S&P Capital IQ

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Allianz SE DB:ALV

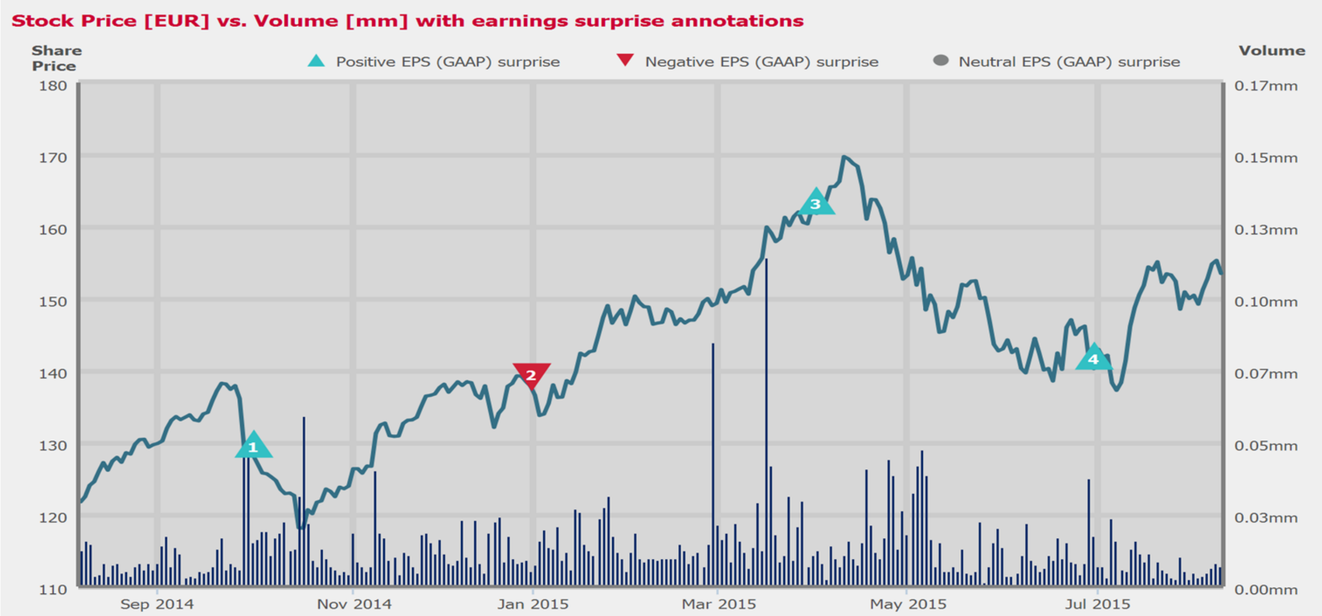
FQ3 2015 Earnings Call Transcripts

Friday, November 06, 2015 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2015-			-FQ4 2015-	-FY 2015-	-FY 2016-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS (GAAP)	3.49	2.98	(14.61 %)	3.45	14.85	14.84
Revenue (mm)	29093.00	27500.00	(5.48 %)	-	126837.39	133840.04

Currency: EUR
Consensus as of Nov-06-2015 12:19 PM GMT



- EPS (GAAP) -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2014	3.34	3.52	5.39 %
FQ4 2014	3.22	2.67	(17.08 %)
FQ1 2015	3.70	4.00	8.11 %
FQ2 2015	4.01	4.38	9.23 %

Call Participants

EXECUTIVES

Dieter F. Wemmer
CFO & Member of Management Board

Oliver Schmidt
Head of Investor Relations

ANALYSTS

Andrew Broadfield
Barclays PLC, Research Division

Andrew James Ritchie
Autonomous Research LLP

Farooq Hanif
Citigroup Inc, Research Division

Frank Kopfinger
Commerzbank AG, Research Division

Jonathan Michael Hocking
Morgan Stanley, Research Division

Michael Hermann Haid
MainFirst Bank AG, Research Division

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Nick Holmes
Societe Generale Cross Asset Research

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

Vinit Malhotra

William Elderkin
Goldman Sachs Group Inc., Research Division

Presentation

Operator

Ladies and gentlemen, welcome to the Allianz Conference Call on the Financial Results for the Third Quarter 2015. For your information, this conference is being recorded.

At this time, I'd like to turn the conference over to your host today, Mr. Oliver Schmidt, Head of Investor Relations. Please go ahead, sir.

Oliver Schmidt
Head of Investor Relations

Thank you. Yes, good afternoon from my side as well, and welcome to our conference call about the results of the third quarter 2015. There's nothing specific to be added from my side today. So without further ado, I hand directly over to Dieter.

Dieter F. Wemmer
CFO & Member of Management Board

Yes. Thank you very much, Oliver, and good afternoon to everybody on the call. Let me just dive directly into the presentation.

When I started the business highlights, we continue to focus on new product development in retail property and the Life and Health space, also, mainly retail, and then in Asset Management. And I think in all categories, we are seeing a very good progress, which is then also visible into our profit margin and new business development in the segments. I will come to this later in the investment space. We had a successful quarter with some really headline-making large investments in Germany, U.K., but also in Ireland, helping to diversify our investment portfolio.

So now let's start with the numbers. So Page 5 on the group overall results. EUR 2.5 billion operating profit might have seen by some of you as a small disappointment. Actually, the underlying operational results are unchanged on a high-quality level and also very good. But financial markets had some particular volatility in Q3, so FX results, volatility in equity markets also influenced the P&C and Life and Health segment results. So that created some negatives, and I will explore on the details of this when I come to the specific segments.

Total revenues down, mainly coming from the Life segment because P&C and also Asset Management is in revenues up in the third quarter. And so reduction in Life and Health is very welcome by us because it is an evidence of our change in strategy, that we are clearly reducing the volume in traditional single-premium business and replacing it with new products that so far had a lower volume. And new business value and new business margin, when we come to this page, it's clearly demonstrating that this strategy is working.

Net income is more down than the operating profit, added to the reduction, operating profit is a higher tax rate and some more impairments also coming from Q3 number, the financial market movement, that explains the difference. But already, to be mentioned, I come back to this also at the end of the presentation. We stick to our operating outlook for 2015. We are well prepared for a very good year-end, as predicted.

