this, if you can take this on an annual basis where we make 13 billion-plus current investment income minus say 8% we need to achieve for guaranteed interest rates and what I would call constructive obligations, i.e., no formal guarantees but where there's firm market expectations and the competitors are paying certain amounts. That leaves us with an excess investment income of 5 billion euros plus/minus harvesting, which is then subject to profit-sharing with your policyholders. That gives you also an idea of how much of a cushion is there going forward for further impairments. And that does not yet take into consideration that we have about 16 billion euros of unallocated policyholder funds, which by and large are available to buffer losses in case those losses would occur. So what I'm trying to say is that there's a certain floor in the business going forward in terms of operating profit.

Now on the banking side, I think I would like to talk over Page 26 and Page 27. Just one remarks probably that separate. We are talking about operations of round about 600 million euros right now revenues per annum. That is very small compared to the other 3 segments. And as soon as Dresdner will be finally deconsolidated, I guess we do not show anymore a separate banking segment as a result of materiality.

Let's talk about asset management, Page 29. Our profit is down 43%, but that is pretty much impacted by negative FX development and some one-offs. The one-offs basically are reflected, if you look at the operating profit drivers, by the reduction in other income, which is likely mark-to-market of seed money that used to be a positive number last year, a negative number this year. And also by the negative contribution of FX such as mainly U.S. dollar hedges. But there is also an increase in investing expenses, which we are not happy about, but where there is some explanation which I come to in a second on Page 30. If you look at the 3 divisions then -- and I apologize, it's probably not quite as clear from that slide. But if you look at fixed income, then you see that fixed income is growing by 16%. Revenues are growing stronger or in line with the expenses. So that net-net, fixed income is reporting an increase in operating profit.

Now you have the contrary picture in equity, where revenues are severely impacted. As for all the other competition by the markets and the outflow, basically, the outflow from equity funds, but we have not reduced the expense base by the same level. Because we think going forward there will be, again, once the markets are back to normal, we want to be positioned to take advantage of that. And to some extent, that goes also for our distribution division.

Now if you look at performance and close, then you'll see that on a 3-year rolling basis, there's a sharp drop in performance end of September to 51% outperformance of the assets under management. That is almost entirely driven by our fixed income portfolio, which was some, to some extent, are severely hit by the unprecedented U.S. market disruptions in the second half of September 2008. But despite this performance volatility, we do believe that our fixed income is well positioned for the future, and that is illustrated by the net flows on the right-hand side, where we have positive net flows of 8.5%. And if you look at the next page, the total net inflows for the year have been 39 billion euros, and that is entirely fixed income. In fact, it was over 40 billion because for the year, we had also net outflows from our equity business.

Now very quickly on the special topics. First of all, Dresdner, and this is the format you are used to which we have reported in the previous quarters. We have a net operating loss of 835 million euros. Profit drivers are illustrated on the right-hand side. I think in revenue terms of apart from markdowns, interest income x IFRS 39 was pretty stable and especially in PN -- in PCC well under way. Fee income reduced in particular regarding developments on our client activities and also advisory fees from the investment banking. And our main driver for the reduction obviously was operating income.

Now from a divisional perspective, P&C has been almost stable year-on-year, just 20 million euros down. So the main shortfall is coming from DKAB. Now you see also a pretty huge increase in expenses. That is entirely driven by higher bonus accruals, which were largely triggered by change-of-control clauses following the transaction with Commerzbank, and we have kind of anticipated the consequences here. But in order to make that point as well, tight expense management and control continues at Dresdner on a year-to-date basis, including the effects I've just mentioned. Our personnel expenses are down by 40 million euros and non-personnel expenses by 100 -- some-130 million euros.

You'll see also this year an increase in the loan loss provision, 240 million euros. That is mainly driven from several large tickets. And in particular, it's Lehman Brothers and 2 of the Iceland banks, which have defaulted in end of September.

Now on Page 34, you see the usual slide of critical exposure. Three or four remarks on that. Firstly, to better reflect reality, we have reclassified certain assets in the market value or notional value of 1.7 billion euros. Impact on the P&L had been 450 million euros, negative impact on OCI, 155, so the net impact on equity was 250 million euros. Plus, having talked about reclassification, remark #2, equally important. We have not changed our valuation approach and also the most recent clarification of the SEC. We had no change. We still use observable marks to the extent available into our valuation.

Third remark, net exposure is up. You should be aware of that, because I think we have talked already during the presentation of Q2 about this. That was about 2.5 billion euros or 2.6 billion euros, formerly protected by monoliners, XL and CIFG, who went through some restructuring in the meantime. And where we had to put those 2 positions from flat risk to outright positions that explains the increase in the exposure.

And then you see on the very right-hand column, the impact on the P&L in the third quarter. And the only remark, really, I want to make or maybe 2, is if you look at the LBO commitments, there is 105 million euros, 90 million euros of which are also included in this 240 million euros increase of loan loss provision I have just mentioned. And the other one is K2, where based on further increase of credit spreads, we have a mark-to-market adjustment of 148 million euros.

