S&P Capital IQ

CONTENTS

Allianz SE DB:ALV

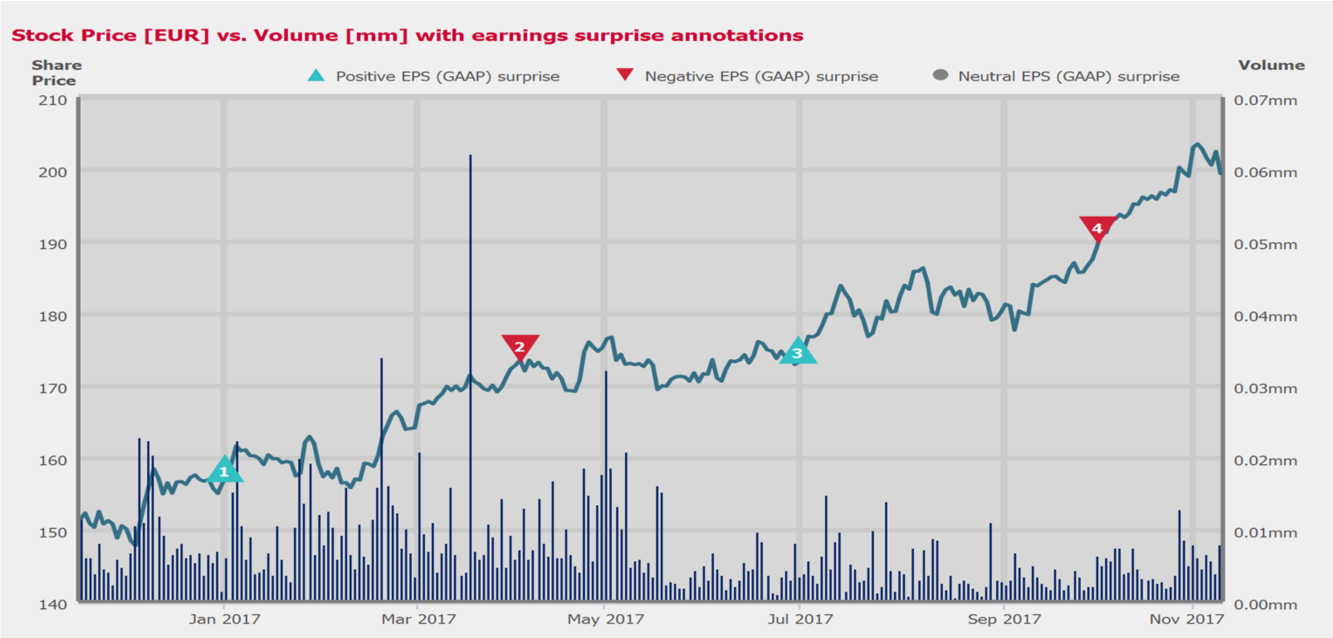
FY 2017 Earnings Call Transcripts

Friday, February 16, 2018 2:30 PM GMT

S&P Capital IQ Estimates

	-FQ4 2017-			-FQ1 2018-	-FY 2017-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS (GAAP)	3.65	3.24	▼(11.23 %)	4.68	15.54	15.23
Revenue (mm)	30612.58	31700.00	▲3.55	31714.04	124470.56	126100.00

Currency: EUR
Consensus as of Feb-16-2018 9:00 AM GMT



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Presentation

Oliver Schmidt
Head of Investor Relations

Yes. Good afternoon from my side as well, and welcome to our conference call. As you know, we have 2 presenters today. Oliver will kick it off and share his assessment of our result. And after that, Giulio will explain the numbers in detail. We intend to keep it brief and to close the call after 90 minutes. Therefore, without any further ado, I'll hand directly over to Oliver.

Oliver Bäte
Chairman of Management Board & CEO

Yes. Good afternoon, everybody. Thank you for joining on a Friday afternoon. Oliver told me to be quick and crisp. So since you have all the slides in front of you, I'll try to hit the highlights.

I'll start on Page A2 with the overall numbers that we've had, and I'd like to highlight a few of them. You are all aware that we are still battling declining interest rates in our investment portfolios that we had to deal with. They're probably the strongest NatCat year in our history as an industry and regulation. What I think some people haven't had on their mind or, at least not in the spreadsheets, was the development of the U.S. dollar, who has weakened significantly, as you will see later, in a number of ways that is affecting us not just in '17 but also again in '18. So please bear that in mind.

We have worked very hard to put our capital and our investors' capital to productive use, and the market has nicely rewarded us for that. Thank you very much. Capitalization is with 229%, very strong. And we are, therefore, in the position to increase dividend per share to EUR 8. That is 5% up and in line with what we've been telling you since November of 2015, that we want to grow earnings and dividends per share by 5% on a CAGR basis. And I think again, a few people didn't have on their mind that we're sticking to our 50% payout ratio, but given the fact that by the AGM, we will have bought enough shares to go to 8% and still stick to the 50% payout ratio.

We're in the process of executing the second share buyback, the EUR 2 billion, over the first quarter and hope to be done by April. This program will be executed. I think there were some concerns that M&A or so would disturb that and we may stop the buyback. We will not stop the buyback and fully execute it, and that's why it's consistent with the EUR 8 dividend per share proposal to the Supervisory Board, who's supporting it, and then to the AGM.

Now just a quick -- a few -- a quick look at the highlights, A3. We are very proud of our colleagues that they have weathered the NatCat season very strongly. We've turned around the LatAm business after 5 years, and the results are very good. And by the way, continuously, to go better and we are now the third largest P&C insurer in the United Kingdom with a very innovative joint venture that we have formed with LV, strengthening our direct business in the group and particularly strengthening our focus on client. LV is the brand with the highest customer loyalty in the United Kingdom. There's a lot that we can learn for our customer satisfaction journey.

On the Life and Health side, really resounding success. We are close to achieving our targets for '18 already. In '17, the value of new business is 30%, and the new business margin is 3.4% despite again the decline in the [effective] earned rates.

Asset Management has more than EUR 150 billion third-party net flows. Our AUMs have reached the highest ever level, and that is despite the exchange rate effect that was exceeding EUR 100 billion negative. And cost-income ratio has improved by 1.5 points, so really outstanding results.

Let's look A4 that gives you a little bit of a view of what the industry losses were, EUR 100 billion when you just take the 4 ones we've mentioned here. The Allianz share in that was negligibly small; even the largest one, in terms of our market share, 1.7%. That's actually partially due, I think, to some of the [remaining points] that we still have from the old Fireman’s Fund portfolio. The rest has been far below our market share, and I can only congratulate the colleagues for good underwriting here.

Page A5 gives you a view, and we've deliberately taken '13 as a starting point because this is when we really launched the program and accelerated in '15. At the time, we still had more than half of our new business production in traditional products with significant long-term guarantees on the interest rate side, not just Tom Wilson who doesn't like them. I don't like them either. So we got to work. And now we have 76% of our new business production on the products that we'd like to be in. Again, target for this year is 80%, and I'm very comfortable that our colleagues will achieve that. And more importantly, we have translated that into higher new business value, 30% above the 2016 level, which was already more than 25% up from prior year.

Now on Asset Management, a fantastic story. Thank you both colleagues in PIMCO and in AGI. A6 gives you the picture. It looks really beautiful, like if we had designed it for this chart. You have sort of, the last time, negative flows in the second quarter of '16. And we have broken the waterline in the third quarter of '16 already and then consistently had very strong flows. Again, in the -- we will talk about it a little later. Also, the first 2 months of 2018 are very positive. In line with -- that is the development of the 3-year outperformance versus benchmark. And again, congratulations. 91% outperformance is a spectacular number. And with the flows obviously and the efficiency programs that we had launched, you'll also see the result in improving margin. I think we're one of the few places in our industry where you actually not just have very strong flows. I would bet that in the active management arena, you will hardly find any other company with a strong level of flows but also really driving productivity up.

Now that leads me to Page A7, capital. We have had that in -- over the last 2 years, and we have the aim to return over this year more than EUR 5.4 billion in cash that makes us in 13 -- EUR 23 billion in cash returned to our shareholders. That's dividends plus share buybacks. And it includes, obviously, our dividend and the program that we have running while at the same time, our Solvency has improved consistently. And that's also no small feat because we did not know how the implementation and introduction of Solvency II in '16 would work. We had a number of additional challenges, whether that's the volatility, adjust their changes and other things that are constantly going against our solvency, but I can only tell you the colleagues have worked very hard and it -- the solvency is strong.

Now it has to be strong and has to remain strong, and I'd like to mention that because we have a very cautious outlook. Everybody is back [parting] because equity markets are stabilizing. We have to be very cautious for the outlook because as central banks have to normalize our policies. As interest rates in the U.S. have to go up to balance inflation, there will be disruptions. We said that -- we said that the last few weeks. And therefore, we are remaining on the cautious side and protecting our balance sheet.