Now the capital page. Shareholders' equity, actually slightly up in total. Unrealized gains did not move a lot. We had offsetting effects between European government bonds and corporate bonds. So one has widening spreads, the other has reduction in spreads and also base input rates. And in the equity market, actually the unrealized gains stayed pretty stable. The stocks which were impacted by the market actually directly go to the 20% hurdle, and we have impaired them in the quarter. That should not surprise you. That is quite a lot of stocks in the energy and commodity sector, which mainly created immediate impairments.

So Solvency II capitalization at 200%. And we are now really converging to the number and the IMAP approval I would expect in the next couple weeks. The 12 percentage points done is split into 3 categories. Number one is market movements. These are just 5 points. And if you want to test it against our published stress numbers from last quarter, use 20 basis points on the interest rates and 7 percentage points on the stock market movements. And that gives you both sensitivities combined, 5 points movements.

The next 5 points is coming from adjusting to EIOPA rule on how to calculate U.S. equivalents. And we move from the 100% CAL to 150% CAL and that is recommended formula by EIOPA. And the last 2 percentage points are final adjustments coming from the German regulator on our IMAP, mainly affecting our German Solvency ratio, and then the 2 percentage points is the effect on a group level. And then there were some smaller changes coming from the IMAP approval process, which are adding up to the 0 because there are pluses and minuses.

So overall, a very comfortable level, ready for the final go on Solvency II. And still, the same dividend level as promised last year being accrued.

Now moving to the P&C numbers. Internal growth, nominal 2.4%. If you correct for acquisitions and FX, only 0.6%. That is -- actually, we still have pretty good growth in our core markets. However, in Germany, the same strategy as we do in Life, we reduced traditional products with guarantees. And please be reminded that we have a fairly large book in Germany in retail accident business, which is a savings product with guarantee which is sold as a single-premium product, and therefore, the same strategy as in Life is being applied here. When I ignore this product line and I go to what you would all perceive as real P&C business, Germany has actually a growth rate above 3%, or even close to 4% in the quarter.

The other reductions are coming from Brazil. Further cleaning up of the portfolio, but I would say, aggravated by the macro picture in Brazil, which clearly darkened. Then, the runoff of our Russian retail. We are now with our Russian retail business year-to-date, 95% down compared to the year before. And then Fireman's Fund is also -- continue to reduce volumes. So that are the negatives in the overall growth.

And then we are very more careful in the writing in our global line business, credit insurance as well as large corporate business and specialty business. So the growth is really coming more from the retail and mid-corp businesses. I would really positively highlight our Allianz Worldwide Partners, that is the global health and assistance business, as well Australia and Spain, who has a real run in its business development, because you will see that I highlight Spain also on the following pages further.

So moving to the results in P&C. Combined ratio at the first glance, pretty flat with a 94.1%, so a tick-up in total, but underlying some moving figures. So first of all, last year was free of cat events. This year, we have 120 basis points. Last year, we had a run-off result of 2.6%, where we had a big negative coming from Fireman's Fund, about 1.8 percentage points. This year, we don't have a negative from Fireman's Fund. So the reserve -- the positive run-off across the segment is roughly the same, the 4.4%.

Expense ratio had ticked up. There is a one-off effect as we have reallocated in our assistance business some numbers between loss ratio, so service provided versus expense ratio. That is neutral for both numbers, but it is a shift between the 2 lines. And then we see also a further mix change with the trends to higher commission and acquisition costs, so therefore, the expense ratio is up.

The underlying loss ratio is suffering a little bit from large losses more, but not significant. I think that is some 40, 50 basis points. And then we see also clearly a deterioration of the numbers coming from Argentina. And we have booked in Argentina actually additional EUR 50 million split between prior year and current year. That is a catch-up on the deterioration of the inflation rate in Brazil. And we have to turn this business -- this might be -- that is in Argentina easier than in Brazil. We are already on a track to increase at the moment our prices by 2.5% to 5% per month, because Argentina Motor runs on 30-day policies, and not 6- or 12-month policies.

So the operating profit in P&C is down compared to last year by EUR 70 million, and it is all coming from the investment result. And underwriting, a very small reduction that is a slight uptick in the combined ratio. And I come to the investment results in a moment.

Let's look first at the operating profit development country-by-country and the combined ratio. When you look at the individual combined ratios, I think that strong combined ratio is really supported by a broad basis of successful large entities. There are our 3 Continental European in home and core markets: Germany, Italy and France. There is AGCS, which continues to have a very good result. The 98.6%, which you find here on the page, you have to split into the old AGCS business and then the Fireman's Fund commercial business addition. AGCS standalone is below 91%, and Fireman's Fund is the 117%, so still above 100%. We have actually in this quarter still booked some cleaning up. We have not increased reserves, but we have cleaned up some other commitments from full participations, receivables or other smaller balance sheet items. And then we had a final settlement with the disposal of the business with ACE. So all in all, that cost us about EUR 45 million in operating profits for the quarter. So that was a smaller clean-up.

The Latin American number, the big negative is coming from Argentina, as I explained already. And Brazil is also still negative as the environment really delays, I would say, the recovery quite some time. The other numbers are still all very strong. And again, I would point out to Spain, which is not only growing but with the 85% combined ratio, also doing a great job on creating margin. The other businesses are pretty much in the area of what you would have expected. Where I should add here that we see in Germany, France, and also Belgium, actually, quite some smaller weather-related claim events in the third quarter, nothing which is being called a cat, something which is just costing some money. And when -- for example, in Germany, our normal quarterly budget would have been 6.3% for weather, and we consumed 6.7%. So that is -- and for France, the difference is bigger. And also, Belgium has some effects of this that affected this part of the continent.

If we move to the investment numbers of P&C, so Page 15. The running yield income is pretty stable. So all decline in yield has been compensated by higher asset volume, and we ran pretty flat on investment income. However, foreign currency investments held in the hard currency balance sheets created some EUR 70 million loss in the quarter because foreign currency goes through trading directly with the change of the currency. And that is all of the reduction in our P&C number here.