To close the Dresdner Bank section on Page 36, our Tier 1 ratio is 8.1%, still a very competitive level of capitalization. And also our liquidity profile was a principal ratio of 1.10 is well above the required needs.

Now then, let's go quickly to the investment portfolio. We included that section because there is increasing discussion out there in the market at very many occasions. What is the quality of investment portfolios and what more is to come? I think I can put the key message very simple. There is nothing to worry about from my perspective.

But I guess we can jump over Page 38, because we've talked about this at the very beginning. Also Page 39, it's just for information and I think self-explaining. It gives you the breakdown of our gross exposure, the shareholder exposure, net of policy takes and minorities and the underlying risk capital base on our models. And at the end if you just go back to the previous page, you see that our excess capital, both in terms of conglomerate solvency as well as in terms of risk capital, is higher than what we have allocated in a 99.97 confidence level as necessary risk capital.

Maybe to become more pragmatic, I'm talking the real stuff on Page 40. We have given you, again, the equity stress test based on the end of September numbers. And what you see here is that was a further deterioration of 10%, 20% or 30% on our equity portfolio. That is the additional impairments we are likely to expect or to suffer. As of today, we are probably halfway in between or 2/3 in between the 10% and 20% scenario. That would mean that if yearend, we'd close at the end of October stock market levels, I would expect round about 1 billion euros of additional -- or 1 billion euros of impairments in the first quarter. On the right-hand side, you'll see what would that very development do to our remaining unrealized gains and losses in our equity portfolio, and what's the impact on the solvency ratio.

Now on the next page, we have given you some sensitivities and stresses on our interest rate risk. What you see on the right-hand side of this slide is the duration. And you see there is no major change from when we talked last time. On the left-hand side, you see the economic impact on a parallel rate shift -- of parallel shift of the yield curve. If that would be 100 basis points up, the economic effect on Allianz would -- economic effect meaning the net present value of the expected profits are of that would be 1.5 billion-plus euros. On the downshift, that is minus 3.3 billion euros. You see that this is mainly driven by Life Health. And that kind of illustrates the asymmetric risk distribution we have in Life Health. And with a further downshift of interest rates, obviously the options and guarantees come closer or get into the money.

Now before I get misunderstood, or there is some confusion, with the recent rate cuts being announced by the federal banks in England, in the U.S., et cetera. Those are all rate cuts at the short end, which will not impact that calculation because we are only impact if the rates come down on the long end. And I think currently there is 2 schools of thought out there. Some of them are protecting -- projecting an increase of rates and others. Just the opposite, though, we need to sit down, to see -- to wait and see. But would you see from the bullet points and the takeaways at the very bottom, there is still huge buffers available to go with those developments.

I think our fixed income portfolio, Page 42, is of high quality and well diversified. You see that more than 60% are governments and covered bonds. You see on Page 43 the impairment. And let me just say, in Q3 and that's before policyholder and tax et cetera, we had 370 million impairments of our fixed income portfolio. That was almost entirely driven to a large extent, driven by 3 position. Lehman unsecured exposure, we had written off 80%. AIG subordinated debt, we have written off 100%. And Washington Mutual unsecured exposure, we've written off also 80%. Over the 5-year period, 5 basis points impairments overall, I think that's an okay number, which translates into an applied rating of AA.

Now there was also just recently some concerns about the credit quality of some countries. You see on Page 44, the ballpark of our government exposure is in G10 countries. Of course, we have also exposure in some countries which are currently under discussion. Please keep in mind or let me make 2 remarks on that. We have only exposure in those countries if we are writing business in those countries. And obviously, we have to cover our liabilities in local currency. That's why we are there. We do not take bets in countries, which might provide nice interest rates but where we don't do business. And just look at the very last number, so we are not taking bets over here.

Covered bonds, I think you are familiar with this stuff. I do not need to talk about this. Our bank debt portfolio, 2/3, on Page 46. 2/3 of that is in the Life Health business. We have a strong average rating and overall, it's just 8% of our total fixed income portfolios. And if you look at the left-hand side, Eurozone, NAFTA, Germany, U.K., those are all banks and countries which currently have provided rescue packages for their markets, and which should be in reasonably good shape.

Our other corporate debt portfolio again, I think, is pretty well diversified. The high share of NAFTA is simply explained by the fact that our investments, the assets under management and asset life are largely invested in corporate bonds as is with other life insurance companies. But let me make this comment already up front. They have only very little exposure, and this is different to other U.S. life insurers. They have only very little exposure in structured credit.

You see on the very next page our investments in asset-backed securities, and that is only 0.4 billion euros in structured credit. And we have only 25 million euros, I repeat, 25 million in. Let me also mention on the right-hand side, because that's the next category where we see some concerns out in the market and I've mentioned this already earlier, is credit card. 5% of this 20 billion euros, i.e., 1 billion is in credit card and this is on a strong and daily monitoring.

