Business Operations

Allianz Group structure

Allianz SE and its subsidiaries (the Allianz Group) offer property-casualty insurance, life/health insurance and asset management products and services in over 70 countries, with the largest of our operations located in Europe. The Allianz Group insures 86.3 million customers. Allianz SE, the parent company of the Allianz Group, has its headquarters in Munich, Germany.

The Allianz Group structure reflects both our business segments and geographical regions. Business activities are organized by product and type of service, based on how these are strategically managed: insurance activities, asset management activities, and corporate and other activities. Due to differences in the nature of products, risks, and capital allocation, insurance activities are further divided into property-casualty and life/health categories. In accordance with the responsibilities of the Board of Management, each of the insurance categories is grouped into regional reportable segments. Corporate and other activities are divided into three different reportable segments in order to differentiate between the respective products, risks, and capital allocation. In 2016, the Allianz Group had 16 reportable segments.

ALLIANZ GROUP STRUCTURE – BUSINESS SEGMENTS AND REPORTABLE SEGMENTS

PROPERTY-CASUALTY	LIFE/HEALTH
– German Speaking Countries and Central & Eastern Europe – Western & Southern Europe, Middle East, Africa, India – Iberia & Latin America – Global Insurance Lines & Anglo Markets – Asia Pacific – Allianz Worldwide Partners	– German Speaking Countries and Central & Eastern Europe – Western & Southern Europe, Middle East, Africa, India – Iberia & Latin America – Global Insurance Lines & Anglo Markets – Asia Pacific – USA
ASSET MANAGEMENT	**CORPORATE AND OTHER**
– Asset Management	– Holding & Treasury – Banking – Alternative Investments

Insurance operations

We offer a wide range of property-casualty and life/health insurance products to both retail and corporate customers. For the Property-Casualty business segment, these include motor, accident, property, general liability, travel insurance and assistance services; the Life/Health business segment offers savings and investment-oriented products in addition to life and health insurance. We are the leading property-casualty insurer worldwide and rank among the top five in the life/health insurance business. Our key markets (in terms of premiums) are Germany, France, Italy, and the United States.

Most of our insurance markets are served by local Allianz companies. However, some business lines – such as Allianz Global Corporate & Specialty (AGCS), Allianz Worldwide Partners (AWP) and Credit Insurance – are run globally.

Asset Management

Our two major investment management businesses, PIMCO and AllianzGI, operate under Allianz Asset Management (AAM). We are one of the largest asset managers in the world that actively manage assets. Our offerings cover a wide range of equity, fixed income, and alternative investment products and solutions. Our core markets here are the United States, Germany, France, Italy, the United Kingdom, and the Asia-Pacific region.

Corporate and Other

The Corporate and Other business segment's activities include the management and support of the Allianz Group's businesses through its central holding functions, as well as Banking and Alternative Investments.

HOLDING & TREASURY

Holding & Treasury manages and supports the Group's businesses through its strategy, risk, corporate finance, treasury, financial reporting, controlling, communication, legal, human resources, technology, and other functions.

BANKING

Our banking operations, which place a primary focus on retail clients, support our insurance business and complement the products we offer in Germany, Italy, France, the Netherlands, and Bulgaria.

ALTERNATIVE INVESTMENTS

Alternative Investments provides global alternative investment management services in the private equity, real estate, renewable energy, and infrastructure sectors, mostly on behalf of our insurance operations.

Worldwide presence and business segments

MARKET PRESENCE OF OUR BUSINESS OPERATIONS[1]

INSURANCE WESTERN & SOUTHERN EUROPE, INSURANCE MIDDLE EAST, AFRICA, INDIA

Property-Casualty	Life/Health	Banking	
			Europe
■	■	■	Italy
■	■		Greece
■	■		Turkey
■	■	■	France
■	■		Belgium
■	■	■	The Netherlands
■	■		Luxembourg
			Middle East and North Africa
■	■		Egypt
■	■		Lebanon
■	■		Saudi Arabia
			Africa
■			Benin
■	■		Burkina Faso
■	■		Cameroon
■			Central Africa
■			Congo Brazzaville
■			Ghana
■	■		Ivory Coast
■	■		Kenya
■	■		Madagascar
■			Mali
■			Morocco
■	■		Senegal
■			Togo
■	■		India

INSURANCE IBERIA & LATIN AMERICA

Property-Casualty	Life/Health	Banking	
			Iberia
■	■		Spain
■	■		Portugal
			Latin America
■			Argentina
■			Brazil
■	■		Colombia
■	■		Mexico

INSURANCE GERMAN SPEAKING COUNTRIES, INSURANCE CENTRAL & EASTERN EUROPE

Property-Casualty	Life/Health	Banking	
			German Speaking Countries
■	■	■	Germany[2]
■	■		Austria
■	■		Switzerland
			Central & Eastern Europe
■	■	■	Bulgaria
■	■		Croatia
■	■		Czech Republic
■	■		Hungary
■	■		Poland
■	■		Romania
■	■		Slovakia

US LIFE INSURANCE

Property-Casualty	Life/Health	
	■	United States

GLOBAL INSURANCE LINES & ANGLO MARKETS

Property-Casualty	Life/Health	
■		United Kingdom
■	■	Australia
■		Ireland
■		Allianz Global Corporate & Specialty
■		Credit Insurance
■	■	Reinsurance
■	■	Russia
■		Ukraine

ALLIANZ WORLDWIDE PARTNERS

Property-Casualty	Life/Health	
■	■	Allianz Worldwide Partners

INSURANCE ASIA PACIFIC

Property-Casualty	Life/Health	
■		Brunei[3]
■	■	China
■		Hong Kong[3]
■	■	Indonesia
■		Japan[3]
■		Laos
■	■	Malaysia
	■	Pakistan
	■	Philippines
■		Singapore[3]
■	■	Sri Lanka
	■	Taiwan
■	■	Thailand

ASSET MANAGEMENT

Retail Asset Management	Institutional Asset Management	
		North and Latin America
■	■	United States
■	■	Canada
■	■	Brazil
		Europe
■	■	Germany
■	■	France
■	■	Italy
■	■	Ireland
■	■	Luxembourg
■	■	Spain
■	■	Switzerland
■	■	Belgium
■	■	The Netherlands
■	■	United Kingdom
■	■	Sweden
		Asia Pacific
■	■	Japan
■	■	Hong Kong
■	■	Taiwan
■	■	Singapore
■	■	South Korea[4]
■	■	China
■	■	Australia

■ Property-Casualty ■ Life/Health ■ Banking ■ Retail Asset Management ■ Institutional Asset Management

1 — This overview is based on our organizational structure in place as of 31 December 2016.
2 — Oldenburgische Landesbank AG in Germany is classified as “held for sale”.
3 — Property-Casualty business belongs to Allianz Global Corporate & Specialty.
4 — Classified as “held for sale”.

Our steering

BOARD OF MANAGEMENT AND ORGANIZATIONAL STRUCTURE

Allianz SE has a divisional Board structure based on functional and business responsibilities. Business-related divisions reflect our business segments Property-Casualty, Life/Health, Asset Management, and Corporate and Other, and in 2016 were overseen by five Board members. The remaining four divisions (i.e. Chairman of the Board of Management, Finance, Investments, and Operations) focus on Group functions, along with business-related responsibilities.

For further information on Board of Management members and their responsibilities, please refer to Mandates of the Members of the Board of Management starting on page 12.

TARGET SETTING AND MONITORING

The Allianz Group steers its operating entities and business segments via an integrated management and control process. It begins with the definition of a business-specific strategy and goals, which are discussed and agreed upon between the Holding and operating entities. Based on this strategy, our operating entities prepare three-year plans which are then aggregated to form the financial plans for the business divisions and for the Allianz Group as a whole. This plan also forms the basis for our capital management. The Supervisory Board approves the plan and sets corresponding targets for the Board of Management. The performance-based remuneration of the Board of Management is linked to short-term, mid-term, and long-term targets to ensure effectiveness and emphasize sustainability. For further details about our remuneration structure, including target setting and performance assessment, please refer to the Remuneration Report starting on page 24.

We continuously monitor our business performance against these targets through monthly reviews – which cover key operational and financial metrics – to ensure we can move quickly and take appropriate measures in the event of negative developments. The Allianz Group uses operating profit and net income as key financial performance indicators across all its business segments. Other indicators include segment-specific figures, such as the combined ratio for Property-Casualty, return on equity[1] for Life/Health, and the cost-income ratio for Asset Management. To steer and control new business in our business segments Property-Casualty and Life/Health, we use Return on Risk Capital (RoRC). For a comprehensive view of our business segment performance, please refer to the chapters from page 39 onwards.