Now we're not just using our money for buybacks. Page A8 shows you that we do something else with it. Most of that is bolt-on, whether that's buying out the Euler minorities or investing in the joint venture we have with LV and a couple of other things that we've done last year. We'd also like to reiterate the point that it's not just about investing. It's also about disinvesting or divesting. And we have finally sold OLB. We've got a portfolio in Allianz Taiwan out at least in terms of agreeing with the buyer, and we exited the general insurance business in Korea.

So overall, we have invested about EUR 3 billion for external growth and just to say that we're in the business of growing our business, not shrinking it to death. Therefore, we'd like to invest more in our core business. However, the prerequisites, ladies and gentlemen, are that we earn a decent return on these investments. And the continuous questions that we get, why are you not buy anything larger, is not for the fact that we're not looking. But given the very high valuations in equity markets, any acquisition at a larger scale needs to absolutely make strategic sense. But as important it is, it needs to make sense for our shareholders. When you look at the buyback, we know that it's an implicit sort of cost of capital of 9%. So we need to really compare an acquisition with the impact of a buyback. And we are doing that just we -- rest assured we will not waste our shareholders' money.

Now when you go to A9, the delivery against our targets has been very consistent through all the years that you see on this page. And by the way, the EUR 300 million overachievement for '17 is understated. If you take the effect into account, it would have been EUR 300 million larger. And that's despite the fact that the euro swap rate for 10 years is still at a very low point. So we have been able to drive profits up with very low volatility in an environment that was far from being benign.

Because we have been able to do that -- and please turn to A10 now, we believe we are going to get to our targets as we have set them. We've said we want an ROE of 13%. Now you say, "Well, it's only 11.8% for the year." This is a very sensitive number to very small changes particularly due to the fact that capital moves around, in the accounting terms, FXs, for example. One of them, it was 12.2% adjusted for the OLB disposal. And we are pretty confident that we are going to get to or very close to the 13%, which is an outstanding number given the fact that our cost of equity is -- has been reduced to 9%.

The second thing, earnings per share growth. We've said we would like to have a 5% CAGR. We are very confident to get to this number as we are for dividends per share. That's another 5% that we have to deliver in '18. And again, we are highly confident that we are going to deliver that.

Now what is the outlook? What are we working on? I think some of you may be interested in what are we working on. We have, by and large, completed our turnaround. Our colleagues in AGCS are still working hard on the integration of Fireman's Fund that will take until about 2020 to get to the right direct profitability levels. But by and large, in the P&C portfolio, we're done with turnarounds. The 94% combined ratio -- Giulio will talk about it -- is very much in reach because the attritional loss ratio is really improving net of NatCat on large losses.

So what are we having to do going forward? We have a transformation job to do now. We have worked on digital innovation the last 2.5 years. What becomes crystal clear is that digital is not a sideway or something extra. It has to be introduced into the core business, and we now need to dramatically simplify our processes and business models and take the technology to achieve much more simpler product and services for our clients that have to be more reliable. And that's why we're looking at customer-centricity as the #1 priority in our Renewal Agenda.

On the Life and Health side, the -- a business shift change is proceeding as expected. We're continuously working on the in-force management. But given our level of new business profitability, we would like to grow further. '17 was the year where we, again, grew in Life, not just new business value but also revenues, and that we would like to continue now that we are working in the right race car and we would like to accelerate for the future.

Asset Management. The PIMCO turnaround is complete. AllianzGI cost-income ratio has further improved. So again, here, the story is around continued profitable growth. And we know a lot of people are saying, "Yes, with wobbly markets, can you do that?" We believe actually that active Asset Management will prove in a crisis -- or not prove, but we believe Allianz will prove that it's better to be having an active management partner. And that's particularly true for fixed income because the worse you can do is buy a passive product when interest rates rise because the only thing you do then is lock in a loss. And so we believe it's a huge opportunity for PIMCO to show its differentiation.

Now on capital, let me reiterate. I think we have optimized capital and cash generation. We have a very attractive dividend policy. At the current level, it's about 5% dividend. We'll just think about that. And I think that the markets have not really internalized Allianz' ability and willingness to continuously grow its dividend. Now people may say, "In a rising interest rate environment, is that really attractive?" It's highly attractive because -- I tell you it's not so clear how and when interest rates will rise and whether they will actually compensate for the proper increase in inflation. While in Allianz, you get that baked in, so very attractive investment. And we'll make sure that with whatever we do, whether that's organic or inorganic, we make our cost of capital. We make the appropriate spreads to grow the value of the company.

So Oliver, that -- was that quick enough?

Oliver Schmidt
Head of Investor Relations

Perfect. Thank you.

Oliver Bäte
Chairman of Management Board & CEO

Very good. I'll now hand over to Giulio, and we are ready for your questions thereafter.

Giulio Terzariol
CFO & Member of Management Board

Perfect. Thank you, Oliver, and good afternoon to everybody. I will go first to the fourth quarter results and then speak more in details about the results for the full year 2017.

If you go to Page B3, you can see the key indicators for our fourth quarter. We had a good fourth quarter performance. Those -- some of the minus signs on this slide might not give that impression, but I'd like to give you some perspective. When you take the operating profit of EUR 2.8 billion and you annualize the EUR 2.8 billion, you get to more than EUR 11 billion of operating profit, which is about the midpoint of the outlook that we had for 2017.

Also, there were 2 effects which are affecting the comparison to the prior period. First of all, the FX development has been in our disfavor, and this has impacted our operating profit compared to the last year by EUR 100 million. And also, if you remember, in the first quarter 2017, we did a restatement for Allianz Life. That restatement caused, in the fourth quarter of 2016, a positive onetime effect of EUR 140 million. So if you adjust for these 2 effects, you can see also that the performance in the fourth quarter of '17 is very much in line with the performance of '16.

Also, when you look at the operational KPIs, you can see that they are improving. This is clear for the new business margin. This applies to the cost-income ratio. But even the combined ratio is improving. You see on this slide a deterioration of 50 basis points. Reality is if you adjust the combined ratio for the impact of natural catastrophe, there is an improvement of over 1%.

Finally, on the shareholder net income, we have the impact coming from the disposal of OLB. And also, we have the impacts coming from the tax reform in the United States. So all in all, when you look at the performance of fourth quarter and you adjust for some special effects, this is again a picture of resilience and good performance.

Moving to Page 5. We see here the main KPIs for the full year 2017. I'd like to highlight that we were able to grow our revenue by 5%. This was driven by Life/Health and Asset Management. On the operating profit, you can see that we were able to close the year in the upper half of the range, and this is by the natural catastrophe that has impacted the industry in 2017. So that's a very good result. Also, if you look at the comparison between 2017 and 2016, we had a negative impact due to currency translation of EUR 140 million. So when you look at the quality of this operating profit in 2017, it's very high.

On the shareholder net income, you see a reduction of 2%. This is predominantly driven by restructuring expenses. I'm going to come back later on this topic. On the EPS, you can see they are generally flat. And if we adjust the EPS number for the numbers of shares that we have at the end of the year instead of using an average, the EPS is EUR 15.5. And this will also explain our dividend per share of EUR 8, which has increased by 5% compared to the level that we had last year.

Moving to Page 7. We can see the development of our solvency ratio. It says improved by 11 percentage points. I'm going to come back on the solvency ratio development in a slide. On the shareholder equity, you can see there was a drop of EUR 1.5 billion. This is all driven by the impact out of the fixed rates. On the sensitivity, they are relatively unchanged compared to the sensitivities you saw in the third quarter except for the sensitivity to an up movement on the interest rates, which went down from plus 8% to plus 2%. But in general, the picture is consistent with the sensitivities that you saw in the third quarter.

Moving to Page 9. We can see here the development of the own fund and also the capital requirements. When we look at the main drivers, we had several changes in models, and these are explained in 9 percentage points of improvement in solvency ratio. The main change was due to the introduction on negative interest rates. The business evolution, if you take out taxes and dividend, has contributed about 15 percentage point to the improvement of the solvency ratio. Then the market impact has been very positive. We had a situation last year where interest rates in Europe went up. The spread have been narrowing. The markets were, in general, favorable. So all kinds of things have moved in the right direction. This explains why we got also some positive impact from the market development.

Under the section capital management, you see the impact from share buybacks, dividend accrual and also the impact out of the acquisition, like increasing the stake in Euler Hermes or the acquisition of the LV that we completed at the end of 2017. And finally, tax in the other is simply the taxes. And plus, we had some transferability [registration], which applied to this calculation.