The last slide, 49, to me was almost unnecessary because it talks about liquidity. Because in the normal course of the business, there is no real liquidity issue with the insurance business. We have high predictable cash flows. We are the only ones to collect the price in advance. And as you know and I've mentioned the numbers, we have ongoing free cash flow generation in our Life and non-Life business. But for those of you who have still some concerns, on the right-hand side I illustrated, I was just talking about euro lend, about 140 million euros of this total portfolio would be eligible as collateral for the ECB [European Central Bank]. And I mean, I think with this I can stop and that proves there is certainly no liquidity issue for Allianz going forward.
In the sake of time, I'm too long already. I spare you the summary, because it's the same as we've talked before. And I would just like to close in reemphasizing or reiterating that I do believe that our underlying fundamentals are strong, and we have a very strong capital position and no need for capital increase. And with that, let me just open the floor for your questions.

Question and Answer

Operator

Let's start take our question from Andrew Broadfield from Morgan Stanley.

Andrew Broadfield
Morgan Stanley, Research Division

Just 2 quick questions, I hope. On the dividend you've accrued and I understand the mechanics for the way you've accrued your dividend. I was just wondering though, when it comes to decision time in February or whenever it's made, how much would you -- would be the sort of minimum amount you've had to cut it on prior year? I'm assuming that the solvency benefit you would get a 4.8 euro dividend, down from 5.5 euro which would be so small as to be of that help to you at all, really. So I'm assuming you did 5.5 or you'd do something significantly less. I'm just wondering what your thoughts are on that. And the second question is on the P&C business, I see that the reserve releases were down a little bit on the quarter, and I appreciate it's gotten down quarter-on-quarter. But I guess just sort of looking ahead, is there any sense in your minds that we are seeing this sort of gradual turnaround in the reserving cycle that we've had the year, the greatest releases that we're going to have cyclically and that we got a period we're entering into reserve leases likely to be cyclically lower?

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

With respect to your first question, Andrew, I'm always in the same awkward position that the dividend is subject to Supervisory Board, not only a total board decision. I think what we have done is, let me make 2 comments. What we have done is simply to accrue dividend in line, was what we have stated as policy. And if you were to compare the 1.6 billion euros, which would have been what we had to accrue based on previous year's dividend level, that would translate into 1.8 billion euros. So there's not a real meaningful or decisive difference. Second remark, I think we do know, and we are very conscious about the fact that dividend is a very important factor for our investors, and this will be appropriately considered in our final decision. Let me put it this way, our recommendation to the Supervisory Board, to be politically correct. Now in terms of runoffs, I think I've mentioned we took the opportunity to strengthen a little bit our IBNRs with the 1.5% runoff in Q3. We are still at 3.3% year-to-date, which is slightly in excess of what we had in 2007, where we grew at 3.1% at the same time. So I think what I'm trying to say here is you should not take the 1.5% in whatever shape or form as an indication for weaker reserve positions.

Andrew Broadfield
Morgan Stanley, Research Division

Okay, thanks, and just coming back to my dividend question. So it's a reasonable assumption that you wouldn't recommend a 5.5 to 4.8 dividend per share count, given that the sensitivity around it is 5.5 to something significantly smaller or 5.5?

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

Well, I just wanted to make you aware of that at that point in time, you cannot seriously expect that we do any public statement about what is the ultimate number or ultimate level of dividend. All I'm saying is I think we have accrued a sizable amount. We will continue to accrue through Q4, and then we have to make our decision. But again I mean if you look at our solvency ratios and those are, as I have said, net of dividend accrual, I think that would put us in a reasonable good position.

Operator

Our next question comes from Will Morgan from Goldman Sachs.

Will Morgan
Goldman Sachs Group Inc., Research Division

I've got a couple of questions, please. The first one is just on the P&C business. It appears that you're now posting, albeit very slight, premium growth. But I just wondered what your kind of outlook on the growth funds is for the core business and whether or not some of the talks we're seeing about pricing up in the reinsurance echelons are actually maybe going to filter down to any of your core businesses going forward. And just related to that, I just wondered if you could state whether or not your policy of increasing your attention going forward in the P&C business is still intact? Or whether or not you might actually look to try, I guess, preserve capital as much as possible in this uncertain environment perhaps even buy more reinsurance? And the second question I have just relates to any comment you might have on M&A in general. Obviously I guess given some of the changes you've made to the accounting side, I guess the solvency position is looking a little bit more relaxed. And what are you thinking about in terms of opportunities out there in the market for deals? And also specifically relating to the Hartford, is that something that was just a one-off investment? Or is that something that you could potentially expand your interest in down the line?