When I just mentioned FX in the total group balance sheet, the FX trading result of the quarter was on a gross basis, EUR 600 million loss. In P&C, it is the share growth rate for the shareholder. In Life, it's, of course, depending on what balance sheet, it is split with the policyholder. So that is the volatility of Q3.

In October, actually, a surge, so around EUR 200 million of the EUR 600 million returned to the positive. So even if you don't know what will it be on December 31, that is actually a good start into the year-end quarter. And the other information, I think on reinvestment rate duration, there is nothing to talk about in particular. It's all business as usual.

Let's move to the Life business. Yes, a 10% reduction in volume, a lot of single-premium reduction. Actually, when we would use what we are not doing but maybe here for comparison with our peers, the APE terminology. Our APE is actually 9% up in new business year-over-year because we are writing a bigger share in recurrent premium, and single premium is down. We are in recurrent premium slightly up.

So that is the first visible change in the mix. And when we then go to the different markets, you can see in detail that the traditional business, so there's the traditional guarantees in Italy, in France and in Germany, is down and we have replaced it with unit-linked business, or in Germany with the products with a new lean guarantee type, which is consuming less capital. And we will actually, on our Capital Markets Day, explore this section much more to show you also the effects on capital consumption and what does it mean long term.

The only volume number where you could say, "Well, that is not great," is actually the new business volume in the U.S., which is, currency adjusted, 30% down. So our market share in fixed index annuity moved from 30 percentage points we had last year to 20 in 2015. 20 is still at the upper end of our long-term market share in the fixed index annuity space, and we have probably a bit underestimated how fast the competition will copy our Part B [ph] product. And it's not only copying it, actually putting it with more aggressive terms into the markets. Therefore, the new business value we have generated out of the business this quarter is really very good. And I would -- I come to the new business value in a moment.

Let me first spend a minute on the operating profit development. If you see an increase in the investment margin, that is sometimes a bit difficult to understand effects that we have in the policyholder-shareholder split in Germany to do the catch-up for the whole 9 months, depending on how the realized gains and losses and the overall investment income develops for the full 9 months. And the low participation for the shareholder in Q1 is now turning into a higher participation in Q3. And overall, we are still on track for the full year result. I think the German results are much easier to understand when we have the 12 months together, because that is then the legally binding allocation of the profits to shareholder and policyholders. So therefore, during the year, it is always a bit of volatile proxy for really targeting the policyholder credits. That drove the investment margin here in numbers up.

However, we have 2 big individual negatives in this P&L for the quarter. There is on one hand another write-down of Korea of EUR 148 million. This time, it is the old Life product with traditional guarantees above 6%, as the guarantee level of this block. And the last quarter, we had old block of Health business which also has high guarantees, which was being evaluated and being written down. For the next quarter, as we have now covered both blocks of business which could create trouble, we are not seeing any further write-down. Actually, last year, we had this Life block write-down in Q4, and now it is in Q3. So it is a bit of advancing when you want to compare it to the 2014, what we had a year -- a quarter later last year.

So the other negative one-off in the overall numbers is actually out of the dynamic hedging process of our old VA business. We had a EUR 100 million base risk negative. The base risk in the old VA block is very simple coming from the fact that customers' money is in actively managed equity funds, and the hedging goes to index funds. And when active managed equity fund moves differently than the index, you create a base risk. And that base risk was actually very benign, and the last 2 years in most quarters slightly positive. This quarter, it created a EUR 100 million hit, which is buried here in this operating profit development.

So now coming to the new business margin. We've put the new business margin in the heading because 3.0% is the second-best new business margin the group ever reported. Only before the financial crisis, there was a 1 or 2 quarters with a better number. So 3.0% is a tremendous success in this environment, and it is a tremendous success for our business mix change strategy.

So how do I get from the last quarter's maybe disappointing number to this quarter's 3% number? First of all, we are using, for the evaluation of the new business margin, always the interest rate curve at the beginning of the quarter. So we talk here, the Q2 was evaluated at April 1. And when you would evaluate the second quarter at July 1 interest rates, and we would have seen 2.6% new business margin at last quarter. So here, you have 3.0%, so it's 40 basis points, a true mix change. And we are expecting that in the next years continue our trend to move the new business mix. Also, I told you already some time ago that we are adjusting in the U.S. the fee schedules and the expense charges to price for higher new business margin. That is now becoming visible in the Q3 numbers with a 3.8% percentage points new business margin.

And again, Spain has not only a very good growth in new business, but also with 4.8%, a great average interest rate and is producing a nice new business value.

If we have a look at the overall investment margins, the investment margin overall is 22 basis points. Our midpoint new business margin is 17 basis points a quarter. That is our expected value for each quarter. So therefore, 22 is at the upper end. So from a structural point of view, the investment portfolio and the numbers are very strong. But you can also see that the net harvesting number was negative with other equity impairments and the FX losses, but mainly coming from Germany, compensated by the policyholders. Therefore, you see a -- in the mechanics an offsetting effect, and there's a profit sharing, and the net margin for the shareholder is pretty stable. That does not mean that the policyholder are not getting anything in Germany. Actually, for the whole 9 months, the profit-sharing percentage for the policyholders is slightly higher than the year before. And duration, we are managing to a fairly high level. So we are -- continue to run our duration gap below 0.5 years, which is, I think, a good, stable evidence of our risk policy.

Now coming to the assets under management. I believe that this is the second positive story I can talk about today. PIMCO's outflows, EUR 16 billion, that is certainly, a -- substantially less than the previous quarter, so we are very well on track in the reduction of the outflows. And that is further evidenced by the October numbers. In October, we have for both asset manager achieved positive net inflows. So PIMCO has in October, since April 2013, the first positive inflow month. And Allianz Global Investors had in October another good month. Here, the quarter number for Allianz Global Investors is EUR 1.3 billion. Now the last 4 quarters, I think, they created some EUR 18 billion of net inflows. The assets under management were affected by markets. The equity markets down and also corporate bond market. It was a credit spread widening down, so 2.8% market value loss. Also, this is looking completely different in October. So therefore, we have certainly, for Asset Management, a very good start into the last quarter of the year. And we are looking forward then to the year-end results.