Besides performance steering, we also have a risk steering process in place, which is described in the Risk and Opportunity Report starting on page 62.

Non-financial key performance indicators (KPIs) are mainly used for the sustainability assessment that we conduct when determining mid-term bonus levels. In line with our Renewal Agenda, KPIs mainly represent three key levers: True Customer Centricity, Digital by Default, and Inclusive Meritocracy. Examples include the Allianz Engagement Survey and Net Promoter Score (NPS[2]) results, diversity development, and the share of digital retail products/digital client communication.

1 — Excluding unrealized gains/losses on bonds net of shadow accounting.
2 — NPS is a measurement of customers’ willingness to recommend Allianz. Top-down NPS is measured regularly according to global cross-industry standards and allows benchmarking against competitors in the respective markets.

Our Corporate Responsibility approach

As an international financial services company, we find it vital to ensure that our growth is both sustainable and profitable. We want to create long-term value by strategically embedding sustainability in our core business and by enabling our customers to address tomorrow's challenges. This requires us to continually adapt our business strategy in response to our stakeholders' and working partners' needs, to the most pressing sustainability issues, and to the activities of national and international sustainability bodies and initiatives, in order to deliver on global commitments such as the United Nations Sustainable Development Goals.

Our Corporate Responsibility Strategy contributes to our Renewal Agenda and focuses on our most material sustainability issues:

Low-carbon economy: supporting renewable energy and decarbonization through our investments; providing green insurance solutions; reducing our environmental footprint.

Social inclusion: supporting the social inclusion of children and youth through our Future Generations program; developing solutions for customers in emerging markets; promoting diversity and wellbeing among our employees.

Business integrity: integrating environmental, social and governance (ESG) issues across our investment and insurance businesses; building trust through transparency, responsible sales, and data privacy.

In 2016, we surveyed over 6,000 stakeholders to identify our most material issues as well as the relative importance of the solutions we provide. The results show that the most important megatrends and risks Allianz faces across those target groups and countries surveyed are climate change & environment, personal customer safety, digitalization, societal change, and fiscal crisis. We will continue to integrate our stakeholders' views in both our sustainability strategy and our reporting approach.

For reporting purposes, we organize our approach around Allianz's five key roles as sustainable insurer, responsible investor, trusted company, attractive employer, and committed corporate citizen.

Please refer to our 2016 Group Sustainability Report (to be published on 5 April 2017) for full details of our corporate responsibility strategy, approach and performance: **www.allianz.com/sustainability.**

Business Environment

Economic environment 2016[1]

In 2016 the global economy proved to be remarkably resilient in the face of heightened political and economic uncertainty. Neither concerns about a slowdown of the Chinese economy, which prompted some turmoil on the equity markets in early 2016, nor major political surprises – including the outcome of the Brexit vote in June and the U.S. presidential elections in November – managed to derail the global economy from its moderate growth path. Compared with 2015, economic growth in the industrialized countries decelerated in 2016. Real gross domestic product rose by 1.6 % (2015: 2.1 %). In the United States, the loss in economic momentum in 2016, compared to the average pace in the current cycle, primarily reflects weakness in business investment. By contrast, private consumption continued to grow robustly. In the Eurozone, the economic recovery continued, albeit at a slightly slower pace than in 2015. Real gross domestic product expanded by 1.7 % (2015: 1.9 %). Private consumption was supported by both low inflation and a gradual labor market improvement. With an increase of 1.9 %, the German economy recorded a slightly higher growth rate than the Eurozone as a whole.

In the emerging markets, growth deceleration finally came to an end in the course of 2016. Commodity-exporting emerging markets benefited from the uptick in commodity prices. Most Eastern European E.U. member states continued to benefit from the ongoing recovery in the Eurozone. Russia saw its economy stabilizing, following a severe recession in 2015. Thanks primarily to fiscal stimulus, China's growth decelerated only marginally from 6.9 % in 2015 to 6.7 % in 2016. As a whole, the emerging-market group expanded by a rather disappointing 3.6 % – the same rate as in 2015 and well below the long-term average of roughly 5.5 % per year. Overall, the world economy grew by an estimated 2.4 %, somewhat slower than in 2015, when global output rose by 2.7 %. Global merchandise trade registered its lowest growth rate since the Great Recession in 2009: less than 1 %. The pace of globalization in merchandise trade has evidently abated considerably.

Financial market developments in 2016 continued to be characterized by very low interest rates, a strong U.S. Dollar, and relatively low stock-market volatility – the latter despite high political uncertainty. In the United States, the Federal Reserve raised the target federal funds rate to 0.50 % – 0.75 % in December; this was its second move since ending the zero-interest policy in late 2015. By contrast, the European Central Bank continued to ease its monetary policy stance with a bundle of measures, including the extension of the bond purchasing program at least until the end of 2017. Yields on 10-year German government bonds reached 0.2 % at year-end 2016, a decrease of 40 basis points compared to the previous year. Major stock-market indices, following a negative start, registered gains in the course of 2016. The Euro lost further ground against the U.S. Dollar, closing the year at 1.05 U.S. Dollar to Euro – almost 4 % below the level seen at the beginning of 2016. The diverging monetary policies of the Federal Reserve and the European Central Bank were a key factor behind this downward correction. In terms of portfolio flows, emerging markets had a difficult year: net non-resident capital inflows to bond and equity markets fell below USD 28 BN – the lowest annual inflow since 2008 –, which was mainly due to rising U.S. yields.

Business environment 2016 for the insurance industry

2016 was an eventful year for the insurance industry, with most of these events having more downsides than upsides. The macroeconomic environment presented significant headwinds: the recovery of the world economy continued, but with reduced momentum. 2016 also marked the end of a three-year streak of relatively low losses from natural catastrophes: Not only did the number of events increase further – among them an unusually high number of flood events – but losses jumped to levels more than 50 percent higher than the previous year's. On the regulatory front, the industry as a whole managed to adjust smoothly to the new Solvency II regime which had come into force as of 2016. Regulatory pressure remained high, however, in particular with regard to reserve requirements, stress testing, or reporting.

And these are only the macroeconomic challenges. Even more daunting were events in the microeconomy, first and foremost the digital revolution. Not only will digitization, big data, and artificial intelligence fundamentally transform the industry – in addition, highly connected technologies have begun to cause a radical shift in the nature of risks faced by society. As a result, the industry is confronted with new demands: It has to find new solutions that allow people to take new risks – for example in the sharing economy – and also promote the use of new technologies. So, in the short term, the need to innovate and adjust its current business model will put additional pressure on the industry. In the longer run, however, the digital economy should offer plenty of opportunities to expand the business, as is already exemplified by the rapid rise in cyber-insurance (albeit from a very low base). Against this backdrop of macro- and micro-challenges, the industry proved remarkably resilient in 2016. Premium income was more or less stable; profitability was under pressure but dropped just a notch or two.

In the ***property-casualty sector,*** premium growth decelerated slightly in advanced markets, reflecting some weaknesses in Japan and North America. Western Europe, on the other hand, kept more or less pace thanks to the ongoing economic recovery, but overall the market remained rather weak. As in the past, premiums grew much faster in the emerging markets, driven by a robust growth in Asia. The other two major emerging regions fared quite differently: Whereas the slowdown in Latin America continued in 2016, Eastern Europe showed clear signs of a recovery. Pricing continued to be a concern in nearly all markets, particularly in the commercial insurance segment. Premiums, overall and at a global level, rose by an estimated 4 % in 2016 (in nominal terms and adjusted for foreign currency translation effects).

1 — At the date of the publication of this report, not all general market data for the year 2016 used in the chapter Business Environment was final. Furthermore, the information provided in this chapter is based on our own estimates.

Underwriting profitability suffered from more frequent and more costly natural catastrophes, such as the Kumamoto Earthquake in Japan, severe storms and floods in Germany and France, and Hurricane Matthew in the United States. Insurers' investment income remained weak as investment returns were challenged by very low interest rates. As a result, overall profitability is likely to have slipped marginally in 2016.

In the ***life sector,*** premium growth was very strong in emerging markets or, more precisely, in emerging Asian markets: Life premiums rose by more than 20 percent there, mainly due to the extraordinary growth experienced in the Chinese market. The other two emerging regions show a totally different picture: Premium growth in Latin America flattened, reflecting the economic troubles of its biggest market, Brazil; Eastern Europe remained in the doldrums, not least due to changes in the tax regime for life products in some key markets. For advanced markets, too, 2016 proved to be a rather difficult year. Premium growth slowed – or even turned negative – in many markets as the ongoing low-yield environment continued to pose problems for the savings-type core insurance business. In total, according to our own estimates, global premiums grew by almost 5 % in 2016 (in nominal terms and adjusted for foreign currency translation effects).