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

Okay, with respect to P&C, I think when we talk about pricing, when I talk to my CFOs and we've got started the budget discussions, they are slightly optimistic about pricing for 2009. Frankly, I'm less optimistic. I think what we should expect going forward is flat prices and no increase in pricing, unless there's a triggering event. But I think the financial market crisis has not yet turned into a triggering event for P&C. So I would think we will see flat markets, which would mean our focus is still put profit first and volume second. We would like to maintain our underwriting discipline. But by the same token, do we want to buy more reinsurance, I don't think so because we are making very nice returns on our P&C business, which are still in the range of 20% return of risk-adjusted capital, and I would hate to give this away to the reinsurers. Now M&A, I think in general, yes, there is opportunities out there. Obviously, I think, and you would also expect us to look and analyze what comes along. But point #1, I think there is no need to hurry. Point #2 it needs to work out in terms of financial terms. And point #3, I think in this kind of environment, and you make this point in a different context, it is our first obligation to preserve a strong level of capitalization. So having said this, there's not a lot of room. Now with respect to Hartford, well, let me put this very simple. Currently, we have a mutual agreement that we are not going to increase our shareholding over and above 25%. It is a financial investment and nothing has changed so far.

Operator

Next question comes from James Quin from Citigroup.

James B. Quin
Citigroup Inc, Research Division

3 questions, please. The first one is simply, I was wondering if you could let us know what the off-balance-sheet unrealized losses on the Commerzbank stake at the moment? So just the gap between what you've gotten as an associate and what the market value was in the end of September? And the second question is just coming back to the Life operating earnings. Helmut, I know you've tried to give us some guidance here. I wonder if you could possibly try and give us a range for what you would see as the life operating earnings run rate, if you assumed no realized gains but no realized losses either. And on that point, is it really this that's causing the, I guess your decreased level of confidence in 2009 operating target, or is it something slightly different. And then the third question is just on the 150% target for solvency. I mean obviously, the BaFin has given you a bit of a free pass here, and I guess you're just coming to line what the other regulators are doing. But it would seem a bit strange that something so obviously not risk-based in its approach wouldn't really have a great deal of impact on how you would see, for example, your ability to pay dividend or how you see the solvency position more broadly. So I wonder if you could give us a comment on that, and maybe just how you would characterize solvency at the moment. Would you also at least see it as needing say 12 months of balance sheet rebuilding to get you back to a level you'd feel truly comfortable with?

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

Well, off-balance-sheet unrealized loss of Commerzbank, I mean at that point in time, we are just talking about an anticipated loss out of the Dresdner transaction. We don't have yet Commerzbank shares on our balance sheet just to be clear. Now what you can say is if you take the calculation, we have applied for this anticipated loss, then on average, the Commerzbank shares in our calculation, or the book value of the Commerzbank share is close to 16 euros. Now I think today's share price of Commerzbank is some 8 something. So then that is an easy calculation to make that up. Well ultimately again, that will be decided once all that, once we have Commerzbank on our books. And obviously going forward then the question is, as always was with equity accounting, those book values have to run through a standard impairment test, and we have a year. And if for whatever reason then the fundamental value at some point in time would be below the net asset value, obviously that would trigger some impairment for that situation. I think that would mean that Commerzbank going forward is, more or less, a loss-making operation.

Now on the Life side, operating -- or range for operating profit, coming back to that calculation. And that is really a rule-of-thumb or back-of-the-envelope calculation where again, if you think that we're going to make 13 billion euros of investment income, then we need 8 billion euros for again the guarantees and constructive obligations with no harvesting and no impairments. That would leave about 5 billion euros to be shared between policyholders and shareholders. And now again if you apply a range of 30% plus/minus, which of course depends on the markets, then you have about a 1.5 billion plus euros, yes, 1.5 billion euros of investment income plus what you normally would expect as technical result. That's on average probably for 2006 to 2008, 700 million euros to 800 million euros plus an average level of expense gains, which tend to be a little bit lower for all the reasons I have mentioned, and probably rather than being 200 million euros historically, might be only 150 million euros or even slightly lower.

Now that could be an indication of where we are. Now that does for the ballpark of our business, if you divide our business based on how it's reflected in the balance in the financials, then we have say, 360 or yes, 350 billion euros of reserves on our Life business, 290 billion euros are non-unit-linked and 60 billion euros as separate account assets. Now on the separate account assets and the unit-linked business, the ballpark of that is really plain vanilla unit-linked, where any change in equity markets will change our management fee, but not a lot on top of that because they bear hardly any guarantees. That is different for the U.S. VA business as you know. And short-term of course, if we have a significant reduction of the equity markets alongside with the current level of volatilities that could give us, in whatever quarter, that could give us some difficult numbers maybe in Q4 this year or in one of the quarters next year. Now and that is also, of course, if we assume that's when you ask for less confidence in our outlook 2009, obviously if we have ongoing impairments in 2009, maybe not over the average of the year. You could even have the same level of the stock markets beginning of January and end of December. But with a lot of volatility on the way, you might well run into impairments and you might well run into some of your VA obligations or guarantees being in the money with impact on your results. Not a huge point in the range that we might not achieve the 9 billion euros.