The revenue development for Asset Management, I'm now on 27, is 1.1% up. Here, the underlying fees and commissions are 11% down on currency adjusted. That is still driven by the outflows we have experienced over the last 4 quarters, obviously. The plus is coming from the performance fees and -- which we first booked in September. And I told you in the beginning of the year that you will see in the PIMCO operating profit a back-end loaded development, where we are expecting in the last month of the year, starting in September, a series of one-off performance fees, where we have booked the first number here in September, as just being mentioned. This -- the revenue margin are pretty flat in development. Actually, PIMCO with 39.7% in '15, and this margin excludes obviously, the performance fees. We are a tick-up against second quarter and a further tick up against the first quarter, so all a very stable development. In Allianz Global Investors, there is some more complex stories being, because we included a change beginning of the year, some advisory mandates which we included in our assets under management calculation. That is the main driver for the shift of the fee margin. When I do it on a like-for-like basis, the margin development is very unexciting, flat. So now what does this mean for the operating profits of the Asset Management space?

Clearly, when you start with last year's third quarter, the volume effects are what they are. The performance fee is the positive impact. And then we also have made in a like-on-like basis improvement in our cost-to-income ratios. When I start with Allianz Global Investors, here showing a 74.5%, but we have booked in the third quarter, EUR 34 million restructuring charge to really improve the cost-to-income ratio in the upcoming years more. And that is the first half of the restructuring charge. We will probably see in 2016 more of it. When I take out the restructuring charge, AGI was already at 68.5% cost-to-income ratio, which is since we started the setup in the current form, the best cost-to-income ratio so far, and clearly, below the 70%.

PIMCO, including performance fees, below the 60% level. But let's do a fair comparison to the second quarter and ignore the performance fees for a moment. Then we can actually see a 2 percentage point improvement against the second quarter, so no additional one-off burdens, but also, an improvement in the underlying expenses, in particular back-office administration, also out of offshore-ed outsourced services.

So overall, the EUR 600 million operating profit for the Asset Management business looks not only very good, I think with the underlying explanation, it's really hope and appetite for the future in Asset Management.

Corporate segment, pretty uneventful, flat. Nothing really specially to report on it. And then I would go to the last page of my presentation, the translation from operating profit to net income.

Clearly, additional write-downs driven by Q3 markets, that was EUR 100 million more than last year. And when we ignore the slightly complex tax treatment last year where we had -- did win with our Life business, the big court case for old tax claims. When we take this aside, our tax rate worsened by 6 percentage points compared to last year. We had last year, some tax where we realized gains. This year, we have more tax where we realized losses. And also, we have actually, a planned restructuring in Italy, where we are merging and collapsing some stockholding structures which cost us some money. Therefore, the tax rate in Q3 is higher than what we would like to see as a long-run version.

And now I'm coming to the summary. 9 months, revenues still up. Clearly, the Life volumes trending down, but I think to the benefit of shareholder and also policyholder because they are now getting the better products with the lower guarantees and higher returns.

Operating profit, flat against last year. So therefore, a very promising starting point for the last quarter of the year, where we have to expect, at least from the things we can control, less one-offs in the financial markets. It goes yo-yo around Christmas. That I cannot influence. And shareholders net income is 4% up, with -- compared to last year, with a positive outlook for the year-end operating profits. So that number should be then also, relative to last year, improve further. And we are in a very strong capital position and balance sheet position. The 200% Solvency II ratio, and we are seeing the IMAP approval shortly happening, and we are well prepared for it.
And with this one, I would stop here and look forward to your questions.

Question and Answer

Operator

[Operator Instructions] We will now take our first question from Farooq Hanif from Citigroup.

Farooq Hanif
Citigroup Inc, Research Division

Firstly -- I've got 2 questions, really, but firstly, on Life. In terms of your outlook for earnings growth, because there are 2 contradictory things going on here. So firstly, obviously, your new business sales are down a lot and -- but new business margins are sort of -- sorry, new business profit is kind of flat. But on the other hand, the IRR has gone through the roof. It's really strong. And your payback period is -- on that business, it seems to have fallen to 4 years, based on your current assumptions. So what I wanted to ask is are we kind of going into a new paradigm of halting growth for the sake of Solvency II and low interest rates and margin management? Or do you actually think if you add these 2 things together, your earnings -- reported earnings can actually grow? So that's a long question. Sorry, but question 1. And the second question, in Lat Am, you talked about the sort of delay in the turnaround progress. This feels a bit like Russia, obviously, for different reasons, different drivers, so I mean, just not high on the agenda for exiting.

Dieter F. Wemmer
CFO & Member of Management Board

Okay. So thank you very much. I think that the better IRR is coming very much because the products are consuming less risk capital, and that is clearly a driver and improvement for it. So for the customer, the products are actually more attractive, but also for the shareholder. I think we have adjusted really very well this year to the Solvency II world big time. You could argue that we maybe started later than some others, but I think we are now running a more complex strategy, not only to moving to unit-linked and risk products. Our strategy is unit-linked risk products, yes, but a big focus on the capital-light or capital-efficient products with this alternative guarantee concept which we are running now everywhere, whether it's a fixed index annuity in the U.S., and copies of these products in the German market, plus some new and innovative developments for the German markets, specifically. And that allows us actually to show the bigger IRR. That this product needs to be training with all the sales forces and also with independent financial brokers. So therefore, the volume is going down. When you say, "I don't want to give you the traditional product." I would say that it's a transition phase. I don't think it has anything to do with the product. That is now acceptance and training. And when more -- actually, in Continental Europe, it would be good for us when more market participants would copy our product strategy, because then it is becoming much easier, the market standard. And then we can -- I think with the size of our organization and advantages we have in having dealt with this product earlier, I think also, grow our market share further. Lat Am, I would not compare it with Russia at all. Russia was a structural problem of the market, which disadvantaged foreign players against local players. I cannot say the same in Brazil. I think in Brazil is an open market, and everybody who is doing the right things can be successful. And we are still believing that we can do the right thing. But the economic outlook in the country has changed quite a bit. And therefore, the transition, in particular in corporate health, but also in the motor retail, is a bit harder. Customers are really very keen to get the best price offer. And the negotiations are tougher when an economy is not doing well. And that is the main reason for the Brazilian delay. But we stick to our plans. So long-winded answer, sorry.