The current low-yield environment also presented the greatest challenge in the life sector, impairing the profitability of in-force business. Insurers responded by continuing to shift the product mix towards less capital-intensive products, for example by offering lower or more flexible guarantees. At the same time, the focus moved from traditional savings to protection business. To boost investment income, insurers increasingly turned to non-traditional investments such as infrastructure. These actions notwithstanding, overall profitability is likely to have drifted downward slightly.

Business environment 2016 for the asset management industry

This was a disruptive year for the asset management industry. Global equity markets started 2016 with a sharp drop, then made a broad recovery in the following months. Emerging-market and U.S. equities finished the year particularly strong; European indices lagged a bit and exhibited higher volatility, particularly after the Brexit vote, but still finished the year in positive territory.

Continued accommodative monetary policy across major economies led to falling yields and rising bond prices through most of the year. This resulted in very strong returns for bond indices in both Europe and the United States – until the results of the U.S. election sent yields soaring, as prospects of a more supportive fiscal policy and a tightening labor market raised inflation expectations. There was also some spill-over into the Eurozone, causing yields to rise late in the year, albeit to a lesser extent than in the United States. Bond indices in both the United States and Europe still finished the year with positive returns.

Currencies proved highly volatile during the year, with the British Pound weakening significantly after the Brexit vote. The U.S. Dollar strengthened markedly after the U.S. election and a subsequent spike in yields.

The shift in investor preference towards passively managed funds continued throughout 2016 and was especially pronounced in the United States, where active equity mutual funds were particularly hard-hit. Actively managed taxable bond mutual funds in the United States finished the year with positive flows, but were also notably outstripped by their passive counterparts. Investors showed a general preference for bonds over actively managed equities most of the year, though this trend reversed towards year-end as yields rose and U.S. equity markets rallied following the election. European investors directed flows predominately into active fixed income funds and to a lesser extent into passive equity and fixed income products.

Executive Summary of 2016 Results

Key figures

KEY FIGURES ALLIANZ GROUP[1]

		2016	2015	Delta
Total revenues[2]	€ MN	122,416	125,190	(2,774)
Operating profit[3]	€ MN	10,833	10,735	98
Net income[3]	€ MN	7,250	6,987	263
thereof: attributable to shareholders	€ MN	6,883	6,616	267
Solvency II capitalization ratio[4,5,6]	%	218	200	18 %-p
Return on equity[7]	%	12.0	12.5	(0.5) %-p
Earnings per share	€	15.14	14.56	0.58
Diluted earnings per share	€	15.00	14.55	0.45

Earnings summary

MANAGEMENT'S ASSESSMENT OF 2016 RESULTS

Our *total revenues* decreased by 2.2 % this past business year, a drop of 0.8 % on an internal basis[8] compared to 2015. Much of this decrease was attributable to our Life/Health business segment, where we continued our targeted shift towards preferred lines of business. Both lower other net fee and commission income, mainly due to lower third-party assets under management-driven margins, and a decrease in performance fees in our Asset Management business segment further contributed to the decline. Our Property-Casualty business segment enjoyed internal premium growth, mainly arising from Turkey, Germany and Allianz Worldwide Partners.

Our *operating investment result* increased by € 692 MN to € 25,125 MN, mainly due to gains from the net of foreign currency translation effects and financial derivatives, with the latter being used to protect against equity and foreign currency fluctuations as well as to manage duration and other exposures related to interest rates. This was partly offset by lower interest and similar income, driven by the low interest rates.

Our *operating profit* was near the upper end of our 2016 target range and increased by 0.9 % compared to 2015. Our Life/Health business segment recorded an increase in operating profit, mainly due to a higher investment margin in the United States as well as favorable DAC unlocking effects in France. The operating result in our Corporate and Other business segment also improved, primarily as a result of lower pension costs. The operating profit generated by our Property-Casualty business segment declined, reflecting the impact of lower interest yields on our investment result. In addition, 2015 included a € 0.1 BN net gain (net of related expenses and restructuring charges) from the sale of the Fireman's Fund personal insurance business. The business segment's underwriting result, however, improved. In our Asset Management business segment, a reduction in operating expenses could only partially compensate for lower operating revenues, resulting in a decline in operating profit.

Our *non-operating result* was stable at a loss of € 541 MN, with a number of offsetting effects. On the one hand we had significant impairments (net), partly due to the impairment losses on our South Korean Life/Health business as well as on the Oldenburgische Landesbank AG[9] upon classification as held for sale at the beginning of the second quarter of 2016 and end of 2016, respectively. In addition, the negative result that the South Korean Life/Health business generated until its disposal in the fourth quarter of 2016 was considered as non-operating, as it is no longer part of the ongoing core operations of the Allianz Group[9]. On the other hand, non-operating realized gains (net) increased following portfolio rebalancing. We also reported higher non-operating income from financial assets and liabilities carried at fair value through income (net), mainly due to favorable impacts from hedging-related activities.

Income taxes fell by € 167 MN to € 3,042 MN, mainly driven by higher tax-exempted income. The effective tax rate decreased to 29.6 % (2015: 31.5 %).

The increase in our *net income* was driven by the higher operating profit and lower effective tax rate.

Our *shareholders' equity* rose by € 4.2 BN to € 67.3 BN, compared to 31 December 2015. Over the same period our Solvency II capitalization ratio strengthened from 200 % to 218 %.

For a more detailed description of the results generated by our business segments – specifically, Property-Casualty insurance operations, Life/Health insurance operations, Asset Management, and Corporate and Other – please consult the respective chapters on the following pages.

1 — For further information on Allianz Group figures, please refer to note 5 to the consolidated financial statements.
2 — Total revenues comprise statutory gross premiums written in Property-Casualty and Life/Health, operating revenues in Asset Management, and total revenues in Corporate and Other (Banking).
3 — The Allianz Group uses operating profit and net income as key financial indicators to assess the performance of its business segments and of the Group as a whole.
4 — Figures as of 31 December.
5 — Changed regulatory tax treatment of German life sector reduced our year-end Solvency II capitalization ratio from 200 % to 196 % on 1 January 2016.
6 — Risk capital figures are group diversified at 99.5 % confidence level. Allianz Life US included based on third country equivalence with 150 % of RBC CAL since 30 September 2015.
7 — Represents the ratio of net income attributable to shareholders to the average shareholders' equity, excluding unrealized gains/losses on bonds, net of shadow accounting, at the beginning of the year and at the end of the year.
8 — Internal total revenue growth excludes the effects of foreign currency translation as well as acquisitions and disposals. Please refer to page 60 for a reconciliation of nominal total revenue growth to internal total revenue growth for each of our business segments and the Allianz Group as a whole.
9 — For further information on the impairment loss on the Oldenburgische Landesbank AG, and the disposal of Allianz Life Insurance Co. Ltd., Seoul, please refer to note 4 to the consolidated financial statements.

Other information

During the year ended 31 December 2016, the Allianz Group disposed of its South Korean Life/Health business (Allianz Life Insurance Co. Ltd., Seoul), a 100 % owned subsidiary of the Allianz Group. The entity had been classified as held for sale since the beginning of the second quarter of 2016. The entity was deconsolidated on 30 December 2016.

At the end of the fourth quarter of 2016, all requirements were fulfilled to present Oldenburgische Landesbank AG, Oldenburg, as a disposal group. Thus, the assets and liabilities of this consolidated entity, which are allocated to the reportable segment Banking (Corporate and Other), were classified as held for sale.

For further information please refer to note 4 to the consolidated financial statements.

Other parts of the Group Management Report

The following information also forms part of the Group Management Report:

- Statement on Corporate Management pursuant to § 315 (5) and § 289a of the HGB starting on page 19,
- Takeover-related Statements and Explanations starting on page 21, and the
- Remuneration Report starting on page 24.

Property-Casualty Insurance Operations

Key figures

KEY FIGURES PROPERTY-CASUALTY[1]

		2016	2015	Delta
Gross premiums written	€ MN	51,535	51,597	(62)
Operating profit	€ MN	5,370	5,603	(233)
Net income	€ MN	4,158	4,124	34
Loss ratio[2]	%	65.6	66.2	(0.5) %-p
Expense ratio[3]	%	28.7	28.4	0.2 %-p
Combined ratio[4]	%	94.3	94.6	(0.3) %-p

Gross premiums written[5]

On a nominal basis, ***gross premiums written*** were almost stable compared to 2015.