Some indication for the future. So our solvency ratio, it's clearly very high, 229%. We are expecting a couple of negative impacts in the first quarter. One is coming from the change in the way we are treating the deduction and aggregation for Allianz Life. This is going to impact us by 3 percentage points. Also, we had the change in the UFR. This is going to impact us by 1 percentage point. And then also, we are anticipating that somehow during the year, we are going to get an impact out of the tax reform in the United States, and we think this impact might be about 3 percentage points. So I'd like you to keep this in mind as you draw your consideration about our solvency level.

We go to Page 11. We go now into the discussion of our Property-Casualty segment. You can see a growth rate of 2.3%. And in general, you can see also that most of our companies have been able to post a positive growth rate. There are just a couple of exceptions. But in general, we have a good picture in the sense of the growth that we have been able to achieve. Even more important is the outlook for 2018. And right now, we think that the rate changes we're going to see moving into '18 that they will be either stable or positive. So this is fundamentally a benign outlook as we go into 2018.

Moving to Page 13. You can see the development of the operating profit by drivers. And also, you can see the combined ratio development. The combined ratio has deteriorated by 90 basis points. This is, however, driven by the impact of the natural catastrophe. Indeed, if you do a calculation where you adjust the combined ratio for the natural catastrophe and also for the runoff -- so if you go to a sort of accident here, combined ratio adjusted for catastrophe, you can see that there was an improvement of 40 basis points compared to the prior period.

We always do our normalization of the combined ratio where we adjust the combined ratio for the differential between the extra cat losses and our average expectation. We adjust the combined ratio for the actual runoff and what we think is a mid- or long-term expectation. And also, we adjust the combined ratio for the impact of weather-related and large losses. When we do this normalization, our combined ratio has improved compared to the prior period, and it is slightly north of 94.5%. So now the question is how we go from 94.5% plus to 94%. 30 basis points will come from expense ratio. We are very committed to reduce our expense ratio from 28.7 to 28.4. And the other 30 basis points that we need together, they would come from underwriting discipline. And as I was talking before, also, the environment seems to be rather benign. So we are confident that we're going to get to the 94% combined ratio in 2018.

Moving to Page 15, this is more for your eyes. You can see here the operating profit development of the different company and also their combined ratio. In general, you see that the majority of the companies had a positive performance. There are a couple of exception, like Germany or AGCS. In that case, these 2 companies have been affected by natural catastrophe and also, in the case of Germany, weather-related losses. In the case of AGCS, there were some large losses more than -- at least expect in our trend. But in -- overall, I think this is a strong picture. We should keep in mind there are not many companies in the insurance industry, property-casualty, that have -- had these kinds of results. And despite 2007 (sic) [2017] having been the costliest year for the insurance industry in cat losses, we were able to keep the performance of the segments within the target range. So I believe this is a strong achievement for our Property-Casualty segment.

Going to Page 17. You can see the development of the investment results, which has been relatively flat, if you want. So there was just a decrease of about EUR 65 million. What happened here -- clearly, we are still suffering from the decrease in interest rates. But on the other side, our investment income on equity has partially compensated for that. So the development that you see in 2017 has been relatively benign and, indeed, a little bit above of our expectation.

Now we can go into the Life/Health segment. In the Life business, our production went up about 4%. This is something different compared to what we saw in 2016. In 2016, as we were trying to change the business mix, our production went down compared to the level of 2015. Now you can see that we are capable to change our mix and also to get growth into the system. When you combine this growth with an improvement in margin of 70 basis points, the result is that the new business value is going up by 30%.

On the quality of the business, as you know, we have a target to achieve 80% of production in capital-light products. This is the target for 2018. We are now at 76%. Last year, we were at 72%. So you can see there is an improvement. And we are confident that by 2018, we are going to get to our target of 80%.

Moving to Page 21. You see the operating profit for the Life segment. That's a EUR 4.4 billion operating profit, which is record profit for the Life segment and also above the target stage. When you look at waterfall by profit sources, you see a lot of movements. In the case of the loadings and fees, this is driven by Asia and also by [production] unit-links. The investment margin, which is negative by about EUR 400 million compared to the 2016 level, is driven entirely by the United States, where we had the impact of the restatement that I was mentioning before. There was about EUR 120 million. And then we had also a combination of unlocking and hedging efficiency. And this is a swing between 2016 and 2017. In '16, the hedging efficiency and unlocking were positive. In '17, they have been on the other side. So when you combine, you'll see a little bit of a swing, which is, however, partially compensated in other profit sources, like in the technical margin, you see there is an improvement of over EUR 200 million. Allianz Life is contributing EUR 180 million of those EUR 220 million. So there is a little bit also of geography going on. Bottom line is that we have achieved an operating profit of EUR 4.4 billion. I believe a few years ago, nobody would have believed that the Life segment could have contributed this kind of performance.

Moving to Page 23. You see again the picture of our value of new business, new business margin, operating profit by the different companies. When you look at the value of new business, you'll see that there are just plus signs. So that's not only good growth at the group level, but basically, all entities are contributing to the growth in value of new business. I'd like also to highlight Asia, which is now contributing to our value of new business in a significant way. And after Germany and U.S.A., Asia is the third largest contributor to our value of new business.

Just one word on the U.S.A. since we talked so much about Allianz Life in the previous slide. When you look at the operating profit in 2017, it's pretty much in line with the 2016 operating profit. Indeed, if you put the numbers, U.S. dollar is basically almost flat. So all the geography and noise that you saw on the waterfall, in reality the performance of the company, has been extremely good also in 2017.

And with that, I would move to Page 25, where you can see that the investment margin is strong at 97 basis points. There is a reduction of 10 basis points compared to the level that we had in 2016. These, however, are not unexpected. And indeed, we had this conversation several times in the last quarter. We always attempt to normalize our profit a little bit below the level that we usually see in the quarters. And also, for next year, our guidance will be that the investment margin should be between 90 and 95 basis points. So this is our working hypothesis when we look at our numbers for the Life segment.

And now we come to the Asset Management segment, Page 27. 2017 has been exceptional for our Asset Management segment. We had EUR 150 billion of inflows. And clearly, PIMCO, as you know, did the heavy lifting. But I'd like also to point out that AGI was able to change the direction compared to 2016. In 2016, the flows in AGI were negative. And in 2017, you can see positive flows with AGI. One thing that I'd like you all to keep in mind is when you look at the FX impact, you see EUR 120 billion of assets, which are affected, if you're wondering, because of the exchange rate. So this is something that we need to keep in mind. However, despite this big impact, we have been able, in 2017, to grow our third-party assets under management.

Moving to Page 29. You can see the development or the revenue colors, basically the development of the assets under management. So you can see an internal growth rate of about 8%. What is important for us in this slide is to look at the fee margin. When you look at PIMCO, the fee margin is relatively consistent with the level of 2016. When you look AGI, you see there is a deterioration of 2.4 basis points. But of this 2.4 basis point, 2 basis points are due to technical factors and just 0.4 is real deterioration. What is important, we are looking at this measure on a quarterly basis, as you know. And in the last 3 quarters, this metric has been stable. So we don't see that there is a continuous drop of the fee margin, but at least in the course of the last 2, 3 quarters, we saw stability in this KPI.

At Page 31, you can see the [power], the operating leverage, that you have in the Asset Management segment. Clearly, where revenue are growing, the expense ratio is reducing. This creates a situation in which the operating profit is growing more than the growth of the revenue. Indeed, the growth in operating profit has been double digit, so very good performance from the Asset Management segment. And as you see, they were able to grow at 10.6% despite the impact of EUR 50 million coming from exchange rate.

Page 33. On the corporate segment, I'd just like to highlight that all subsegments have contributed to the [positive deviation].

And so we can move now to Page 35, where you can see the reconciliation between the operating profit and the shareholder net income. As usual, you can see a lot of movement in this view. I like to draw your attention to the restructuring charges. They went up by EUR 300 million to EUR 450 million. Of these restructuring charges, 1/3 applies to our Allianz Technology business and the rest is -- applies to the P&C business. This also explains why we are confident about our ability to achieve a 28.4% expense ratio in 2018. We have already taken measure that should support the achievement of that target.

On the tax rates, as you see, despite the impact of the tax reform, the tax rate was slightly better than what we had last year and, in general, was not so far away from what could be our expectation moving forward. We expect the tax rate to be, if you look at the notes, 26% to 28%. I will say 28% is a very conservative estimate. So I would say my expectation for the tax rate in 2017 is more between 26% and 27%. That should be somehow where our tax rate is going to eventually land.