Farooq Hanif
Citigroup Inc, Research Division

Sorry for the long question as well. But just quickly, so are we within sight of profitability within a year, 2 years?

Dieter F. Wemmer
CFO & Member of Management Board

I think it takes a year longer than we have hoped, but I think we are turning. And still for me, Brazil, but also now, Argentina, is clearly important upside potential for next year.

Operator

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

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

It's not a real question, but I was just a bit surprised that you're cutting costs at AGI when they're doing so well. And I just wondered why that is. It's a bit of a lobbying question. I apologize for that. And then as a completely off-the-wall question, and I may misunderstand these things, since you're writing new business in Life, capital light and you're stopping the capital intensive, presumably the Life embedded value account is throwing up -- is releasing lots of free surplus. What are you doing with that money?

Dieter F. Wemmer
CFO & Member of Management Board

Yes. So AGI that -- the cutting cost exercises are mainly on back-office and administrative functions. We are actually globalizing functions we could have globalized already some time ago. Take the finance function and other back-office function. So it will not stop the great distribution and products development as well as products successes. So we do it really in a very measured basis to the benefit of both sides. The new business in Life, yes, it's -- that is the long-term idea, that the new business mix is creating a higher Solvency ratio for each of the balance sheet. That will be one of the levers we are using to improve the IFRS ROE of all our Life OEs. And exactly on this point, we will explore further on the Capital Markets Day on November 24.

Operator

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

Jonathan Michael Hocking
Morgan Stanley, Research Division

I've got 3 questions, please, firstly on capital. Given these are sort of 9-month numbers, and you've included a couple of IMAP adjustments, are these basically your Solvency II numbers, obviously, without the formal approval? That's the first question. The second question, on performance fees. Can you just comment on a little bit how much you're through that performance fees and -- I just expect more of this come through 4Q than 3Q, so I wonder how much we've got left for 4Q. Can give some guidance, please? And then just finally, just a follow-up on the Life product changes. Obviously, I hear this is a good news for ROE. I just wonder whether you need to do more in terms of expense management at some point on the back. But given that, I guess, you're not replacing the nominal profit you would be generating on traditional products with these new-style guaranteed life products?

Dieter F. Wemmer
CFO & Member of Management Board

On performance fees, certainly there is substantially more to come, but I would not guide to a specific figure because the booking and accounting of this performance fees is spread over September till January, potentially February. So how much will exactly hit 3 months, I think that is too difficult for me to estimate it precisely. And you would only shoot me afterwards when I am giving the wrong number, and I want a peaceful Christmas this year. So on Life, well, in number of policies, we are not reducing. So therefore, the admin task as such will stay the same. The new products are not less complicated, so that is not a natural source of savings. And actually, when you want to improve the IFRS result and the ROE, the risk management actions what you can take are bigger drivers than admin costs. Before you see the impact of admin costs in a Life ROE for our Continental European businesses, I think you have to send every second employee home that you see something, and that I wouldn't see possible to run the business like this. So therefore, it's -- it is a driver, but in magnitude, pretty small.

Jonathan Michael Hocking
Morgan Stanley, Research Division

And just on capital question?

Dieter F. Wemmer
CFO & Member of Management Board

Yes, the Solvency II? Yes, that is my understanding of the final approach to the approved number. Well, if there is a last-minutes incoming from the regulator, I'm not assuming it, but that is still the caveat I have officially to make.

Operator

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

Nick Holmes
Societe Generale Cross Asset Research

A couple of questions. The first is actually again on Solvency II. Dieter, I just wondered how you justify the 150% CAL coverage when, as you know, peers are on 250% and 300%. And then a different subject. I just wanted to look at Italy, and the combined ratio is exceptionally good, and I just wondered if you could explain a bit more how sustainable you think that is.

Dieter F. Wemmer
CFO & Member of Management Board

Yes. Well, I think the justification is pretty simple on the U.S. equivalents. That is the official rule communicated by EIOPA. And the German people are always very simple. They just follow rules. And -- but also for the CAL, it is a more complex concept because depending on your business mix in the U.S., 100% CAL s translated in European language quite different depending on what business you are writing. And when you look at our net asset value levels in our U.S. Life business, which are substantially higher also when you divide it, for example, by the assets of the balance sheet, you see that our capitalization in our U.S. subsidiary is substantially higher than some of the peers you have mentioned. And that is hopefully another explanation why 150% is sometimes a better number and a bigger number than 250%.

Nick Holmes
Societe Generale Cross Asset Research

Dieter, that's very interesting. Can I just follow up on that? I mean, do you think other regulators who are requiring 250% and 300% are interpreting EIOPA's 150% guidance in the same light that you described, i.e. they are looking at the quality of the CAL ratio?

Dieter F. Wemmer
CFO & Member of Management Board

I think that is clearly among the European regulators an understanding that regulation for VA in the U.S. has not moved a lot since the financial crisis, and the European regulators, still they are watching this development. And that is always -- when you have any discussion on the international capital standard between U.S. and Europe, that is the main discussion point. And therefore, the CAL, I would say, is VA-adjusted in its interpretation by the European regulators. But we all have developed a good understanding of this, and the regulators in Europe are smarter than many people believe here.

Nick Holmes
Societe Generale Cross Asset Research

But just one final question. I mean, is that interpretation entirely judgmental? Or is there any additional guidance that EIOPA is giving over how to measure the relative risks of the VA book and stuff like that? Or is it entirely up to the judgment of the Dutch regulator and the French and the British?

Dieter F. Wemmer

CFO & Member of Management Board

I think what you -- later you said is true. I'm not aware. Maybe they have an internal discussion about this and discussed it in the EIOPA board meeting together. But I am not participating in this one, so then you have to ask the regulator on this one. And the Italian combined ratio, sure, it is a really good combined ratio. And we have a strong advantage over the market since many years and quarters. So the distance to the market has not moved a lot. And we should also -- actually, we included the Unipol business in this and still the combined ratio stayed at a very excellent level. And I would expect that we still see a pressure from the motor business. But we have, for example -- when I compare it with the year ago, we have a 10 percentage point improvement in our commercial business. And so to reduce Italy to motor only, it's maybe not fair to our Italian colleagues. Plus, what I mentioned on the first page, our retail nonmotor product which we are selling, now with large number of pieces, is also contributing to a stable good combined ratio, and that effects we are managing. And I would see, yes, clearly pressure for motor in the next years but also positive in the other categories. So overall, still a very strong outlook for our Italian business.