Unfavorable foreign currency translation effects amounted to € 1,138 MN, largely due to the depreciation of the British Pound, the Argentine Peso, and the Turkish Lira against the Euro.[6]

Consolidation/deconsolidation effects were negative, amounting to € 519 MN. This was largely attributable to the sale of the Fireman's Fund personal insurance business to ACE limited in 2015.

On an internal basis, our growth was strong at 3.1 % driven by a positive volume effect of 2.0 % and a positive price effect of 1.1 %.

The following operations contributed positively to internal growth:

Turkey: Gross premiums reached € 1,695 MN. The internal growth of 43.0 % was driven by positive volume and price contributions in our motor third-party liability insurance business.

Germany: We recorded gross premiums of € 9,902 MN, an increase of 2.8 % on an internal basis. This was mainly due to favorable price effects in our motor insurance business, and supported by favorable volume effects in our non-motor commercial insurance business.

Allianz Worldwide Partners: Gross premiums increased to € 4,185 MN. The internal growth of 4.7 % was mainly driven by our U.S. travel business and our assistance business in France.

AGCS: Gross premiums stood at € 7,592 MN. The internal growth of 0.5 % was largely generated by positive volume effects at Allianz Risk Transfer, much of which was offset by negative price impacts across both our corporate and specialty lines of business.

1 — For further information on Allianz Property-Casualty figures, please refer to note 5 to the consolidated financial statements.
2 — Represents claims and insurance benefits incurred (net), divided by premiums earned (net).
3 — Represents acquisition and administrative expenses (net), excluding one-off effects from pension revaluation divided by premiums earned (net).
4 — Represents the total of acquisition and administrative expenses (net), excluding one-off effects from pension revaluation, and claims and insurance benefits incurred (net) divided by premiums earned (net).
5 — We comment on the development of our gross premiums written on an internal basis, which means figures have been adjusted for foreign currency translation and (de-)consolidation effects in order to provide more comparable information.
6 — Based on the average exchange rates in 2016 compared to 2015.

The following operations contributed negatively to internal growth:

Italy: Gross premiums were at € 4,572 MN, a decline of 3.9 % on an internal basis. Main drivers were negative price and volume effects in our motor insurance business.

United Kingdom: Gross premiums amounted to € 2,623 MN, a decline of 3.6 % on an internal basis. Positive price developments in our retail motor and pet insurance businesses were more than offset by negative volume effects, mostly in our retail motor insurance business.

Credit Insurance: We recorded gross premiums of € 2,200 MN, a decline of 0.5 % on an internal basis. This decrease resulted from negative price and volume effects mainly in Germany and Asia.

Operating profit

OPERATING PROFIT
€ MN

	2016	2015	Delta
Underwriting result	2,354	2,281	73
Operating investment income (net)	2,971	3,138	(167)
Other result[1]	45	184	(139)
Operating profit	**5,370**	**5,603**	**(233)**

1 — Consists of fee and commission income/expenses, other income/expenses, and restructuring charges.

The decrease in ***operating profit*** was mainly driven by the expected decline in investment result due to the current low-yield environment. Furthermore, our 2015 operating profit had included a € 0.1 BN net gain (net of related expenses and restructuring charges) from the sale of the Fireman's Fund personal insurance business.

Our ***underwriting result*** increased thanks to a higher contribution from run-off as well as lower losses from natural catastrophes and weather-related events, compared to 2015, resulting in an improvement in our ***combined ratio.***

UNDERWRITING RESULT
€ MN

	2016	2015	Delta
Premiums earned (net)	46,588	46,430	159
Accident year claims	(32,661)	(32,646)	(15)
Previous year claims (run-off)	2,084	1,924	160
Claims and insurance benefits incurred (net)	(30,576)	(30,721)	145
Acquisition and administrative expenses (net), excluding one-off effects from pension revaluation	(13,352)	(13,208)	(144)
Change in reserves for insurance and investment contracts (net) (without expenses for premium refunds)[1]	(306)	(220)	(86)
Underwriting result	**2,354**	**2,281**	**73**

1 — Consists of the underwriting-related part (aggregate policy reserves and other insurance reserves) of "change in reserves for insurance and investment contracts (net)". For further information, please refer to note 28 to the consolidated financial statements.

Our ***accident year loss ratio*** stood at 70.1 % – a 0.2 percentage point improvement compared to the previous year. It was driven by a slight decrease in losses from natural catastrophes from € 738 MN to € 689 MN, representing a reduced combined ratio impact from 1.6 percentage points in 2015 to 1.5 percentage points in 2016.

Excluding losses from natural catastrophes, our accident year loss ratio improved to 68.6 %. This was predominantly due to a combination of lower losses from weather-related events and profitability programs we conducted across the Allianz Group.

The following operations contributed positively to the development of our accident year loss ratio:

United Kingdom: 0.2 percentage points. The accident year loss ratio benefited from a very low impact of natural catastrophes in 2016.

AGCS: 0.1 percentage points. The improvement stemmed from lower losses in the property and marine lines of business, while lower large losses were offset by higher natural catastrophes compared to 2015.

Spain: 0.1 percentage points. This was driven by portfolio cleaning actions in loss making lines of business and price increases across the portfolio.

The following operation contributed negatively to the development of our accident year loss ratio:

France: 0.2 percentage points. The deterioration was driven by a combination of higher large losses as well as higher losses from natural catastrophes compared to the previous year.

The higher *run-off result* led to an increased run-off ratio amounting to 4.5 % (2015: 4.1 %), driven by reserve releases across most of the portfolio. In particular France and Australia delivered more run-off compared to the prior year, due to a beneficial development in their long tail business.

The increase in our *expense ratio* was driven, in equal parts, by a higher acquisition ratio and a higher administrative expense ratio.

OPERATING INVESTMENT INCOME (NET)[1]
€ MN

	2016	2015	Delta
Interest and similar income (net of interest expenses)	3,391	3,576	(185)
Operating income from financial assets and liabilities carried at fair value through income (net)	(23)	(25)	3
Operating realized gains/losses (net)	285	252	33
Operating impairments of investments (net)	(51)	(59)	8
Investment expenses	(376)	(365)	(11)
Expenses for premium refunds (net)[2]	(255)	(240)	(15)
Operating investment income (net)	**2,971**	**3,138**	**(167)**

1 — The operating investment income (net) of our Property-Casualty business segment consists of the operating investment result – as shown in note 5 to the consolidated financial statements – and expenses for premium refunds (net) (policyholder participation).
2 — Refers to policyholder participation, mainly from APR (accident insurance with premium refunds) business, and consists of the investment-related part of "change in reserves for insurance and investment contracts (net)". For further information, please refer to note 28 to the consolidated financial statements.

Our *operating investment income (net)* declined, mainly due to lower interest and similar income, essentially driven by debt securities as a result of the low yield environment.

OTHER RESULT
€ MN

	2016	2015	Delta
Fee and commission income	1,527	1,474	54
Other income	21	232	(211)
Fee and commission expenses	(1,407)	(1,367)	(40)
Other expenses	(3)	(6)	3
Restructuring charges	(94)	(149)	55
Other result	**45**	**184**	**(139)**

In 2015 we recorded a € 0.1 BN net gain (net of related expenses and restructuring charges) from the sale of the Fireman's Fund personal insurance business.

Net income

Net income increased, driven by a higher non-operating result, which benefited from the absence of negative effects from pension revaluation and an increase in the non-operating investment result, thus offsetting the decline in operating profit.

Life/Health Insurance Operations

Key figures

KEY FIGURES LIFE/HEALTH[1]

		2016	2015	Delta
Statutory premiums[2]	€ MN	64,636	66,903	(2,267)
Operating profit[3]	€ MN	4,148	3,796	352
Net income	€ MN	2,581	2,621	(40)
Return on equity[4]	%	10.3	10.8	(0.5) %-p

At the beginning of the second quarter of 2016, all requirements were fulfilled to present our South Korean business – until its disposal in the fourth quarter of 2016 – as held for sale. Consequently, the negative result of € 268 MN that the South Korean business generated was considered as non-operating, as the entity is no longer part of our ongoing core operations. In order to better reflect the true underlying drivers of our operating profit, we report it by profit sources and by lines of business for both 2015 and 2016 excluding South Korea, and specify the South Korean operating loss as a separate item.

Similarly, the figures for present value of new business premiums are shown without effects from the South Korean business.

To ensure consistency with the group income statement, however, statutory premiums are presented including premiums collected from our South Korean business.