Finally your question with respect to solvency, yes, you're right. It's not risk-based. But if on the other side, you take into consideration that from an asset liability management point of view, our interest rate risk is very much limited and very much manageable. What we've got now was from the BaFin with these new regulations would even overestimate our interest rate risk , i.e., the other way around on a pure risk point of view. We would need lower capital to cover the interest rate than what is now reflected in our calculation.

James B. Quin
Citigroup Inc, Research Division

I guess just sort of broadly on solvency, would you effectively characterize the balance sheet as -- it's obviously strong enough. But would you look to really maybe put another year's earnings behind you before you'd feel it was back in really where you want it to be?

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

Well again, I think we are okay with that number. We said always, we want to manage our business between 150 and 170. 150 to us is kind of the lower, the floor where we can survive major equity stresses without going out in the market and asking for fresh money. The delta between 150 and 170 would give us some financial flexibility to take advantage of opportunities on the street. And above 170, we think there is excess capital available for contribution to the shareholders.

Operator

Next question comes from Michael Huttner from JPMorgan.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

A few questions. One is crop sales. I don't understand I spoke from earlier that explained why normally crop insurance guarantees the income of Fireman's. Here you seemed to be guaranteeing the price of the crops, which seem a strange contract. The second, you just gave a really nice explanation of the earnings power of the Life business. Do you have a figure for this, the guarantees, how much, what's the kind of costs in terms of volatility of the guarantees in the VAs in the U.S. or maybe or in the "money-ness" of these contracts? And the final one, I looked on the corporate bonds where you seem, to say you feel quite comfortable, the 50 billion figure, the other corporate bonds of 30% which is BBB, that's 15 billion euros in total. And I just wondered, I mean it seems a very high percentage, and I just wondered what's actually in there.

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

Okay, price for crops. The current crop products offering, we offer 2 kinds of protection. A, if there's something happening to the harvest, i.e., there's hail, flood, what have you, but also that the price for crop is locked in. And that's why it depends on the commodity. Now before you finger point on Fireman's Fund, the product as well as the pricing of the product, is entirely set by the government. And if you look in today's markets, that's probably the crop protection is 50-50 split between harvest and price. And Fireman's Fund is no exception here. We simply have to accept, if a customer or farmer is asking for protection, we have to accept this. Now, what the government is offering in return is that you can retrocede business to the government. Normally, you have also a kind of a natural hedge in this business, because the commodity prices basically do change if the harvest is changing. Now in this time in the end of September, it was just a component or say a entire cyclical development, where it was just the component of the more global development of raw material commodities and other stuff. That's why we have been hit here. But still year-to-date, our Crop business, it's not a good number, but is running, if I'm not mistaken out of the top of my head, at 103 combined. Yet traditionally, it was in the order of magnitude of say 92 plus/minus 2%. So earnings power of life, I'm not sure whether I got your question.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

You gave us a lovely explanation on giving the earnings power of traditional business, 2.3 billion euros. But on the unit-linked kind of -- well, I didn't get the number.

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

That's true. I mean you have to some sensitivity. If in the U.S. market, if the S&P is going down to say, 800. At the level of volatility we have observed in October where we had daily volatilities of 80% plus, that would cause a hit of 300 million to 400 million to our Variable Annuity business in Q4. That's a sensitivity.

Let me just take this opportunity to make some clarification because there's too much excitement out there. If you look at our DAC [deferred acquisition costs], we are carrying 900 million of DACs in our Variable Annuity business. And that hit I've just described you on the potential impact going forward is getting lower as our separate account assets or general fund assets are growing. But in more general terms talking about the portfolio overall, if you look at our DACs, our pay factor is still 0.6, meaning we need only 60% of the expected operating profits to cover the DACs going forward. So if you take this around and take into consideration that we have about 12 billion euros of DAC on our Life business, so the expected profit margin, which is still included in the reserves of that business, is 20 billion euros. So there should be again, some comfort that there needs to have a lot until we get in serious troubles on our Life business. Now on the corporate bond portfolio, we have -- yes, there is BBBs, 30%. I'll come back to that one in a second, helping out of here. Over the course, I cannot answer out of the top of my head.

Operator

Next question comes from Marc Thiele from UBS.

Marc Thiele
UBS Investment Bank, Research Division

Just coming back to Slide 40 and the stresses you presented. And also following up on Michael's question regarding the DAC. Could you also provide us with sensitivities on how the DAC would be impacted in these various scenarios? And then you get these 14 percentage points or 20% decline compared with the end of September, but the number presented on Slide 4 is 5%. I mean am I missing something? Can you reconcile these numbers?