Nick Holmes
Societe Generale Cross Asset Research

And just as a very quick follow-up. What percentage is motor of earnings would you say?

Dieter F. Wemmer
CFO & Member of Management Board

You mean in Italy?

Nick Holmes
Societe Generale Cross Asset Research

In Italy.

Dieter F. Wemmer
CFO & Member of Management Board

Around 60% premium or...

Nick Holmes
Societe Generale Cross Asset Research

60% premium, right?

Dieter F. Wemmer
CFO & Member of Management Board

Maybe a bit more because you have also the big direct business included in this year. I have to look it up. I don't know it by heart.

Operator

We will now take our next question from Andy Broadfield from Barclays.

Andrew Broadfield
Barclays PLC, Research Division

A few questions from me. So the first, just on the reserves, can you just give us a bit of a feel for where the releases are coming from, whether there's been any changes over the last few periods as to whether -- arising from whether they're fairly poorly set? And I'm also interested -- you've clearly focused on the Latin American business, Brazil, Argentina on the clean-up, and you have obviously dealt with Russia. How should we think about the temptation from outsiders to say, "Well they'll be dealt with next year and then we can improve your numbers by that amount?" But clearly, an organization like yours has things going right and wrong all the time. Do you view these as exceptional fix-it jobs, or are they just kind of run-of-the-mill -- do you view them more as run-of-the-mill from organization like yours? And then just -- and finally, on the Life -- just returning to the Life product mix shift and the hope that -- or the expectation to shift the products, is it right to assume that the profits you generate on EUR 100 of unit-linked product will be, in absolute terms, less than EUR 100 of traditional product? And therefore, when we think about absolute profitability of the new products, it is -- it should be lower than on the traditional products? Maybe you can just give us a feel for that absolute level of profits generated by those, a unit of premium.

Dieter F. Wemmer
CFO & Member of Management Board

Okay, so let's start with the reserve releases. It is really broadly distributed to many OEs. Clearly, Italy is always part of it. Our large corporate business is always part of it. [indiscernible] is always showing a positive -- a strong positive run-off, but also Spain. So actually, also one who show really this -- an excellent combined ratios, always have a process of very prudent reserving and the recycling then as one-off. So therefore, we show in these countries also a worse accident-year loss ratio maybe than some others, but that comes then back later. And you cannot have every quarter a strong positive run-off result and then not having it at the end. Well, actually, LATAM, sure, I cannot promise to you for 100% that there will be no new LATAM next year in another place of the world. I would not see it for the moment, but you can also say I didn't see Argentina a year ago. Otherwise, we would have prevented it. I'm still positive that we get LATAM moving. The Fireman's Fund story, yes, the cleaning brought actually still some more items to the surface which need to be cleaned. But the progress at Fireman's Fund is very strong and the integration is really very well working. But the Life mix change, I am inclined to say no to your question, because the new business margin is nothing else than the present value of the future profits. So the operating profit coming out of it, forget that taxes, extend the correction [ph] of the duration of the product over how many years it will emerge. So if EUR 100 of premium has the same new business margin, then it will also generate the same operating profit. Now I'll get to the more advanced calculation. You have a little bit less profit emergence on unit-linked because you have less capital charges on it, therefore, also, a smaller risk margin embedded. And so risk margin also comes up as operating profit. However, the unit-linked business is quite often attached to PIMCO or AGI funds. So we have also a profit emergence in our asset managers. So therefore, in total, taking everything into account, I would say, it's equal, plus/minus around it.

Operator

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

Vinit Malhotra

Just, Dieter, on this -- on the solvency sensitivities which seem to have changed reasonably significantly in 3Q, particularly on the credit spreads and also on the interest rates, one discussion I was having with the Investor Relations teams was it's linked to the policyholder participations, I mean, directly linked to the level of interest rates. And that is intuitive, but is this sort of a bit worrying that suddenly we have such a big impact in the sensitivities as well, so it's sort of a moving scale for us and the movement is quite high? And just any thoughts on that would be really appreciated. Then 2 more clarification questions maybe. In Korea, the understanding I had was that if interest rates worsen, it could again worsen. But you seem to suggest that the 2 portfolios which needed these charges are sort of fixed. Just could you confirm that, please? And lastly -- last question is very quick one as well, the P&C in Germany, the investment contract type of business. Now we can also see a material change in the investment income line, where the investment contract line shows up part of the net harvesting, and quite a significant change from previous quarters in history. Is it a one-off-ish effect?

Dieter F. Wemmer
CFO & Member of Management Board

In which balance sheet, sorry?

Vinit Malhotra

In the P&C investment income line, we see a -- there's always an investment line for reserves and investment contracts, and that has significantly changed in this quarter due to the minus 100, minus 50, now it's minus 8. And probably, it's linked to this AVB [ph] change. Is that sustainable?

Dieter F. Wemmer
CFO & Member of Management Board

That is sustainable is the Life book, yes.

Vinit Malhotra

So is that a sustainable effect or is it just there's no [indiscernible]?

Dieter F. Wemmer
CFO & Member of Management Board

No, no, that is a bit, also again, the compensation for the write-downs in the portfolio. That is pretty much like the German Life business, because this portfolio is actually -- in the mechanic, a smaller copy of the German Life book but within a P&C company. I think it's confusing for many people what a Life product has to do in a P&C balance sheet, but that is the way how it's started many decades ago. And in this yield environment, the products will probably not have such a brilliant future, and so -- but it is also more driven by the financial market losses in the quarter.

Vinit Malhotra

So it could normalize, okay.

Dieter F. Wemmer
CFO & Member of Management Board

Yes, yes, I wouldn't normalize it. So Korea write-down, because this is a formulaic mechanical calculation, so therefore, you can actually say with pretty high certainty that today, with today's interest rate in Korea, there will be no further write-down this year.