At Page 37, we can speak about the outlook. As you see, we have an outlook of EUR 10.6 billion to EUR 11.6 billion with a midpoint of the range of EUR 11.1 billion. Now the EUR 11.1 billion is EUR 300 million over the guidance that we gave last year. What is also important to notice is when you look at the guidance of 2017 and then you look at the guidance we are giving now for '18, the swing in the fixed rate is about EUR 300 million. So at the end of the day, when you look on a constant fixed basis, you can say that we are giving a guidance for 2018, which is EUR 600 million above the level that we gave for 2017. So this is a massive improvement in the level of guidance that we are providing when you adjust for the fixed rate.

When you look at the different segments, we expect to get to EUR 5.4 billion in Property-Casualty. The underlying combined ratio is obviously 94%. On the Life/Health side, we expect to be at EUR 4.2 billion. As I was mentioning before, this is below the EUR 4.4 billion level of 2017. But here, we are considering for a normalization of our investment margin. And in the case of Asset Management, the EUR 2.4 billion, which is in line with the level that you are seeing for 2017, is driven by the fixed effect. On a constant basis, we would expect the Asset Management business to grow high single digit. But clearly, the depreciation of the U.S. dollar compared to the euro is somehow offset in this operational improvement. So this is the way we determine our EUR 11.1 billion outlook for 2018.

And now moving to Page 38. We have here this [forecast] for our Renewal Agenda, and you can see how we are doing now compared to our targets for 2018. We are confident that we are going to get to our 5% earnings per share growth. And also, we are confident that we're going to get at least close to the 13% ROE. Why I'm saying that? When you look at the income -- net income that we need to get to a 5% EPS growth, we need, in 2018, about EUR 7.3 billion of net income. In 2017, our net income was EUR 6.8 billion. And if you consider that we had some special effect in '17, if you consider that we have a higher participation in Euler Hermes and also if you consider the swing in the tax rate because of the United States, then I think it's relatively easy to make a possibility check of our ability to achieve a 5% EPS growth and also to get close to our ROE of 13%. The other KPIs, I think, I have already covered at least with respect to the financial KPIs.
And with that, I would just open up to Q&A.

Question and Answer

Operator

[Operator Instructions] We'll take our first question from James Shuck with Citi.

James Austin Shuck
Citigroup Inc, Research Division

I had 3 questions for you this afternoon, please. Firstly, the capital generation, Solvency II capital generation, it seems like you're upping in the guidance slightly from 8 to 10 points, massive dividends. That's what you previously guided to. And I don't think you're saying above 10 points now, which presumably is explained by the tax situation. Could you just kind of give some insight into the -- how you expect the SCR to evolve going forward? I think you mentioned that the Life capital requirements are offset by the Life capital release. So should we be thinking that the SCR is actually going to be flat going forward? And at what stage does the Life capital release kind of run off and then you start to get an increase in the requirements from the Life side in particular? Second question, a more general question around capital allocation within the group. But I understand that you -- when you were kind of assessing projects and choosing to invest capital in the group, you sort of -- you have a hurdle rate of about 15% return on capital on P&C and you have a 3% new business margin on the Life side. Could you just kind of explain a little bit how that works when you're trying to grow and innovate and invest? Because obviously, you don't always get a 15% ROE to begin with in year 1. And then finally, just a quick one on the restructuring charges, EUR 450 million. I don't remember that really being flagged, and it's sort of occurring below the line as opposed to above the line. Can you just give an indication of the outlook there and whether that number has actually turned out bigger than you expected?

Giulio Terzariol
CFO & Member of Management Board

Okay. So I can start with the question about the guidance that we are giving about the generation capital on an organic basis. Yes, we moved the guidance up a little bit compared to what we were saying just maybe a few quarters ago. And the reason why we move the guidance is not because we have a different expectation on the own fund generation, but it is because we see that the business evolution tends to be indeed favorable. And that's because of the issue you mentioned. We see that we get capital relief coming out of the Life segment. So from that point of view, moving forward, we would expect to see the same picture also in 2018 and also at least for the next years. It's difficult for us to say exactly when this is going to change, but our expectation right now will be to see this development also in the future. I'll just put a caveat. These models are very complicated. And sometimes, they might not always give the intuitive answer. But fundamentally, based on what we see now, we would expect to see a negative, which means positive from an economic point of view, business evolution also, in the following years. The other question was on the capital allocation. So what we do when we speak about capital allocation, I'd like to go back to the topic that Oliver raised before. We are going to -- we are looking somehow at what are the possibilities that we have to invest capital, and then we look at what is the cost of equity or cost of capital or the opportunity we are looking into. And usually, we try also to achieve a spread clearly above the cost of equity, and this is how we are determining capital allocation. And clearly, we have different cost of equity dependent on the segment, but also different cost of equity dependent on what is the profile of the opportunity we are looking into. So this is the way we are allocating capital. And the final question was about the restructuring charges. We had overall EUR 450 million restructuring charges. I think your question was whether this was unexpected. No, because clearly, we are controlling how much restructuring we want to do. So this was not a surprise to us. And the second point is what is the expectation for, let's say, 2018. I would say that if you do a sort of average between '17 and '16, you might get close to what the expectation could be for this year.

James Austin Shuck
Citigroup Inc, Research Division

Can I get just a quick follow-up in terms of the capital allocation within the group? I think my question wasn't so much to do with kind of M&A starting. It's more to do with how the individual business units are competing for capital within the group and the actual internal hurdle rates that you want them to achieve. So I thought that in Property and Casualty, the capital -- there was a hurdle rate of about 15%. And in Life, you need to make a new business margin of 3%. But please contradict me if I'm wrong. But if that's the case, they both sort of have implications for how you allocate capital based on growth and innovation.

Giulio Terzariol
CFO & Member of Management Board

Yes, okay. I mean, okay, on this one -- okay, in the case of Life, we had a 3% new business margin. And also we have a clear statement we want always to be at 10% ROE. In the case of P&C, we are not speaking of 15% ROE. You might remember maybe 15% RoRC, which is a little bit of a difference metric. But if I translate this into ROE, I will say that on the P&C segment, we -- definitely, we expect also to have at least 10% ROE. The situation is we are doing more than 10% ROE on the P&C segment. And by the way, also, on the Life segment, the ROE in 2017 was 12%. So we have a target where every company should be at least at 10%, but we shouldn't forget that the ROE of the segment is 12%. And this is an ROE without any leverage. So when you put leverage into the question, we are speaking of a 14% ROE in the Life segment.

Operator

We'll go next to Peter Eliot with Kepler Cheuvreux.

Peter Eliot
Kepler Cheuvreux, Research Division

I had 3 questions, please. The first one was on M&A. I know you can't comment on market rumors and thank you very much for the comments you've already given, Oliver. But could you also confirm that you were still only really looking at friendly deals? And within that, could you also give us a bit of color on your strategy for asset gathering in Italy especially in light of the 8% ROE that the Life segment shows there? The second one is on the solvency modeling changes. Can you explain what led to the -- exactly what led to the 10-point increase that we saw in Q4? And also, what caused the sensitivity to interest rate increases to fall? Because the plus 50 basis points went from 8 points in Q3 to 2 points at full year. And finally, on the outlook. Sorry if I missed it, but I was a little bit surprised that the corporate and consolidation showed you're going to a bigger loss in 2018 than 2017. Sorry if I missed that comment. But could you explain why that's the case?

Oliver Bäte
Chairman of Management Board & CEO

Yes. Thank you for the question. I'll start with M&A. Yes, absolutely, we do only friendly deals because otherwise, you destroy value. I can hardly imagine one -- maybe there is one, that one would do unfriendly. But practically, I have never seen it in our industry. And certainly, Allianz would not want to do that. And then on the background asset gathering in Italy, we are very happy there were some rumors that we would do something with the asset gathering strategy. No, in Italy, we're super happy. We are growing very fast both in the Life side and with Allianz Bank. By the way, I would like to mention their outstanding performance in the last year. What we are now trying to do in the Life side in Italy, grow our risk business. So while the ROE is very high, what you also have at the other side is what is the net number of earnings, I think, so that the absolute amount of earnings can increase in terms of -- given the strong distribution power we have in Italy. So we are building a risk product strategy now at the moment that is in full swing. We have plans to grow on the Health side. So we believe it's a fantastic franchise, and we're just starting. And with that, I'll hand over to Giulio for the solvency and the corporate segment question.