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

Yes, you are missing something because that is a very precise calculation at the end of October. And at the end of October, we had also a positive impact from FX, so equity is increasing and that explains the difference. On your question regarding the DAC, I do not have a sensitivity with me. I can only broadly answer that. Having said this, that the K factor is 0.6. So I think at the end of the day, what I can say is in neither of that scenarios, we see a write-off of DACs. The only thing, that's why I mentioned this, where there could be some write-off of DACs is the U.S. Variable Annuity business. And again there, we are carrying 900 million on billion -- 900 million euros, I think and USD $1.2 billion. There could be, if we are in this kind of scenario, S&P down to 800 and the same level of volatility, there could be some write-off of DAC being required.

Marc Thiele
UBS Investment Bank, Research Division

Excellent. One question on the P&C side. Can you give us a bit of a feeling for how you sort of want to benefit from AIG's weakness to a degree, both in the U.S. as well as globally?

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

Well, I think there is no comprehensive strengths or strategy to attack AIG and their businesses. But obviously, what we see is that in particular on the industrial side, business is being offered and in some other countries as well. In broad terms, I think we are likely to benefit here because we are perceived in the market, rightfully so, as a pretty strong player. And if market is seeking new carriers, then I think this is a competitive advantage. But again, no comprehensive strategy to attack this business in whatever shape or form.

Operator

Next question comes from Brian Shea from Merrill Lynch.

Brian Shea
BofA Merrill Lynch, Research Division

I have 2 questions please. First of all, on the pricing outlook for non-Life, I think you said the average price change year-to-date was a negative 0.8%. My memory might be faulty, but I thought back in February, you were expecting an increase of 0.5% to 1%. I just thought if you could say, what's changed here? I appreciate you've given an outlook for flat pricing next year. But why is this year turning out to be worse? And then secondly, when you entered that calculation on discontinued operations, you were still going with 350 million shares to be issued. Does that mean, how much should we read into that? Do you still think the exchange ratio would be fixed at 1.41. Or given how much things have been changing, how much banks have tapped the government, should we expect the exchange ratio to be different now?

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

So on the pricing side, I think, Brian, already in Q2 and also in Q1, I indicated that the assumptions we had in our plan are not likely to come through. We have observed slightly lower prices already starting in Q1. Albeit the level is coming down somewhat. I think 3 or 6 months ago, I had estimated a higher price change that we are actually in. What has changed here is really across the board. But pricing assumptions of our operations turned out to be a little bit positive. In particular, I think we are more impacted in the United States where I said there's a price decreased in our book of 3.9%. We had lower assumptions of around 1% to 2% with 3.9% in our book compared to the market. I think the market in the commercial lines business is around minus 7%, minus 8%.

On the discontinued operations, I think we need to make, first of all, a distinction between step 1 and step 2. For step 1, 160 million of shares are predetermined. They will come in any case. Now then, obviously the exchange ratio you mentioned is important for step 2 when we go into the merger. And the exchange ratio will only have an impact on the remaining -- or the value of the remaining 40% of Dresdner. And so far, the exchange ratio is important. Do I expect a major change? Well as of today, I have no evidence that there will be a change, but ultimately, this depends on the multiyear plans going forward in both banks, meaning the plan of 2009 to 2011 plus what you know that we have neutral auditors here to make this valuation, what they think about the planning. Now the rescue package, that's a good question, and I don't have a firm answer now how this is getting into the whole valuation. I think what one should assume or should know is the additional capital Commerzbank is raising is via a silent participation and is not equity capital. And so far, the assumption would be that it would not basically not have a major impact on this exchange ratio.

Brian Shea
BofA Merrill Lynch, Research Division

Okay, very good.

Operator

Next question comes from William Hawkins from KBW.

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

I'm just interested to know, the 157% solvency ratio that you've published, how, if at all, has that been affected by the change in the way you've accounted for the discontinued operations? As you know as you said back in September, it was going to be on the base of the market price of Commerzbank. I know you've done your share of book value. I'm assuming the numerator is 2.5 billion higher than it would otherwise have been. But I'm not quite sure what happens on the denominator side, so if you could help on that. And then secondly, I mean apologies if this is a bit of a strategic question, but Allianz has been leading proponents of market-consistent accounting, both for solvency and for IFRS Phase 2. They are possible to argue that the bond decision on the Commerzbank decision today fundamentally go against that principle. So I'm just wondering, I know that we're in a world where special circumstances are always applied. But how what you've experienced has affected your thinking in potentially the CFO is thinking about market consistency?

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

Okay. So your first question, William, is not an easy one. But you might remember, we have said in September, 1st of September, the potential impact is probably up to 14%. What I have said today is we see end of September 9%, plus when the transaction comes through in line with those values, we have at the end of September, that will translate into another benefit of say 10%. So if you just take this numbers, 9% plus 10% minus the 14%, my intuitive reaction would be the difference is 5%. But to be honest, I have made this reconciliation, but it sounds like a reasonable number.