Vinit Malhotra

And is this a beginning-of-period point and/or end-of-period point that you measure this formula in Korea?

Dieter F. Wemmer
CFO & Member of Management Board

This is a 16-quarter rolling average. So even if the number in the last quarter moves a little bit further, the 16-quarter rolling is clearly seen, but that also tells you that it is not going away for 2016. And the solvency sensitivity, I think you spotted the right driver, that is the lower policyholder participation, but that is not driven by the market movement of 20 basis points. Yes to some extent, but we had a large share of our internal model driven by the feedback from the regulator in the summer, and that has increased, and then finally also this volatility number. So that is also a consequence of the contractions [ph] process to the final Solvency II number. So it's not that you have to now with each 20 basis points that we move further up the rope, that is not happening here.

Operator

[Operator Instructions] We will now take our next question from Michael Haid from MainFirst Bank.

Michael Hermann Haid
MainFirst Bank AG, Research Division

Two questions. First, on the payout ratio. I'm a big fan of your payout ratio of 50% on stated net profit and on the dividend continuity. And to my understanding, the 50% goes for the stated net profit. What do you do in a year when -- or if the net profit goes what you think is above the normal level? Do you adjust for one-offs, or is it just stated net profit and you try to manage down earnings in other ways? Second question, German Life business. You mentioned that the first quarter and second quarter, you had assumed lower policyholder participations. In the third quarter, it goes up. Is it that usually in the fourth quarter we see a burden in the operating -- in the IFRS operating profit from German Life, or should we expect just no seasonal impact here?

Dieter F. Wemmer
CFO & Member of Management Board

Okay. So first of all, the payout ratio is our stated policy that 50% of the net income is paid out as dividends. And we clearly said we want to stick to this dividend policy for a number of years and it was not meant as a one-off. And the result is what the result is, and of this, it will be 50%. And I tried to guide in my speech that the 4% in net income growth we have at the moment for the 9 months, that this could further improve by year-end when you also assume that the operating profit ends up higher than at year-end. That was what I tried to say, but maybe I was not successful in what I am saying. The German Life policyholder participation is actually pretty stable. We had in '14, for the full year, 83.1%. At the moment, year-to-date, it is 82.3%. So that are small movements and -- which are mainly coming also from accounting differences between local step and IFRS, which are always influencing also this number overall. In the last quarter, there are sometimes effects in the German Life operating profit coming from the true-up calculation on the ag [ph] amortization. Depending on the year -- the true-ups, I cannot tell you what would be the outcome of the true-ups this year.

Operator

We will now take our next question from Frank Kopfinger from Commerzbank.

Frank Kopfinger
Commerzbank AG, Research Division

I have 2 questions. My first question is on the 117% combined ratio at Fireman's Fund. Can you comment a little bit there on this development? Do you expect more restructuring charges there? Or should we expect even the reserve strengthening going forward here? And then my second question is overall on back-end goodwill impairments. As your Munich neighbor yesterday indicated that, especially in its German primary life business, this intense risk could be at the risk triggered by the low-yield environment. Do you see the same risk here not only at your German entity -- or entities, but maybe, broadly speaking, as we just had with the debt write-off now in Korea?

Dieter F. Wemmer
CFO & Member of Management Board

Yes, that was the question I answered before, that I do not see the Korean issue in any other balance sheet. But certainly, that is a normal regular amortization of deferred acquisition cost, because in the end, deferred acquisition cost would have an end to their lifetime. If the underlying policy is matured, the debt should be gone. That is the normal process. So therefore, there is an ongoing amortization of it. But this one-off triggered by loss recognition events, I think that is limited to Korea. And goodwill impairments, in particular in Germany, I wouldn't foresee with the strength of our balance sheet. And also, with the money and profit we are producing, our German Life business too, as a reminder, has a 15% ROE. When a 15% ROE couldn't support a goodwill, that would be a really sad economic situation.

Frank Kopfinger
Commerzbank AG, Research Division

And maybe for other international entities?

Dieter F. Wemmer
CFO & Member of Management Board

All we've -- for the third quarter, we've tested all our goodwills. There is nobody is in trouble. Fireman's Fund, sorry, I almost forgot about it. I think we still have too much expenses and infrastructure on it, and we had some cleaning of the numbers so far. So the 117% is certainly not the underlying run rate of the business. We had still not a good loss ratio there, and also the expense ratio is still too high. But in the expense ratio, we moved already to 32% now in the third quarter. And so one who remembers the story from last year, that we started in the commercial business with some 40% expense ratio. I think we have done a tremendous step forward this year. The loss ratio is mainly affected also by some clean-off, so writing off on premium receivables and things like that. So it is not that we increased loss reserves in Q3, and I would also not expect loss reserve increases in Q4.

Operator

[Operator Instructions] We will now take our next question from Paul De'Ath from RBC.

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

A couple of questions from me. Firstly, just looking at the Life new business and the ongoing shift away from traditional products, clearly, you've had great success in Germany with your kind of reduced, but still some elements of guarantee products, and the perspective, et cetera. And the fixed income annuities in the U.S. I was just wondering, in the likes of France and Italy, where unit-linked seems to be coming to the fore, is there any scope to put some of your, I guess, lower-guarantee products into those markets as well? Or are you happy to just continue down the pure unit-linked route in those markets? And the second question was just on PIMCO and the cost-to-income ratio, which is obviously showing signs of improvement. I seem to remember that during the issues that PIMCO has been having, you've been kind of increasing the level of marketing spend, et cetera. And now that PIMCO seems to be turning a corner, kind of further down the line, should we expect the expenses to start reducing again? Just a view on that would be good.