Giulio Terzariol
CFO & Member of Management Board

Yes. Talking about the impact from the model changes, as I said before, this was 9%. That was primarily driven by the change in interest rates. So the introduction, negative interest rates and -- or the 9 percentage points, 6 percentage points is coming from the introduction or the negative interest rate. On this 6 percentage point, we need to consider that at the end of 2016, we had put a sort of buffer because we were not able to model the negative interest rate into our Solvency II calculation. This buffer was 2%. So in reality then, at the end, the calculation showed up to be favorable, but the real swing will be 4 percentage point. The question remains anyway why in introduction, negative interest rate might be a positive rather than a negative. The point is that when we were using the old model, which didn't allow interest rate to go negative, then the calibration or the scenarios around the central estimate gets really counterintuitive. And so we were exposed to an upshot in interest rate of about 12 percentage point after 1 year, just to simplify the story. Clearly, this is not something intuitive. And clearly, as we have introduced a new calibration, now we get a better quality of scenarios. What I'd like all of you to keep in mind, when we speak of Solvency II, we are speaking of a model which is trying to capture what can happen in -- with a probability of 0.4%. So clearly, when you run all these scenarios, you might get sometimes to very counterintuitive results, and the new model is now producing scenario which -- if you were more consistent with what one could expect. So from that point of view, if you want, is an improvement of the entire model and this is not just about introducing negative interest rates. The consequence also of introducing this model is that we have more capacity, and you see this reflected in the sensitivity. So the sensitivity are now different. It is, at the end of the day, driven by the same reason, different scenario, different calibration and this is what the model is telling us that we have more capacity in our Solvency II calculation. Then you had a question about the outlook for corporate. And you miss the comment because I didn't make the comment, but it's a fair point. So indeed, if you look at comment about the segment, we had said there that in 2017 and also in '15 and '16, in the last 3 years, we had a positive impact of EUR 150 million, and we always disclosed that, by the way, in the first quarter. And this impact is going away starting 2018 and this impact is due to a cost allocation scheme between the holding and the German companies and because of the policyholder participation, this was creating a positive contribution to our operating profits. So this is going away and this explains why our outlook for the corporate segment is -- was compared to what we had in '17.

Operator

We'll go next to Michael Huttner with JPMorgan.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

I have 3 questions. One is on the -- my colleagues asked me not to ask that question, but I couldn't make sense of it. This is the phrase you used or I saw in Bloomberg, "Too many share buybacks lead to greed." If you could -- I don't know. Any comment would be helpful. On more detailed questions, when you look at deals, what are kind of funding constraints you look at? I noticed the leverage is relatively high. So if you were -- if I were to -- I'm not owning your company, but if I were to own the company, I'd love to -- and if I were looking at a really attractive deal, I would actually also consider rights issues and that would be the question. And then the last one is on the U.S. tax, you mentioned this negative impact of 3%, which, I guess, works out about EUR 1 billion in available capital. What does that do to the internal cash flow? Does it mean you have to put cash into the U.S. or you suddenly get a shortfall of dividends for 2 years? And how does that impact your -- how you look at dividends and buybacks and things?

Giulio Terzariol
CFO & Member of Management Board

Okay. On the 3 questions you asked, Michael, I could get one. I answer the question regarding -- we can answer the other 2 -- on the funding constraints for M&A. I will say, it depends on how you define funding constraints. If you define funding constraints in the sense of just utilizing cash and debt. This depends on the size of the acquisition. If you assume that we had the ability to raise equity, then I would say the funding constraints are not really [indiscernible] unless we get extremely creative. So -- but if you refer to cash and debt, I will not give you a number, but I will say we have definitely the opportunity to do an acquisition, which is, let's say, higher than putting together [indiscernible] just to give you an idea. The other 2 questions really you need to tell me because I didn't get.

Oliver Schmidt
Head of Investor Relations

Sorry. Michael, we didn't get that last question. Could you [bother] -- could you please repeat that? [indiscernible].

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Yes, the first one was about the Bloomberg citation, "Too many share buybacks lead to greed." I didn't understand what that could imply...

Giulio Terzariol
CFO & Member of Management Board

Too many share buybacks lead to greed...

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Too many share buybacks lead to greed. That's what it says on Bloomberg. Yes. And then the second one was in the U.S. tax -- cash flow. So you've got a note that solvency will be reduced because of U.S. tax changes. That means you need more capital, that's about $1 billion. And I just wonder what does that do to cash flow? How you looked internally at dividends and buybacks?

Oliver Bäte
Chairman of Management Board & CEO

Michael, could you also, on the first question, say who was quoted, so we know who should answer on Bloomberg on what?

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

I have no idea. It just says -- it just says it's in inverted signs. [And answers] -- this is -- I'll cite you, it's line 52 according to Bloomberg News. And the answer is Bäte, "Too many share buybacks leads to greed." That's the citation.

Oliver Bäte
Chairman of Management Board & CEO

Ah, so it's me. So from this morning. So my English was so bad [indiscernible]. I think what the message is that one has to be very careful which instruments used. It depends always on where is the share price trading, what is the right mechanism you can also always think about dividend increases. So we are not hooked on one particular mechanism. I think that's very important. Second, you obviously have cases in this industry and others where management stops thinking really about investing capital in its own business to innovate and grow and rather focuses on just repatriating capital [return]. So what we are having us a framework is very simple to say, we want to invest the capital that our shareholders have entrusted with the best returns that we can achieve for them. And therefore, the buyback or other mechanisms, capital repatriation are always the benchmark. But what we would like to do, obviously, is that we would like to invest it into the core business and grow it. So the quotation was in the sense of we would like, over time, to grow the business organically and organically (sic) [inorganically] and, therefore, people should not continuously pencil in billions and billions of share buybacks over the next few years. There might be other mechanisms to invest the capital properly, and we will always look out for your interest. But the key thing is, we would like to grow this business profitably in the way to grow jobs, customer satisfaction and shareholder value, where we do not have the intention to put Allianz in either mental or practical runoff. Is that a proper answer?

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Yes, that is a very nice answer.

Giulio Terzariol
CFO & Member of Management Board

Yes. And then on the question of the cash flow or the impact of the change in the capital because of the tax reform. We need to distinguish what happens at our level and what might happen at Allianz Life level. So we assume that NFC capital is going to go up. In the case of the Solvency II calculation, we are taking this number. We are multiplying the NFC requirement by 1.5, and then also we are deducting 50 -- starting in Q1, we are going to deduct 50% of this number from the -- on [funds]. So this is going to happen automatically. In the case of the United States, what counts is going to be the reaction of the rating agency to this change in regulation. So if the rating agencies are going to adjust their threshold level, the reality now is going to happen from the point of view or the ability of Allianz Life to pay dividend to Allianz SE. In the case the rating agencies are not going to adjust the threshold or they're not going to adjust completely the threshold, this would have an impact on the distribution dividend to Allianz SE. We are running clearly some scenarios. I will tell you that, that might be a situation where for the next 2 years, we are going to get instead of, let's say, EUR 400 million to EUR 500 million dividend, we are going to maybe able to get EUR 250 million dividend and that will be maybe a possibility. But again, it might be that Allianz Life is going to be able to continue to pay dividend in the same amount as before in the case the rating agencies are going to give full credit for the change in tax rates.

Operator

We'll go next to Farooq Hanif with Crédit Suisse.

Farooq Hanif
Crédit Suisse AG, Research Division

You mentioned in-force management of the Life business during your introductory speech. Now the low-hanging fruit has probably been addressed into the ALM and Solvency II. What kind of things are you looking at? And how material could they be? Secondly, Allianz Partners continues to grow at really strong rates, so it's, I think, 13% to 14% of the fourth quarter. I mean, soon it's going to become your second largest business at this rate in the next 2, 3 years. Is that what you want it to be? I kind of -- you mentioned travel insurance, is that the real reason why it's growing? And the last question I had was just a bit more detailed AGCS pricing. So it turned sort of neutral to positive in your -- in 2017, is it going to be more materially positive, let's say, 2% to 3% in '18?

Giulio Terzariol
CFO & Member of Management Board

So maybe starting from the Allianz Partners, we don't expect them to become our biggest business in the next 4 or 5 years, but we still expect to see growth in Allianz Partners and growth is coming definitely from the travel business, but we see also growth in some part of our international health business and also, we see some growth in the so-called business, it's called NEXtCARE. So there are a few growth engine in Allianz Partners. This growth engine should make sure that there is enough diversification for them to continue to grow. But clearly, the expectation is not to see that they are going to grow forever. But we see that is -- also, that's more important expectation that they're going to grow at a profit. So we really see this company in a positive trajectory for the next 2, 3 years, and then it's hard for us to make any prediction beyond that. On AGCS and the pricing, we see that there is and you heard that definitely also from others that there is some positive development on the pricing side. If you are then referring to the quality of the business that we have because the combined ratio has been disappointing and that's not just because of cat losses, but we had also some large losses. What we do to make sure that the quality of the business is the right one, every time we get large losses, we have a sort of loss review. And this is the way you can determine whether the large losses you are getting are because of bad luck or if you are getting large losses because you have some issues in your underwriting capabilities. The outcome out of these large losses is that we -- review is that we believe is more due to bad luck. So we're kind of confident about the ability of AGCS to underwrite properly. And also if you ask me what will be a driver of improvement for next year in our combined ratio, we'll definitely assume that unless there are other significant cat losses, AGCS is going to contribute to our improvement in 2018 versus 2017. Then there was another question, in-force management. Okay, what are the next steps? On the Life side, I will say, it's a point where we are comfortable with the quality of the new business. So that's really about getting the organic growth like we got in 2017. So we are capable to do this kind of organic growth consistently and the quality of business we see also in the future and there is no reason why we shouldn't be able to do that, but then this is the best way to grow a profitable book of business. And as you remember, we have shown the calculation about what is the translation of the value of new business into [operating] profit. So as long as we are capable to increase the value of new business, eventually this is going to translate also in a long-term growth in operating profit. So if you ask me, it's about doing the right thing in a consistent manner, also in the future years.