Now with respect to your second question, I don't think that this goes intuitively against fair value accounting. We have, what's in all this fair value accounting stuff and all the investments, as you know, has to be accounted for at fair value. And equity accounting has been, still is and is expected going forward, to be a standard part of the setup. Now you might say, "Well, Jesus, why don't you use the fair value of those Commerz share price in step 1 when you physically put these shares firstly on your books?" Yes, you could do that if you were to have a fair value for the market price. But then if you compare this to the net asset value in terms of an equity accounting, you immediately come up with a bad will. If your cost is lower than the pro rata net asset value, then you have a bad will. And also on the fair value accounting, this bad will is net income.

Now we could have probably with this approach, window dress our earnings going forward, which we have not done with this equity approach from the very beginning. With respect to the unrealized bonds, and fully with you, I mean has nothing to do with a risk consideration, of which the few Solvency II is going to apply going forward. But coming back to what I have said early on, we do think that based on our ALM approach, we run only on a very limited interest rate risk. And this very limited interest rate risk has not been reflected in the previous approach where all interest rate increases have gone against our solvency ratio, i.e., deteriorated or decreased our solvency ratio where in real terms, our net asset value should have gone up. Just the opposite. So at least with this approach, we are half way in between.

Will Morgan
Goldman Sachs Group Inc., Research Division

Does the new approach make any distinction for credit spreads and risk-free movements? Or have you just made a blank adjustment?

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

It doesn't. That's a weakness, clearly.

Operator

[Operator Instructions] The next question is from Nick Holmes from Nomura.

Nick Holmes
Nomura Securities Co. Ltd., Research Division

I have a couple of questions. The first one is why is it that you haven't hedged more of your equity exposure? I mean it seems that you've hedged a lot of it but stopped short of eliminating it as a risk. And my second question is how much of your investment in Hartford is held by policyholders? And do you expect it to remain as a policyholder investment?

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

Okay, on your first question, we have basically, we have hedged 1/3 to 40% of our equity exposure. Now we might have a long discussion, was that prudent enough or not? Or should we have done more? I think it was a reasonable approach. If you hedge everything, you shouldn't buy in the first step. So I mean that's how it is. With respect to Hartford, the shares and the warrants are held by the holding company, Allianz SE, and the bonds are spread all over the universe, and there is probably -- here. Do we have a breakdown of the bond, how much is held by Life and how much by non-Life? The major points, I think of the bond is held by life companies. What the guys are just calculating. I'll come back with that.

Nick Holmes
Nomura Securities Co. Ltd., Research Division

Okay. Can I just follow up on the equity hedging and equity exposure? I mean, would it be right, Helmut, to think that your caution about the operating earnings next year is really driven by the equity impairment? Or at least a large part of it is driven by the equity impairment that could arise on the Life side because you're including those in your operating earnings to some extent. And I just, it baffles me that you haven't either hedged those away as other companies, as you know, were like sort of these and so and have done. Or you haven't actually decided to change your definition and exclude equity gains and losses and impairment in the Life operating earnings. I just wondered if you had any comment on that.

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

Well, yes. First of all, it's true that the caution we have going forward is in fact impairments and on a small point of the business, volatility might have on our results on the Life side. Of course, the equity markets also, please don't forget, have some impact on our earnings in the asset management operations, point #1. Point #2, are we going to change in any shape or form our definition of operating profits going forward or exclude impairments? Was that the question? Did I get this right?

Nick Holmes
Nomura Securities Co. Ltd., Research Division

Yes.

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

And the answer to that is no. We will continue with that same approach. And I think it's appropriate because we have, we can and we have -- we can share impairment partly with the policyholders. And we have to share gains on equities also with the policyholders. And therefore, I think it makes a lot of sense to have it in operating, even so that might go against us in the remainder of Q4 and maybe in 2009.

Nick Holmes
Nomura Securities Co. Ltd., Research Division

Okay.

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

Before we move on, we have about, I think, William, the answer I still owe you. About 70% of the bond exposure is in the Life Health operations and 30% in the non-Life operations.

Operator

Our next question comes from Matt Clark from KBW.

Matthew Timothy Clark
Keefe, Bruyette, & Woods, Inc., Research Division

A question on Slide 75 and the ABS portfolio disclosure. The markdown ratios on the high-grade and mezzanine CDOs don't look as aggressive as they were last quarter. I'm just wondering what is it about the assets that were previously insured by XL and CIFG that seems to have been transferred across that makes them better quality than the assets that were in the ABS-CDO bucket as of the second quarter, if that's clear?

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

Yes, I think you mentioned the main reason. We have reclassified or the reclassification of the formerly monoline protected assets impacts a lot this mezzanine position. Now again, the valuation of this mezzanine position follows the same rule, as I made clear at the very beginning, the same rule we've applied consistently over the last 4 quarters. So the result is what it is, and we all feel very comfortable about this. I should mention that we have also now changed our approach a little bit in terms of classification because in previous quarters, the classification into high-grade and mezzanine was based on original ratings. We have now taken also the rating migration into consideration, and that has also added some increase to that position.