Statutory premiums[5]

On a nominal basis, *statutory premiums* went down by 3.4 %. This includes unfavorable foreign currency translation effects of € 347 MN and positive (de-)consolidation effects of € 138 MN.

On an internal basis[5], statutory premiums dropped by € 2,058 MN – or 3.1 % – to € 64,947 MN, mainly due to lower unit-linked single premiums in Italy and Taiwan as well as declining traditional business both in Germany and Italy. The increase in our fixed-indexed and non-traditional variable annuity sales in the United States and the premium growth in capital-efficient products in Germany partly compensated for this development. In line with our changed product strategy, premiums continued to shift towards capital-efficient products.

Statutory premiums in the *German* life business amounted to € 18,876 MN, a 6.4 % increase on an internal basis. This resulted mainly from a growth in our business with capital-efficient products. It more than offset the decline in sales of traditional life products, which include long-term interest rate guarantees. Statutory premiums in the German health business increased to € 3,289 MN, representing an internal growth of 1.0 %, driven by the acquisition of new customers in the supplementary health care coverage.

In the *United States*, statutory premiums increased to € 11,856 MN, or by 13.0 % on an internal basis. This was largely driven by higher fixed-indexed and non-traditional variable annuity sales, mainly as a result of our marketing activities in the first half of 2016.

In *Italy* we recorded statutory premiums of € 9,529 MN. The decrease of 20.2 % on an internal basis was largely attributable to lower unit-linked single premium sales – as a result of higher financial market volatility – and a decrease in traditional life business.

In *France*, statutory premiums fell to € 7,956 MN, a slight decrease of 1.2 % on an internal basis, largely due to a decline in our individual life business.

In the *Asia-Pacific* region, statutory premiums stood at € 5,383 MN, a 19.2 % drop on an internal basis, its main cause being a decrease in unit-linked sales in Taiwan. Statutory premiums in South Korea decreased to € 1,307 MN, or by 21.4 % on an internal basis.

Premiums earned (net)

Premiums earned (net) went down by € 446 MN to € 23,769 MN, resulting from a decline in our business with traditional life products in Germany.

Present value of new business premiums (PVNBP)[6,7,8]

PVNBP fell by € 1,976 MN to € 57,168 MN, largely due to lower sales in our business with unit-linked insurance products without guarantees in Italy and in Taiwan.

PRESENT VALUE OF NEW BUSINESS PREMIUMS (PVNBP) IN % BY LINES OF BUSINESS[1]
%

	2016	2015	Delta
Guaranteed savings & annuities	28.5	35.0	(6.5)
Protection & health	14.4	12.3	2.1
Unit-linked without guarantee	20.1	24.9	(4.8)
Capital-efficient products	37.0	27.7	9.3
Total	**100.0**	**100.0**	**–**

1 — Current and prior year figures are presented excluding effects from the South Korean business.

1 — For further information on Allianz Life/Health figures, please refer to note 5 to the consolidated financial statements.
2 — Statutory premiums are gross premiums written from sales of life and health insurance policies, as well as gross receipts from sales of unit-linked and other investment-oriented products, in accordance with the statutory accounting practices applicable in the insurer's home jurisdiction.
3 — From the classification of our South Korean life business as "held for sale" in the second quarter of 2016 until its disposal in the fourth quarter of 2016, the total result of € (268) MN was considered as non-operating.
4 — Represents the ratio of net income to the average total equity, excluding unrealized gains/losses on bonds, net of shadow accounting, at the beginning of the year and at the end of the year.
5 — Our comments in the following section on the development of our statutory gross premiums written refer to figures determined "on an internal basis", i.e. adjusted for foreign currency translation and (de-)consolidation effects, in order to provide more comparable information.

6 — PVNBP before non-controlling interests.
7 — Prior year figures changed in order to reflect the roll out of profit source reporting to China and the inclusion of the capital-efficient products line of business.
8 — Current and prior year figures are presented excluding effects from the South Korean business.

Operating profit

OPERATING PROFIT BY PROFIT SOURCES[1,2]

OPERATING PROFIT BY PROFIT SOURCES
€ MN

	2016	2015	Delta
Loadings and fees	5,609	5,479	130
Investment margin	4,401	4,062	339
Expenses	(6,687)	(6,390)	(297)
Technical margin	955	1,046	(91)
Impact of change in DAC	(48)	(158)	110
Operating loss – South Korea[1]	(82)	(244)	162
Operating profit	**4,148**	**3,796**	**352**

1 — The 2016 figure represents the operating loss of the first quarter only, as the negative result for the rest of 2016 was considered as non-operating.

Our *operating profit* went up, mainly driven by a higher investment margin in the United States as well as favorable DAC unlocking effects in France.

LOADINGS AND FEES[3]

LOADINGS AND FEES[1]
€ MN

	2016	2015	Delta
Loadings from premiums	3,716	3,584	133
Loadings from reserves	1,143	1,125	18
Unit-linked management fees	750	770	(20)
Loadings and fees	**5,609**	**5,479**	**130**
Loadings from premiums as % of statutory premiums	5.9	5.5	0.4
Loadings from reserves as % of average reserves[2,3]	0.2	0.2	–
Unit-linked management fees as % of average unit-linked reserves[3,4]	0.6	0.6	(0.1)

1 — Current and prior year figures are presented excluding effects from the South Korean business.
2 — Aggregate policy reserves and unit-linked reserves.
3 — Yields are pro rata.
4 — Unit-linked management fees, excluding asset management fees, divided by unit-linked reserves.

The rise in *loadings and fees* was primarily due to the increased *loadings from premiums* and was driven by the higher single premium sales in the German life business as well as by higher production with a favorable business mix shift in Indonesia and Thailand.

INVESTMENT MARGIN[4]

INVESTMENT MARGIN[1]
€ MN

	2016	2015	Delta
Interest and similar income	17,749	18,030	(281)
Operating income from financial assets and liabilities carried at fair value through income (net)	(1,013)	(2,049)	1,035
Operating realized gains/losses (net)	6,610	6,461	149
Interest expenses	(105)	(106)	–
Operating impairments of investments (net)	(1,208)	(1,199)	(9)
Investment expenses	(1,192)	(1,111)	(81)
Other[2]	402	152	250
Technical interest	(8,757)	(8,689)	(68)
Policyholder participation	(8,084)	(7,428)	(656)
Investment margin	**4,401**	**4,062**	**339**
Investment margin[3,4] in basis points	107	104	3

1 — Current and prior year figures are presented excluding effects from the South Korean business.
2 — Other comprises the delta of out-of-scope entities, which are added here with their respective operating profit and different line item definitions compared to the financial statements, such as interest paid on deposits for reinsurance, fee and commission income, and expenses excluding unit-linked management fees.
3 — Investment margin divided by the average of current and previous year-end aggregate policy reserves.
4 — Yields are pro rata.

The increase in our *investment margin* was largely driven by a higher spread margin in our fixed-indexed annuity business and by favorable hedging-related impacts in our traditional variable annuity business in the United States.

EXPENSES[5]

EXPENSES[1]
€ MN

	2016	2015	Delta
Acquisition expenses and commissions	(4,927)	(4,754)	(173)
Administrative and other expenses	(1,760)	(1,636)	(124)
Expenses	**(6,687)**	**(6,390)**	**(297)**
Acquisition expenses and commissions as % of PVNBP[2]	(8.6)	(8.0)	(0.6)
Administrative and other expenses as % of average reserves[3,4]	(0.3)	(0.3)	–

1 — Current and prior year figures are presented excluding effects from the South Korean business.
2 — PVNBP before non-controlling interests.
3 — Aggregate policy reserves and unit-linked reserves.
4 — Yields are pro rata.

Our *acquisition expenses and commissions* increased, predominantly due to higher sales in the United States and in our German life business.

Administrative and other expenses remained stable in relation to reserves.

1 — Prior year figures changed in order to reflect the roll out of profit source reporting to China and the inclusion of the capital-efficient products line of business.
2 — The purpose of the Life/Health operating profit sources analysis is to explain movements in IFRS results by analyzing underlying drivers of performance on a Life/Health business segment consolidated basis.
3 — Loadings and fees include premium and reserve based fees, unit-linked management fees, and policyholder participation in expenses.
4 — The investment margin is defined as IFRS investment income net of expenses, less interest credited to IFRS reserves and policyholder participation (including policyholder participation beyond contractual and regulatory requirements mainly for the German life business).
5 — Expenses include acquisition expenses and commissions (excluding commission clawbacks, which are allocated to the technical margin) as well as administrative and other expenses.