Oliver Bäte
Chairman of Management Board & CEO

And maybe I can add. There is quite a few areas that we would like to further work on. For example, we have said in the past, we would like to grow the risk part of the insurance side. So there's more to be done. We believe that health insurance is a very difficult business, but a strong growth opportunity for Allianz, particular in the emerging markets. So that's where we're working on. So we are at the beginning of the right journey not at the end of it. And actually, we have retooled the ship in order to now full go steam (sic) [go full steam]. So we need to look for distribution opportunities and innovation. And it's a great place to be in because a lot of people haven't even started to retune the machine. And that one I, at least, personally, am very happy. Now the last thing is there is a lot and that is I think people do not understand the [synergy] behind that, is the intersection between Life Insurance and Asset Management. We always look at these segments differently, but when you look at institutional solutions, many international companies, many pension funds, use an integrated solution set from Allianz to solve their need. It can be a CTA here. It can be the support of a pension fund there. It can be a life insurance solution. And people underestimate what the power of the combination is. In many markets, particularly in Europe, we're already succeeding in the U.S. PIMCO is a strong provider for Allianz Life of North America. So as you see pressure on margins, you can withstand this pressure much better if you have both the life and the fund profit inside of the product rather than if you were just to wrap it like on the Life side or you just substitute your fund provider, so we really believe in the power of the combination, and I think it's nowhere yet to be seen in our evaluation.

Operator

The next is William Hawkins with Keefe, Bruyette, & Woods.

William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

On Slide B 21, could you give us a bit more color about the outlook for the 4 key segments of the Life operating profit? So when you're talking about a EUR 200 million net decline this year, can you just sort of help me understand how that's being driven by the 4 segments? And then once we get to that baseline, are we assuming that the 3 kind of growth segments then start growing aggressively and it's just guaranteed savings is falling gently or could we be more nuanced about the medium-term outlook for those 4 segments? And then very briefly, the asset management flows, I'm sorry if you already said this earlier this morning, but where are we on the asset management flows year-to-date, please?

Giulio Terzariol
CFO & Member of Management Board

Okay. Coming maybe for the last question. Year-to-date, we are at PIMCO, it's about USD 20 billion. Now coming to your question about Page 21 and, if I understood it right, it's about how we see the operating profit by segment to develop over time, also considering the compression in the -- or the reduction in investment margin. I would say that -- I would expect that reduction to come through the guaranteed savings and annuities. The capital-efficient products [indiscernible], we should see growth there, also because the German product slowly, slowly is going to kick in with some growth. So this is the area where you should see high operating profit or the unit-linked without guarantees also because we are growing that block and protection and, hence, I would like to see more growth there. But for the time being, we are still finding the right recipe, but that's definitely a strategic target. So as I look into the near future, we'll say guaranteed savings and annuities, it is rather the area where we are going to see a moderation. In the capital-efficient product, we should see growth kicking in. Same for unit-linked and protection, I think we need to wait before we see some -- really this number moving a little bit higher.

William Hawkins
Keefe, Bruyette & Woods Limited, Research Division

Great. So particularly in capital-efficient products, my assumption was that the U.S. could be continuing to fade if for no other reason than the FX impact next year. But you're saying that should be offset by Germany?

Giulio Terzariol
CFO & Member of Management Board

Okay. Sorry. I was not considering for the FX impact. Clearly, when you put FX into consideration, then this might somehow dampen, first, the growth, but FX are moving. So I'm looking more at the growth in operating profit from an organic point of view. But yes, you're right, once you put fixed into the picture, you might not see that growth translated in euro in 2018.

Oliver Bäte
Chairman of Management Board & CEO

There's the translation effect.

Giulio Terzariol
CFO & Member of Management Board

That's a fair comment. Yes.

Operator

We'll take our next question from Paul De'Ath with RBC Capital.

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

A couple of questions, please. Firstly, just going back on the M&A topic, but kind of from the other side. You obviously made a few disposals so far. I just wondered if there's anything else in the portfolio that you're currently looking at as noncore and whether you'd be looking to release some more capital by selling a few more things? And then the second question was on the P&C business and the normalization that you do on the combined ratio. So -- I mean, you quote in the slides about essentially using a 10-year average. Is that what you're thinking about when you're doing the normalization? Or is there another number that you would use there? And linked to that on Slide -- where is it, B 38, I just wanted to clarify the target for the combined ratio is 94%. Is that a normalized combined? And if so, why is the 2017 number, not a normalized number, next to it?

Giulio Terzariol
CFO & Member of Management Board

Okay. I go maybe first. Okay. Let's talk about the combined ratio. Yes, the 94% is kind of normalized in the sense of, if we're going to have massive cat losses next year, then it will be difficult to do 94%. Or on the other side, if we're going to add on our cat losses, we would expect to be better than the 94%. So that's a normalized view on how we derive the normalized combined ratio. I can tell you how we do the exercise. You have almost all pieces of the puzzle, but you don't have all pieces of the puzzle. When you go to Page 14, the -- Oliver and investor relations guys are giving you the 10-year average of 2.1%. So we adjust the actual cat losses against the 10-year average. Then you get also the average run-off that's also something that we put into the normalization. The only piece of information that you don't have is the amount of weather-related losses and large losses. And the only reason why we are not sharing that information with you is because the quality of this number is a little bit more discretionary. So we don't like to give out numbers where you might agree or disagree whether the number is actually that number or a different number. But my point is in a situation like 2017 where you have significant natural catastrophe activities, you can imagine there is overall a weather-related system, which is going to create small weather-related losses that maybe they don't make to the level of a cat loss, but they are still significant. That's the reason that if you do that normalization just based on the numbers that you got from Oliver, you get to 95.2%. But then you can definitely assume that the level of weather-related losses in 2017 was higher than what would be a long-term average and also in the large losses we had a little bit of a deviation. So that's the reason why it's very easy then to go from 95.2% to a number, which is significantly below the 95.2%.

Oliver Bäte
Chairman of Management Board & CEO

Very good. Nick (sic) [Paul], Oliver here. In addition to your question on what is to sell and not to core, I'll give you sort of an actual number and a little bit of a facetious answer. I call -- start with the facetious answer, is, I think, it's really, really intelligent of CEOs to go in and say, "Ha! You're a core business, you are noncore business." By the way, the best thing is to say you are other business. Yes. So people in these businesses, particularly those that are noncore, they feel really great when the CEO gets that. So what we are not doing, we are not doing that. What we're looking at is very simply economic terms, and let's get more serious, it is where are we deploying capital inappropriately because we are not earning appropriate return. Then we try to turn it around as we've done it in the case of Latin America and only if we find that we do not have the management capabilities to profitably grow our business like it was in the case of Korea because regulation in the environment is not conducive to us applying our management skill then we sell it, but then we do sell it. Sometimes we, by the way, don't sell. We closed it down. Remember when we started to build a direct insurance business in the United Kingdom 5 years ago, we tried hard, we failed. We closed it, it costs us a lot of money, more than EUR 200 million, and then we found a much better solution with a joint venture with LV that we believe is going to be much more successful. So there are various ways on how to react, but we have very clear hurdle rates that our business have to meet and if they don't meet them on a consistent basis, and we can't see improvement in trajectory and performance, then we sell them, and I would be pretty foolish if I would go now and here's the 3 businesses that we are looking at and we may sell tomorrow. You will see it when it's closed or sold. Sorry for the [ambiguous] answer.

Operator

We'll go next to Nick Holmes with Societe Generale.

Nick Holmes
Societe Generale Cross Asset Research

I just wanted to ask about your variable annuity book. Just because it's growing so rapidly, I think you've gone from #9 to #6. Really 2 questions. One is, is now the right time to grow when the S&P 500 may be near its peak? I mean, who knows. And secondly how confident are you that the hedging really will protect you, if we get a more serious correction?