Matthew Timothy Clark
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. But I mean previously you're carrying your mezzanine at 0. And now you're carrying them at $0.57 on the dollar, I think, which is quite a big leap. Is there anything you can say about the underlying, the type of collateral there? And I appreciate that your methodology hasn't changed, but just to see why you get such us a different valuation on the benefit of the same bucket.

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

I think what we have seen that in those ones were previously being classified as mezzanines, we have already seen that the cash flows were eating into the waterfall, whereas with the ones we had to reclassify that has not yet been observed. And therefore, we get different valuation rules.

Operator

Next question comes from Steven Kalb from Oppenheimer.

Stephan Kalb
Oppenheim Research GmbH

I would like to ask 3 short ones. And the first one is on your outlook on the P&C business and Europe, where you mentioned that you expect nominal flat development. If I would see claims inflation to continue, I would see increasing loss ratio. Maybe you could comment on your expectation on the loss ratio here. And the second one is on the crop insurance, I understood the development in the combined ratio, but not why the premium was growing so strongly. Maybe you could explain it a little bit in more detail. And the third one is with regards to the consolidation of the Commerzbank stake. Was the equity consolidation the only way to do it? Or I mean, does the IFRS rules require you to do that, that way? Or could you have opted for the fair value option?

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

With respect to P&C, I'm afraid I can only give you a more general explanation, the one I've used pretty often in previous conversations. What I personally do expect here is that the loss ratio is increasing going forward because we have, on one side, we see positive impact still on a frequency. And if the markets go into, real world goes into recession, which I think is not an unreasonable assumption, we will see further benefit on frequency. But on the other side, we have to cope with increasing claims inflation. To some extent, we have been able to compensate. This was different coverage underwriting and better managing our claims leakage better. Net-net, this will go up and is supposed to be compensated by a positive development on the expense side.

Now I beg your pardon to not be more precise, but we are just at the beginning of our budget discussion, and I think it would be just unprofessional to comment about our combined ratio targets for in 2009 before we have those discussions with our operations. On the crop side, basically there are 3 players. That's Wells Fargo, a subsidiary of Wells Fargo. That's Fireman's Fund and a Zurich subsidiary. As I've said, the Wells Fargo subsidiary is not licensed in most of the U.S. states. The Fireman's Fund is fronting all the business for this Wells Fargo subsidiary. So that premium enters first the Fireman's Fund books. It's being then retroceded to the Wells Fargo operation. Then Wells Fargo is ceding 80% of that business, of the total Crop business through Fireman's Fund. And of that 80%, Fireman's Fund is ceding 37% to Zurich, so ultimately, Wells Fargo ends up with 20%, Fireman's Fund with 50%, and Zurich with 30% of the total business. But obviously with this crazy route of the business, that is what I called an artificial inflationing of our top line numbers. On the Commerzbank share, the answer is very easy. There is no choice. That's the only way how we can account for and how we're allowed to account for the Commerzbank stake going forward.

Stephan Kalb
Oppenheim Research GmbH

Very clear.

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

And just to be precise, that would be even true if we go at some point in time below 20%, as long as Diekmann and myself are in the Supervisory Board of Commerzbank.

Operator

We'll now take our next question from Michael Haid from Cheuvreux.

Michael Hermann Haid
CA Cheuvreux, Research Division

With respect to your Life & Health business, premiums in the third quarter went down to 9.4 billion euros. I wonder what your expectations are for 2009, assuming kind of an unchanged market environment and what does it do to your operating profits if say other unit-linked businesses last?

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

Okay, again, I think, Mark, I cannot give you a good answer at that point in time because we are in the discussions. I would not see that there's a lot of growth on the top line going forward in the unit-linked business. But we are starting from a pretty low platform in 2008. And from that perspective yes, I would assume some growth, but please don't nail me with a precise number. What does that do to our operating profit? I think I've made a comment earlier. The most profitable business is the more traditional business, where we have margins of 3.5%, 3.7%, point #1. Point #2 is in the Life business, what you always should keep in mind that close to 100%, sometimes even more than 100% of your operating profit is from the in-force business and new business written in year one. That's only little to nothing or sometimes a negative contribution to your operating profit. So a further shortfall in top line growth 2009. That is not my concern when it comes to operating profit. That would have negligible impact.

Operator

[Operator Instructions] There are no further questions. I'd like to turn the call back over to your host for any additional or closing remarks.

Oliver Schmidt
Head of Investor Relations

Well now, if there aren't any further questions, we thank everybody for joining the conference call and say goodbye to everybody.

Helmut Perlet
Former Chairman of Supervisory Board and Member of Joint Advisory Council
Bye. Thank you.