Dieter F. Wemmer
CFO & Member of Management Board

Yes, thank you for the question, Paul. I think, in France and Italy, France is now running in its new business mix in the retail space at 50% unit-linked, 50% still the traditional. We are certainly thinking of whether we, in the next years, what we call a hybrid products or fixed index annuity style, could be helpful. In Italy, we are now, I think, closer to 80% unit-linked. But also there, the fixed index annuity product is in the design phase, how we find a version which really is suited to the Italian market. We believe from the U.S. experience, and in particular with Italian expense structure, it should really create a very good product and we will certainly see how fast we can bring it to the market. PIMCO is already showing good quarter, 2 percentage point improvement in the cost-to-income ratio, and that is certainly not coming from the recovery of the revenue line. So the 2 percentage point is really a reduction of the one-off expenses but also a reduction of the expenses related to the volume. I think, all in all, we could probably see that in the back-office process, it's about 40% of the costs are variable. We still have the increased marketing costs and some other one-offs, and the retention packages as a one-off, still in the numbers. So going forward, I'm -- we are certainly -- we were already, I think, optimistic in summer about PIMCO's development, but our optimism is growing with the development at PIMCO.

Operator

We will now take our next question from William Elderkin from Goldman Sachs.

William Elderkin
Goldman Sachs Group Inc., Research Division

Three questions just back on the dividend. I just want to check if I've understood the policy correctly. In a scenario where your capital is absolutely fine but net income, for whatever reason, is down a bit year-on-year, would the sort of ambition be to keep the dividend flat when -- or would you be sort of -- allow the payout ratio to rise above 50%, if need be, or is the 50% a fixed number, if you want? And secondly, just on the very strong Italian combined ratio. I'm was -- how much of that combined ratio, if you like, is coming from the core Allianz business, and how much being impacted by the portfolio transfer from Unipol? And finally, do you have any sort of exposure to the liability risks faced by certain German car makers?

Dieter F. Wemmer

CFO & Member of Management Board

Okay, so that's an interesting new question. Yes, I did not mention the second rule of our dividend policy because I thought, when I mention it, you would all conclude on the phone that I am predicting a falling net income. So therefore, I stayed away from this. But you are right. In case that net income would be a bit smaller than the year before, we stick to the previous year dividend, which translates then into a payout ratio above 50%. That is the stated dividend policy, but I thought that could be misinterpreted when I use it. In the Italian combined ratio included are, for the Unipol business, let's say, roughly $200 million in the quarter at a combined ratio of, let's say, 94%. That's what you wanted to know. And then I -- certainly, we have a share of the D&O programs of most German carmakers. But the limit we have for our share on each policy is clearly defined. It will not create a big number when any European or U.S. corporate would come with a claim under their D&O program. And that is, I think, well maintained. Well, I think our risk management in the large corporate business, you can also see how we actually handled the Tianjin harbor claim. Our predicted loss on this is some EUR 60 million. And actually, we took very much the learnings on storage claims from the Bangkok flood event 3 years ago, where we had this surprise concentration from many European and international corporates. And we are now really much more careful on storage concentration and don't want always to be hit by unknown clash, and that is part of our overall risk strategies.

Operator

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

Andrew James Ritchie
Autonomous Research LLP

Two very quick questions. Dieter, you mentioned -- I think you mentioned that the PIMCO had positive net flows in October. Can you give us any more detail across which strategies? I'm assuming you're still seeing outflows in the traditional books, so this is presumably in the income fund? Or is there any -- is it broadly spread? Just any more color as to the nature of the flows you're seeing? With the expectation -- I think the original expectation was that you hoped that PIMCO would be breakeven flows in Q4. I guess, you're now suggesting it could be positive net flows for Q4. And my second question is just a quick one. On the expense ratio, P&C expense ratio, you talk about special effects, and this is mix changes, and obviously, the commission ratios edged up slightly. What is the Q3 expense ratio? Is that at the ongoing level or will the commission ratio continue to rise a bit? I'm not sure what the noise factors are to think about on the trajectory there.

Dieter F. Wemmer
CFO & Member of Management Board

Yes, thank you, Andrew. Well, I don't want to guide to a final number for the inflow. At PIMCO for the quarter, I have absolutely just reported about the October number. And when we analyze the development in Q3, we can actually say that we have seen already, with the customers in Asia, with the customers in Europe and Middle East and Latin America, each net positive net inflows for the quarter. So the U.S. was -- it's actually from a region, is the area where we still have seen the outflows in Q3. So that is then the area to turn around. In particular, the income funds you mentioned are really doing well. For the first 10 months, we had close to $12 billion of inflows in this fund only. So -- and our global wealth management had a very good month in October. So I think that are the main areas. And the general information I would give to you without now really going into the full autonomy of the October numbers. Your other question was on the expense ratio. I would say there was some special effect in Q3 on the admin expense ratio, which will normalize in Q4. The acquisition expense ratio, that development is probably not reverting as our fastest-growing areas -- other areas with higher commission rates.

Andrew James Ritchie
Autonomous Research LLP

So net-net, it should stay around this level then?

Dieter F. Wemmer

CFO & Member of Management Board

Well, in admin, maybe 20, 30 basis points down.

Andrew James Ritchie
Autonomous Research LLP

Okay. But I guess, the commission ratios could still edge up a bit further, it sounds like.

Dieter F. Wemmer
CFO & Member of Management Board

Yes.

Operator

[Operator Instructions] We'll now take our final question from Michael Huttner from JPMorgan.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

It's -- so there was a -- a few hours ago, there was a big mine flood disaster thing in Brazil, and so -- is there any exposure to that? And aligned to that, can you say a little bit more about the trend in large losses? It's just that one of your competitors clearly has issues with that, and just a bit of reassurance would be lovely.

Dieter F. Wemmer
CFO & Member of Management Board

Michael, I was the whole day in communication, so therefore, I don't know what has happened in Brazil and in the mining industry there. So therefore, I can for sure not comment on this. But I believe I mentioned that our accident-year loss ratio has 50 basis points increase in Q3 from large losses, and that is well distributed across many. So it is a -- I would still consider it as a small uptick, nothing really special.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Okay. So no special actions and no...

Dieter F. Wemmer
CFO & Member of Management Board

No, no, cleaning up of portfolios.

Thank you. Then I thank you all for dialing into the call and for participating proactively with your questions. And I hope I see all of you at our Capital Markets Day, which is, Oliver, on...

Oliver Schmidt
Head of Investor Relations

On November 24. Yes. Good bye from my side as well, and we wish you all a very relaxed weekend. Thank you.

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