Giulio Terzariol
CFO & Member of Management Board

Thank you, Nick. Maybe we should change the way we present the numbers because what we are referring as VA is a hybrid VA, and this has nothing to do from a risk profile with a VA business. In reality from a risk profile, it's more like a fixed-index annuity, but just because of the way the product is being created from a regulatory point of view for standard definition of variable annuity. But think of that product as fixed-index annuity product. Indeed, it's even better than a fixed-index annuity product because it's a short-duration product, so there is definitely less, less risk even compared to fixed-index annuity product. So from that point of view, yes, I would say, it's definitely a business that we want to grow. And yes, I think that we should make the change at the finish, or at least, you should keep in mind when you see growth in the VA, in Allianz Life, this means growth of the hybrid VA and upgrowth of traditional VA.

Nick Holmes
Societe Generale Cross Asset Research

Great. Just very quickly, though, as a follow-up, I mean you are deemphasizing general accounts. You're focusing more on risk and health. How does your strategy in America fit with that? Because I mean, it's still a general account product, right? I mean, it's a fixed guarantee product.

Giulio Terzariol
CFO & Member of Management Board

We're not really deemphasizing general account because the hybrid VA, the majority of the assets that go into the general accounts but some of the assets have to go into a variable account and that's the reason why because of that, it gets classified in a different way. And also because fundamentally the customer might lose some money in a hybrid VA, which is not the case in the fixed-index [annuity business] VA. But fundamentally, the majority of the assets are going into the general account. With respect to protection -- growing protection in the United States, this is something, which is maybe not a core expertise to be perfectly blunt of Allianz Life, but we're always looking at possibility to grow our Life business and, indeed, 2017 has been relatively successful. So that's what we tried to do. To be completely realistic, the bulk of the business is fixed-index annuity and there are good growth prospect in fixed-index annuity. So even if we are capable to grow our Life block a little bit more, this is still going to be compared to the big block and not the most relevant parts of the business of Allianz Life.

Oliver Bäte
Chairman of Management Board & CEO

Maybe Oliver can follow up with you on the risk profile. It's really attractive from a risk and a hedging standpoint, and we are -- actuary is nodding very quickly because we got -- for a long time, thinking about innovation to give the clients the variability of the outcomes and the upside, but making sure we have all the hedging under control. And I think it's a very nice innovation for you to look at.

Oliver Schmidt
Head of Investor Relations

Sure. Nick, I would be happy to do that, of course.

Operator

We'll go next to Vinit Malhotra with Mediobanca.

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

So just 3 questions. One on each segment, please. Just on the asset management, Oliver, it looks like the fixed momentum is quite strong, I mean, one of the highest net flows with maybe ever or for a very long time at least. So how far do you think are we from obtaining part of the 2012, 2013 kind of [pre-glory] operating profit base. Because I know the outlook is still capped at 2.7. But if volatility plays to your strength and [close] remain at where they are, then is there a reason to not be more bullish on asset management? That's the first question. Second question is more on the slide details on the Life side. I noticed in the capital-efficient products in fourth quarter, there's a bit of operating profit pressure from unlocking [indiscernible] assumptions. Are these market volatility or are these mortality or some other kind of assumptions? Could you just clarify? And in the same line, I know, Giulio, you mentioned that VA is actually a hybrid VA. But in the past, you also said that your traditional VA of EUR 30 billion liability benefits on low vol in the market and volatility is quite unpredictable at the moment. Are there any risks there? And just last very quick clarification, P&C. After all the normalizations, how should we think of the full year '17 versus '16? Sorry, I missed that. Is it flattish or slightly better versus '16?

Giulio Terzariol
CFO & Member of Management Board

Okay, maybe I can start with the question on the capital-efficient products and the unlocking. The unlocking is -- at least, it's unlocking, so we're looking at all assumptions. So we're looking at annuitization's assumptions, earned rates, mortality, morbidity. At the end of the day, as I said before, there was a swing between 2018 -- '17 and 2016. In the sense of when you look at the Delta, it looks relatively significant. But keep in mind, it was a positive unlocking in 2015 and a negative unlocking in 2017. The primary reason anyway for the negative unlocking in '17 was an adjustment to the earned rate. But again, this is a very normal process and when you look at the performance of Allianz Life for 2017, it has been very good. Your question about VA should do good in an environment where there is low volatility. That's sure. That's also the reason why Allianz Life has very good performance in 2017. You see the low volatility reflected in the guaranteed savings and annuity numbers at Page 21, now you say, why is the number is not going up more? Remember that in 2016, we had this restatement and so we got this onetime profit. So in reality, if you adjust the 2016 number for the restatement, you will see a growth of EUR 130 million in that bucket and that growth will be driven by Allianz Life and specifically by the VA business of Allianz Life. And the other questions I think you need to -- asset management operating profit. Okay. When we look at the asset management operating profit and the question was about, first of all, our outlook for 2018. As I was trying to explain before, we expect on a constant FX basis to get to a high single-digit growth in profit for '18 and maybe I'm even a little bit conservative on this view. The point is, the FX is going against us and that's the reason for the 2018 outlook. As I look at the projection for 2013, in order to get to a level of EUR 3 billion, I would say if you put back the U.S. dollar to a level of 1.11 and this will give us automatically EUR 100 million more profit [indiscernible]. Then I would say, it would take us most likely -- I would say 3 or 2 full years before we get there. So it's not something that we're going to achieve in the next 2 years. But I would say 3 or 4 years, we might get there.

Oliver Bäte
Chairman of Management Board & CEO

Can I add to Giulio? I think we're having a very important debate and for those of you who sort of look beyond the year longer term, what you can basically see is that we are very cautious because of 2018 expected volatility. Politics, normalization of QE, interest rate going up, markets being able to correct. Second, there's a lot of leverage in the system, ladies and gentlemen, I would like to say that a lot of investments, for example, in Asia have been done on a leveraged basis. If we get a market correction that is more material then a lot of money can flow out of the system and affect us, right? So we just have a view that the market are overheated. And we would not find it to be prudent, nor professional to just not support artificial growth in earnings that we know because of what happened to the U.S. dollar are for '18 going to be less than what we normally would expect. Now on the other hand, when you look at the underlying trends, that should really drive valuation. What are the flows and asset management and the margins relative to the competition? What is the new business value growth? What are the new business value margins? First, on growth, again. When you look at the underlying dimensions in P&C relative to the market, net cat losses versus industry, clear that we're going to improve productivity, then we're going to get to the 94%, then we're going to get close to the 13% ROE. All KPIs are going in the right direction. So if you were to look a little bit beyond the professional and prudent outlook that we have, Allianz is firing all cylinders. And when I buy stock, I buy on fundamentals. I don't buy based on the spreadsheet and that's not a criticism, but I think we shouldn't miss the forest for the tree here.

Operator

We'll go next to Andy Hughes with Macquarie.

Andrew Hughes
Macquarie Research

I've got 3 questions. And the first one, if I could, is about the 9% cost of capital on big acquisitions. I might be able to help you out here. Because if I flick on Bloomberg and I look at the rumored target XL lease rate at 11x 2019 earnings, which as we know is a 9% cost of capital. So maybe you can clarify 3 synergies. Maybe you can clarify exactly what you meant by hard to achieve the 9% return. The second question is about the decision to maintain the prospective bonus of 3.7% for next year. Because the bit I'm struggling with is the new business margins are positive for this contract on an MCEV basis, which clearly assumes a very different bonus pattern to what you're actually paying. So should I ignore the MCEV numbers? Maybe you can tell me what bonus is implied in the MCEV number, please. And the third question is about dividends and holding company. So on Slide B 40, I think you mentioned about attitude to return capital, increase dividends. I can see the only answer is to increase the senior debt in the group by EUR 2 billion during the year. Are you actually looking to use senior debt to fund the buyback or in this case is it being used for Euler Hermes and other stuff? And would you do additional -- add on additional senior debt? Could you comment about how the cash flow position of that holding company currently stands?