TECHNICAL MARGIN[1]

Our *technical margin* declined, driven by one-off reserve adjustments predominantly in the United States and increased claims in Switzerland.

IMPACT OF CHANGE IN DEFERRED ACQUISITION COSTS (DAC)[2]

IMPACT OF CHANGE IN DAC[1]
€ MN

	2016	2015	Delta
Capitalization of DAC	1,868	1,721	147
Amortization, unlocking and true-up of DAC	(1,916)	(1,878)	(38)
Impact of change in DAC	**(48)**	**(158)**	**110**

1 — Current and prior year figures are presented excluding effects from the South Korean business.

The improvement in the *impact of change in DAC* was largely due to higher capitalization of DAC, resulting mainly from increased sales in fixed-indexed and non-traditional variable annuities in the United States as well as in capital-efficient products in Germany.

OPERATING PROFIT BY LINES OF BUSINESS[3]

OPERATING PROFIT BY LINES OF BUSINESS
€ MN

	2016	2015	Delta
Guaranteed savings & annuities	2,306	2,090	216
Protection & health	672	764	(93)
Unit-linked without guarantee	339	381	(41)
Capital-efficient products	913	805	109
Operating loss – South Korea[1]	(82)	(244)	162
Operating profit	**4,148**	**3,796**	**352**

1 — The 2016 figure represents the operating loss of the first quarter only, as the negative result for the rest of 2016 was considered as non-operating.

The operating profit rise in our *guaranteed savings & annuities* line of business was mainly due to positive hedging-related impacts in our traditional variable annuity business in the United States as well as favorable DAC unlocking effects in France. Operating profit in the *protection & health* line of business dropped, largely driven by a lower investment margin in the German health business and one-off effects in the United States. Our operating profit in the *unit-linked without guarantee* line of business went down, primarily due to a reduction of unit-linked performance fees in Italy. An increase in operating profit in the *capital-efficient products* line was largely attributable to a higher spread margin in the United States.

1 — Technical margin comprises risk result (risk premiums less benefits in excess of reserves less policyholder participation), lapse result (surrender charges and commission clawbacks) and reinsurance result.
2 — Impact of change in DAC includes effects of change in DAC, unearned revenue reserves (URR) and value of business acquired (VOBA). It represents the net impact of deferral and amortization of acquisition costs and front-end loadings on operating profit and therefore deviates from the IFRS financial statements.
3 — Prior year figures changed in order to reflect the roll out of profit source reporting to China and the inclusion of the capital-efficient products line of business.

Return on equity

As of 2016 onwards, margin on reserves has been replaced by return on equity to better reflect the way we steer our Life/Health insurance operations.

Our return on equity decreased by 0.5 percentage points to 10.3 %, mainly resulting from the unfavorable net income development of the South Korean business.

Net income

A slight decrease in our net income was largely driven by the negative net impact of our business in South Korea in 2016 as well as lower realizations compared to a high base in 2015, mainly in Italy.

Asset Management

Key figures

KEY FIGURES ASSET MANAGEMENT[1]

		2016	2015	Delta
Operating revenues	€ MN	6,022	6,479	(457)
Operating profit	€ MN	2,205	2,297	(93)
Cost-income ratio[2]	%	63.4	64.5	(1.1) %-p
Net income	€ MN	1,411	1,449	(39)
Total assets under management as of 31 December	€ BN	1,871	1,763	108
thereof: Third-party assets under management as of 31 December	€ BN	1,361	1,276	85

Assets under management

COMPOSITION OF TOTAL ASSETS UNDER MANAGEMENT
€ BN

Type of asset class	as of 31 December 2016	as of 31 December 2015	Delta
Fixed income	1,489	1,385	104
Equities	166	176	(11)
Multi-assets[1]	153	151	2
Other[2]	63	51	12
Total	1,871	1,763	108

1 — Multi-assets is a combination of several asset classes (e.g. bonds, stocks, cash and real property) used as an investment. Multi-assets class investments increase the diversification of an overall portfolio by distributing investments throughout several asset classes.
2 — Other is composed of asset classes other than equity, fixed income and multi-assets, e.g. money markets, commodities, real estate investment trusts, infrastructure investments, private equity investments, hedge funds, etc.

Net outflows[3] of ***total assets under management*** (AuM) amounted to € 28 BN in 2016. Thereof, € 20 BN were attributable to third-party AuM net outflows (2015: € 107 BN). A major share of this year's outflows were PIMCO's third-party AuM net outflows – mainly in the United States and the United Kingdom –, which could only partly be offset by third-party AuM net inflows that primarily occurred in Japan. PIMCO's third-party AuM net outflows occurred in the first half of 2016, and turned into net inflows in the second half. AllianzGI recorded minor third-party AuM net outflows, mostly in the United States.

Favorable effects from Market and Other[4] amounted to € 76 BN, which made them the biggest driver of the upswing in total AuM. Again, much of this development was due to PIMCO, where the effects amounted to € 64 BN, and mainly concerned fixed income assets.

An upswing of total AuM of € 31 BN from consolidation, deconsolidation and other adjustments was almost entirely driven by the acquisition of Rogge Global Partners (Rogge) by AllianzGI.

Favorable effects from foreign currency translation caused an increase of total AuM of € 29 BN. This was mainly due to the appreciation of the U.S. Dollar against the Euro.

In the following section we focus on the development of ***third-party assets under management.***

As of 31 December 2016, the share of third-party AuM by business unit was 76.1 % (31 December 2015: 77.3 %) attributable to PIMCO and 23.9 % (31 December 2015: 22.7 %) attributable to AllianzGI.

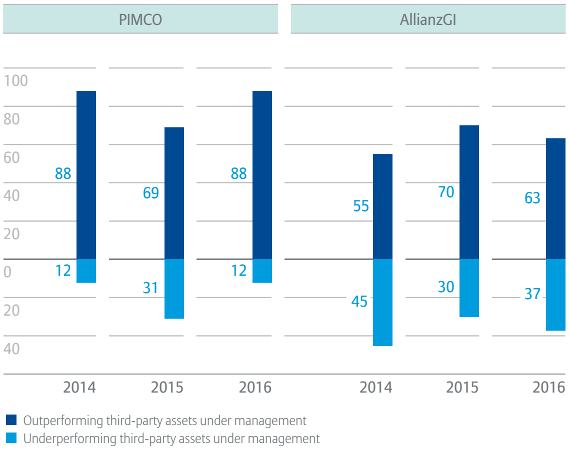
The share of fixed income assets rose from 74.0 % at the beginning of the year to 75.5 %, mainly due to positive market effects and consolidation effects due to the Rogge acquisition. The share of equities declined from 11.8 % to 10.3 %, primarily driven by third-party AuM net outflows which were only partly offset by positive effects from equity markets. The shares of multi-assets and other were roughly stable at 10.0 % and 4.2 % (31 December 2015: 10.5 % and 3.7 %, respectively).

The shares in third-party assets of both mutual funds and separate accounts[5] were quite steady compared to the end of 2015, with mutual funds at 57.8 % (31 December 2015: 58.3 %) and separate accounts at 42.2 % (31 December 2015: 41.7 %).

As for the regional allocation of third-party AuM[6], shares did not shift remarkably: America 55.3 %, Europe 32.8 % and the Asia-Pacific region 11.9 % (31 December 2015: 56.0 %, 32.7 % and 11.3 %). All three regions contributed to the increase in third-party AuM. However, primarily due to positive effects in Japan as well as third-party AuM net outflows in the United States and the United Kingdom, the regional allocation shifted slightly in favor of the Asia-Pacific region.

1 — For further information about our Asset Management business segment, please refer to note 5 to the consolidated financial statements.
2 — Represents operating expenses divided by operating revenues.
3 — Net flows represent the sum of new client assets, additional contributions from existing clients – including dividend reinvestment – withdrawals of assets from, and termination of, client accounts and distributions to investors. Reinvested dividends amounted to € 10 BN.
4 — Market and Other represents current income earned on, and changes in the fair value of, securities held in client accounts. It also includes dividends from net investment income and from net realized capital gains to investors of open ended mutual funds and of closed end funds.
5 — Mutual funds are investment vehicles (in the United States, investment companies subject to the U.S. code; in Germany, vehicles subject to the "Standard-Anlagerichtlinien des Fonds" Investmentgesetz) where the money of several individual investors is pooled into one account to be managed by the asset manager, e.g. open-end funds, closed-end funds. Separate accounts are investment vehicles where the money of a single investor is directly managed by the asset manager in a separate dedicated account (e.g. public or private institutions, high net worth individuals, and corporates).
6 — Based on the location of the asset management company.

THREE-YEAR ROLLING INVESTMENT PERFORMANCE OF PIMCO AND ALLIANZGI[1]
as of 31 December in %



1 — Three-year rolling investment performance reflects the mandate-based and volume-weighted three-year investment success of all third-party assets that are managed by Allianz Asset Management's portfolio-management units. For separate accounts and mutual funds, the investment success (valued on the basis of the closing prices) is compared with the investment success prior to cost deduction of the respective benchmark, based on various metrics. For some mutual funds, the investment success, reduced by fees, is compared with the investment success of the median of the respective Morningstar peer group (a position in the first and second quartile is equivalent to outperformance).

The overall three-year rolling investment performance of our Asset Management business improved significantly, with 83 % of third-party assets outperforming their respective benchmarks (31 December 2015: 69 %). The increase was driven by PIMCO's rolling investment performance, which strengthened towards the end of the year.

Operating revenues

Our *operating revenues* decreased by 7.1 %, which corresponds to a drop of 7.5 % on an internal basis[1].

We recorded lower *performance fees,* mainly due to decreased carried interest from a large private fund at PIMCO.

Other net fee and commission income went down primarily because of lower third-party AuM-driven margins at both PIMCO and AllianzGI. The main cause for this were outflows from higher-margin assets at PIMCO. To a lesser extent, lower average third-party AuM contributed to the decrease in other net fee and commission income.

Operating profit

Operating profit declined by 4.4 % on an internal basis[1]. While operating revenues declined, the corresponding impact on operating profit was mitigated by reduced operating expenses.

Administrative expenses could be lowered significantly, mainly due to decreased personnel expenses. The latter decreased primarily because of a 15.0 % drop in variable compensation, which strongly reflected the lower expenses associated with the Special Performance Award (SPA). The SPA was introduced in the fourth quarter of 2014 at PIMCO to secure performance and retain talent. The decrease in personnel expenses was supported by lower average full time equivalents. In addition, lower non-personnel expenses also contributed to the decrease in overall administrative expenses.

Other operating expenses dropped due to lower restructuring charges.

Our *cost-income ratio* declined slightly, as the relative decrease in operating expenses outpaced the relative decrease in operating revenues. The SPA effect contributed 0.7 percentage points to the cost-income ratio – net of the impact on variable compensation.

ASSET MANAGEMENT BUSINESS SEGMENT INFORMATION
€ MN

	2016	2015	Delta
Performance fees	474	607	(133)
Other net fee and commission income	5,545	5,881	(336)
Other operating revenues	3	(8)	12
Operating revenues	6,022	6,479	(457)
Administrative expenses (net), excluding acquisition-related expenses	(3,817)	(4,141)	324
Other operating expenses	(1)	(41)	40
Operating expenses	(3,818)	(4,182)	364
Operating profit	**2,205**	**2,297**	**(93)**

Net income

We recorded a 2.7 % decline in *net income,* reflecting the decrease in operating profit, which was partly compensated by the absence of the negative effect from the adapted cost allocation scheme for the pension provisions.

1 — Operating revenues/operating profit adjusted for foreign currency translation and (de-)consolidation effects.

Corporate and Other

Key figures

KEY FIGURES CORPORATE AND OTHER[1]
€ MN

	2016	2015	Delta
Operating revenues	1,951	1,899	52
Operating expenses	(2,818)	(2,844)	26
Operating result	(867)	(945)	78
Net income (loss)	(994)	(1,003)	9

KEY FIGURES REPORTABLE SEGMENTS
€ MN

	2016	2015	Delta
HOLDING & TREASURY			
Operating revenues	683	562	121
Operating expenses	(1,664)	(1,639)	(25)
Operating result	(981)	(1,076)	96
BANKING			
Operating revenues	1,029	1127	(98)
Operating expenses	(955)	(1,032)	78
Operating result	74	94	(20)
ALTERNATIVE INVESTMENTS			
Operating revenues	245	213	32
Operating expenses	(206)	(176)	(30)
Operating result	39	37	2

Earnings summary

Our ***operating result*** improved in 2016 due to the positive development in Holding & Treasury which by far overcompensated the decline in Banking.

Our ***net loss*** remained at the previous year's level, as various effects offset one another. We recorded a higher non-operating investment result as well as lower income taxes, offset by the absence of positive effects from an adapted cost allocation scheme for the pension provisions.

In ***Holding & Treasury,*** our operating result increased. This was mainly driven by lower administrative expenses, caused by a decline in pension costs. Also, our income from financial assets and liabilities carried at fair value increased due to the valuation of seed money funds.

Banking's operating result decreased. The year was burdened by a further tightening of interest rate spreads, which led to lower net interest results in almost all our banking units. A reduction in our loan loss provisions could not fully offset this development.

The operating result generated by ***Alternative Investments*** remained stable.

1 — Consolidation included. For further information about our Corporate and Other business segment, please refer to note 5 to the consolidated financial statements.

Outlook 2017

Overview: 2016 results versus previous year's outlook[1]

2016 RESULTS VERSUS PREVIOUS YEAR OUTLOOK FOR 2016

	OUTLOOK 2016 – AS PER ANNUAL REPORT 2015	RESULTS 2016
ALLIANZ GROUP	Operating profit of € 10.5 BN, plus or minus € 0.5 BN.	Operating profit of € 10.8 BN.
	Protection of shareholders' investments, while continuing to provide attractive returns and dividends.	Return on equity (RoE)[1] amounted to 12.0 % (2015: 12.5 %). Proposed dividend at € 7.60 (2015: € 7.30) per share. Stable payout ratio of 50 %.
	Selective profitable growth.	Property-Casualty with continued sound risk selection and strong internal growth, Life/Health with growing asset base and solid new business margins, but Asset Management with net outflows.
PROPERTY-CASUALTY	Growth in gross premiums written by approximately 2.0 %.	Gross premiums slightly declined by 0.1 %, hence almost remained stable. A strong internal growth of 3.1 % was offset by negative foreign currency translation effects as well as by divestitures such as the sale of Fireman's Fund personal insurance business.
	Operating profit in the range of € 5.2 BN to € 5.8 BN.	Operating profit of € 5.4 BN is slightly below the mid-point of our target range. A low impact of natural catastrophes was partially compensated by large losses. Although Argentina and Brazil improved during 2016, the delay of their turnaround impacted the underwriting result.
	Progress towards our combined ratio ambition of 94 % or better by 2018.	Combined ratio was strong at 94.3 % and on track towards our ambition for 2018.
	Pressure on operating investment income (net) to continue due to reinvestments in a consistently low interest rate environment.	As expected, operating investment income (net) declined across our subsidiaries due to the low interest rate environment.
LIFE/HEALTH	Prioritizing profitability over growth and continuing to shift new business mix towards unit-linked, capital-efficient and protection products. Addressing customer needs in the prolonged low yield environment. Revenues are expected to be in the range of € 62.0 BN to € 68.0 BN.	Revenues of € 64.6 BN at the mid-point of outlook. Strong growth from capital-efficient products in Germany and the United States was more than offset by lower unit-linked sales in Italy and Taiwan.
	Operating profit between € 3.3 BN and € 3.9 BN.	Operating profit of € 4.1 BN above target range, driven by favorable investment margin supported by higher level of net harvesting from further portfolio de-risking actions.
	RoE[1] between 9.0 % and 11.0 %.	RoE[1] at 10.3 % above mid-point of target range.
	Pressure on investment income due to low interest rates and continued capital market uncertainty.	Operating investment result reached € 21.3 BN, as lower interest and similar income was compensated by higher realized gains.
ASSET MANAGEMENT	Slight increase in total assets under management (AuM) due to positive market return, supported by a return to positive net flows at PIMCO and continued solid net inflows at AllianzGI.	Total AuM grew by € 108 BN to € 1,871 BN as of 31 December 2016. The increase was driven by positive market returns and foreign currency translation effects. The consolidation of Rogge Global Partners in the second quarter of 2016 added € 32 BN of third-party AuM. In the course of 2016, our Asset Management business segment saw third-party AuM net outflows of € 20 BN coming from both entities. However, as expected, PIMCO third-party net flows turned positive for the last two quarters of 2016.
	Operating profit in the range of € 1.9 BN to € 2.5 BN.	Operating profit amounted to € 2.2 BN and meets the mid-point of the target range.
	Cost-income ratio of well below 65 %.	With a cost-income ratio of 63.4 % our Asset Management business segment came in well below 65 %.