Giulio Terzariol
CFO & Member of Management Board

Okay, so maybe starting from the last question. I will not give you the number of our cash at the holding level, but I can tell you that the level of cash to the holding level has increased in 2017 compared to the beginning of 2016. And when I say, it has increased, I don't mean by EUR 100 million, but I'm speaking of numbers above the EUR 1 billion level. Just to give you a sense of what we are speaking. And also, as you know, we have a so-called [strategic liquid reserve] of EUR 5 billion. We are way above the EUR 5 billion strategic liquid reserve. In the sense of the question whether we are raising senior debt to fund buybacks, no. In reality, we are able to switch. But I just want to give you an idea about internal financing and senior debt. So the reality has nothing to do with raising debt to fund senior -- share buybacks, that's, in reality, more about creating if you want even more financial flexibility in the future because it's a good moment to get senior debt into the books. So that's something that you should consider also how the internal funding might move. Then you have a question on the product in Germany and whether the MCEV reflects what we are doing? Yes. You need to think about the fact that in Germany, you need to apply portfolio view. So clearly, if we were doing things like prospective without having a portfolio view, which is the way the German system works, then you would get to a very different math. But in the case of Germany, we have a portfolio view. So as long as you are adding business and, in general, you have a yield, which is going to be above the guarantee level, you're going to get profit on a marginal basis by adding business. So think about the fact that is not a product-by-product, generation-by-generation business, but this is about a bigger swimming pool and this makes a big difference. And the first question I really didn't get is about the 9% cost of equity. But yes, I didn't get the question -- sorry, I didn't get the -- I didn't understand you a little bit acoustically...

Andrew Hughes
Macquarie Research

All right. So if something is on less than 11x P/E on Bloomberg for consensus forecast, if you buy at the current share price, you will get a 9% return, assuming that growth.

Giulio Terzariol
CFO & Member of Management Board

Yes. If we buy something at 9% that's implied, yes, then you have the synergies, right? And then if you -- in reality, one could look this way in theory, just theoretically, you should always imply that when you buy something on the market, you buy at the cost of equity of that thing, otherwise something will be wrong. And then usually you create synergies and then you split the synergies maybe half and half and this would create the extra value for the shareholders of the target company, for the shareholders of the acquiring company, so that could be a logic to apply.

Andrew Hughes
Macquarie Research

I was just a bit confused because you said, it was hard to find something with a 9% cost of capital and yet you were looking at XL, which is less than 9% cost of capital on consensus forecasts, and you would have your synergies on top as well. Am I getting something wrong here or...

Giulio Terzariol

CFO & Member of Management Board

We are not speaking about any specific companies. This is a general conversation and, now, as I said before, if you believe anyway in the market price that this, then you should apply the cost of capital in this market price. We might also argue that market prices of some companies might be overvalued. And in that case, implied cost of equity will be lower than the 9%.

Operator

We'll take our final question from Andrew Ritchie with Autonomous.

Andrew James Ritchie
Autonomous Research LLP

Three very short ones. You talked several times about interest rates, you think interest rates will rise, albeit in a volatile fashion. I guess, I'm trying to understand how I think about the benefit to the insurance business, I can make my own mind up on PIMCO if interest rates rise. It looks like you effectively neutralized the Solvency II position. And I guess, for IFRS earnings, there's no benefit until the reinvestment rate matches the portfolio yield. Am I wrong? Am I missing something? Are there more management actions you can take to reposition for higher rates? And also, I'm just checking there's no negatives, for example, hedging costs, swaptions, et cetera, that will start to impact if rates rise. So just how you think about the benefits of the insurance business should rates rise, given all the data I can see. Second, very quick question is, I'm afraid it's about the debt. What is the binding constraint on debt? It's clearly not the Solvency II buckets, you have tons of room there. Is it Moody's? Is it the headline IFRS gearing number? What is the headline constraint? And the final very quick question, the 13% ROE has been a fairly long-term target. What was the tax rate assumption in that 13%?

Oliver Bäte
Chairman of Management Board & CEO

The tax rate assumption.

Giulio Terzariol
CFO & Member of Management Board

Yes. Okay. Coming maybe from the question about how we view interest rates and the impact on our insurance operation. On the P&C side, before we go into the Life segment, we would expect that increased interest rates are going to have a positive impact. If you think about how much investment income we had a few years ago and how much investment income we have right now in the P&C business, we are speaking of a difference in value of EUR 300 million, EUR 400 million easily. So clearly, we would expect this to reverse. On the Life side, on the in-force business, I would say you wouldn't see maybe a significant amount of profit more. But at the end of the day, I would say, there is always some -- what you're projecting is low interest rate forever, you might get into some situation where you might assume that there is a little bit more stress into the balance sheet, so higher interest rates are definitely always beneficial from the point of view. And also the new business value would most likely be positively affected. So in general, if you ask me, higher interest rates are rather positive, obviously, for our P&C segment as opposed...

Andrew James Ritchie
Autonomous Research LLP

[indiscernible] Solvency II -- in the Solvency II, I mean, obviously, you [showed] limited move for 50 bps. But I guess, with convexity, above 50 bps, there's more material impact. Is that how I think about it?

Giulio Terzariol
CFO & Member of Management Board

Yes. If you say -- if you move the interest rates even higher what happens to the sensitivity of the Solvency II, that's the question?

Andrew James Ritchie
Autonomous Research LLP

Yes.

Giulio Terzariol
CFO & Member of Management Board

I would say if you move the sensitivity even higher, you will get most likely a sensitivity which is not as good as a plus 2. It might be potentially even lower because of convexity but that will be driven by the SCR. And so I wouldn't say that calculation, which is an instantaneous shock as a proxy for what can happen to our profit. Because there is a difference by running an instantaneous shock as opposed to have a sort of greater increase in the interest rates, you'll get a different answer. And then the question about the 13% ROE, what was the tax rate included in the 13% ROE? I'm sure that it was more than 27% that we mentioned before. But if your question goes, okay, but you are making the 13% ROE just because of the tax rate, we need to consider that a lot of things have changed between 2015 and now. And just to give you an idea, think about the equity market run, and there is definitely more capital that we have in our books compared to what we assumed a few years ago and also think about Korea, which had a negative cost of value. So these are all things that are clearly also have to be considered when you look at the ROE of 13%, what is bringing us there. On this topic, I like to be very clear. Is it coming back to the point that Oliver was making before? You have to look at the development of our operational KPIs. So if we are delivering on the 94% combined ratio, if we are delivering on the new business margin above 3%, if you are delivering on the mix, if you are delivering on the cost-income ratio of PIMCO, [indiscernible], I would say all the things that we could control have been implemented and executed against and this will support the fact that we've been able to drive to the 13% outcome. And then clearly, you have plus and minuses and this might put us a little bit ahead or below the 13% ROE.

Andrew James Ritchie
Autonomous Research LLP

Okay. Finally, on the debt constraints, what's the [indiscernible] that you've got...

Giulio Terzariol
CFO & Member of Management Board

Ah, the debt constraints, yes. On that, are you talking of senior debts? Because if you are talking of subordinated debts, you might -- Sorry.

Andrew James Ritchie
Autonomous Research LLP

Well, total debt -- the total debt leverage or I guess, how do you look at it? I mean...

Giulio Terzariol
CFO & Member of Management Board

Ah, total, yes. I would say eventually that the first constraint to come into the equation will be the Moody's or S&P's leverage ratio, the calculation is slightly different, but they are not giving complete different answers. So yes, the constraint come into play wouldn't be Solvency, Solvency II, the first constraint come into play will come from the leverage ratio, but we are not close to the constraint. So that manages the first constraint that would come into the question. Yes.

Oliver Bäte
Chairman of Management Board & CEO

So we have lots of room on various dimensions, but we are always cautious on our financing structure as you know. We have sort of when you run the S&P and other models, we are sort of at the upper end, we would say, of our current rating scheme, and we'd like that. Again, we believe the world is going to be a little more difficult than other people think, given that the markets are steaming ahead. We are nearing strong economic numbers. But then camouflaging very difficult trends.

Let me repeat that at the end. And thank you very much for your interest. The governments are still dramatically overleveraged, and that leverage issue has not been solved. When you believe that the current gross numbers will address the issues, they won't. With what the U.S. is planning -- it's great to invest in infrastructure, but their leverage and their debt ratio is already very strong. My personal opinion that the U.S. dollar might be weaker than everybody thinks, not because people are talking it down, but because people are worried about the credit rating of the United States and sustainability of the financing, that would be something to really worry about in the long run. We've had a lot of progress in Europe. We now, hopefully, have a government in Germany, but we have elections in Italy and who knows what's happening there. We have a lot of problems in the Middle East every day. So this is a very difficult place, and we are part of a very large animal in a very difficult environment. So we are planning very conservatively that might disappoint a little bit of the enthusiasts, but those that have long-term investors should really cherish that. And with that, I say thank you to the shareholders and thank you for the support from my side and hand it over for Giulio for the closing.

Giulio Terzariol
CFO & Member of Management Board

Okay. Let me just say thank you for listening to the conference call and for your questions. And I guess, we're going to see most of you -- some of you, I'm not sure in the next days, so I'm looking forward to get to know you in person.

Oliver Schmidt
Head of Investor Relations

All right. Thanks from my side as well. Goodbye to everybody, and we wish you a very nice weekend. Thank you.

Oliver Bäte
Chairman of Management Board & CEO
Thank you.