1 — Represents the ratio of net income to the average total equity, excluding unrealized gains/losses on bonds, net of shadow accounting, at the beginning of the year and at the end of the year.

Economic outlook[2]

Following a slight acceleration in the final quarter of 2016, the world economy currently finds itself in fairly good shape and has made a positive start into the year 2017. In the industrialized countries, growth prospects are quite favorable overall. In the United States, despite the fact that there is still not much clarity about the specifics of economic policy under the new U.S. administration, a change in the policy mix is on the horizon: Monetary policy will provide somewhat less stimulus for the economic development, whereas fiscal policy will do more as the new U.S. administration is expected to deliver on the promise to cut taxes and launch investment initiatives. In the course of 2017, these measures are expected to buoy economic growth, despite some dampening effects such as higher inflation. All in all, the U.S. economy is likely to expand by 2.2 % this year. In the Eurozone, the economic recovery is likely to continue. We expect real gross domestic product to increase by 1.8 % (2016: 1.7 %). While the upward movement in oil prices and rising inflation will weigh on private consumption, household spending will be supported by rising employment. The group of emerging market economies is set for a moderate acceleration of growth, mainly driven by a gradual stabilization in the group's heavyweights, Russia and Brazil, and by a recovery in commodity-exporting countries. Overall, global output is likely to expand by about 2.8 % in 2017, compared with 2.4 % in 2016. Industrialized countries are expected to register gross domestic product growth of 1.9 %, while in emerging markets growth could increase to 4.1 % from the 3.6 % seen in 2016.

The uncertain global economic and political environment (e.g. rise of populism, high emerging market indebtedness, risk of E.U. disintegration) is likely to result in higher financial-market volatility this year. As far as monetary policy is concerned, assuming that the labor market remains tight and inflation rates continue to move up, the Federal Reserve is likely to continue to hike interest rates this year. By contrast, we do not see any major change in the European Central Bank's expansionary monetary policy stance.

Modestly rising yields on 10-year U.S. government bonds and higher inflation rates in the Eurozone will exert some upward pressure on European benchmark bond yields in 2017. However, with short-term rates at zero, there are limited prospects of markedly higher yields on longer-term bonds. For 10-year German government bonds,

1 — For more detailed information on the previous year's outlook for 2016, please see the Annual Report 2015 from page 92 onward.
2 — The information presented in the sections "Economic outlook", "Insurance industry outlook", and "Asset management industry outlook" is based on our own estimates.

we predict yields to climb modestly towards 1 % in the course of 2017; for 10-year U.S. government bonds, yields may end the year in a range between 2.5 % and 3 %. While the expected Federal Reserve rate hikes will weigh on the Euro, a number of other factors will support it; above all, the expected rise in the U.S. current-account deficit as well as the speculation – which is likely to increase towards year-end – about the timing and manner of the European Central Bank's exit from its bond purchasing program. We expect the Dollar-to-Euro exchange rate to close the year at about 1.10 (2016: 1.05).

Insurance industry outlook

In 2017, things are likely to start moving in the right direction for the insurance industry: The global economy is set to shift up a gear, inflation will return – which will set the scene for monetary normalization – and last but not least, interest rates are expected to rise. That said, the overall momentum will probably be too weak to finally escape the low-growth, low-yield environment; so, for the time being, we expect premium growth to remain modest and investment income to remain under pressure. Moreover, political risks could easily derail the economy and knock markets from their path to normalization.

While the macroeconomic environment, despite all the uncertainties, offers some glimpses of hope, the challenges on the microeconomic front remain formidable: As technological progress and the digitization of our life gather speed, established business models get under enormous pressure. The industry has to adapt quickly to defend its franchise against new competitors. In combination with the new regulatory regime (Solvency II), which brings more clarity on capital positions, this restructuring process could act as a possible catalyst for more industry consolidation.

To sum up: In 2017, the industry's top line will continue to grow modestly – though some lines of business such as trade-dependent marine and rate-sensitive savings might struggle – while the bottom line remains under pressure from weak investment income and the need to build new, digital business models.

In the ***property-casualty sector,*** growth in advanced markets should remain rather stable: The ongoing recovery supports demand, but pricing is still a concern. For advanced markets, political instability could prove to be the biggest challenge in 2017, as growing protectionism and the looming Brexit drive structural changes in the industry. The outlook for emerging markets is much brighter: Asia is expected to roar ahead, Latin America will stabilize, and Eastern Europe will continue its recovery. Overall, we expect global premium revenue growth to range between 4.0 % and 5.0 % in 2017 (in nominal terms, adjusted for foreign currency translation effects). Given the still challenging pricing outlook and weak investment income, overall profitability might not improve but stay more or less flat.

In the ***life sector*** the overall picture is quite similar. Specifically, we expect advanced markets to maintain their (modest) growth as demand benefits from rising employment and new product offers. Emerging markets, on the other hand, will show stronger performance. Asia might shift down a little after the extraordinary growth spurt seen in 2016; on a general note, however, rising incomes, urbanization, and social security reforms should remain strong engines for growing insurance demand. All in all, we expect global premium revenue to increase by 4.0 % to 5.0 % in 2017 (in nominal terms, adjusted for foreign currency translation effects). To safeguard profitability, insurers will continue to review both their product mixes and their investment portfolios. As a result, overall profitability should not deteriorate any further.

Asset management industry outlook

After a sometimes rocky but ultimately benign year for global equities in 2016, 2017 brings the prospect of increased volatility. This is due in particular to geopolitical uncertainty, as the new administration comes to power in the United States and elections are held across Europe.

Global economic and political divergence creates uncertainty and volatility thus involving risks, but it also provides opportunities. For instance, strong economic trends, such as job and wage growth, as well as a pick-up in inflation should allow the Federal Reserve to continue with gradual rate increases, driving treasury yields higher. Bonds are particularly interesting for the growing number of retirees in developed countries who are looking for a stable stream of income; also, liability-driven investors may look to further de-risk into bonds as yields become more attractive.

2017 is expected to be another challenging and disruptive year for the asset management industry. Markets are volatile and there is some political uncertainty. In addition, industry profitability remains under pressure from both continuous flows into passive products and rising distribution costs. However, digital channels are expected to continue gaining prominence. Measures aimed at strengthening regulatory oversight and reporting could also affect profitability in the asset management sector. In order to continue growing, it is vital for asset managers to keep sufficient business volumes, ensure efficient operations, and maintain strong investment performance.

Overview: outlook and assumptions 2017 for the Allianz Group

OUTLOOK 2017	
ALLIANZ GROUP	Operating profit of € 10.8 BN, plus or minus € 0.5 BN.
	Protection of shareholders' investments, while continuing to provide attractive returns and dividends.
	Selective profitable growth.
PROPERTY-CASUALTY	Growth in gross premiums written: approximately 2 % on a nominal basis.
	Operating profit in the range of € 5.0 BN to € 5.6 BN.
	Progress towards our combined ratio ambition of 94 % or better by 2018.
	Pressure on operating investment income (net) to continue due to reinvestments in a consistently low interest rate environment.
LIFE/HEALTH	Continue with selective focus on profitable growth and further shift new business mix towards capital efficient, unit-linked, and protection products. Considering the disposal of our South Korean business, revenues are expected to be in the range of € 60.0 BN to € 66.0 BN.
	Operating profit between € 3.7 BN and € 4.3 BN.
	RoE between 10.0 % and 12.0 %.
	Pressure on investment income due to low interest rates and continued capital market uncertainty.
ASSET MANAGEMENT	Slight increase in total AuM due to positive market return, supported by moderate net inflows at PIMCO and at AllianzGI.
	Operating profit in the range of € 2.0 BN to € 2.6 BN.
	Cost-income ratio well below 65 %.

ASSUMPTIONS

Our outlook assumes no significant deviations from the following underlying assumptions:

- Global economic growth is set to continue.
- Modest rise in interest rates expected.
  - A 100 basis point increase or decrease in interest rates would, respectively, either raise or lower operating profits by approximately € 0.1 BN in the first year following the rate change.
- No major disruptions of capital markets.
- No disruptive fiscal or regulatory interference.
- Level of claims from natural catastrophes at expected average levels.
- Average U.S. Dollar to Euro exchange rate of 1.11.
  - A 10 % weakening or strengthening of the U.S. Dollar versus our planned exchange rate of 1.11 to the Euro would have a negative or positive impact on operating profits of approximately € 0.3 BN, respectively.

Management's assessment of expected revenues and earnings for 2017

In 2016, our total revenues amounted to € 122.4 BN, a 2.2 % decrease on a nominal and a 0.8 % decrease on an internal basis compared to 2015. We expect a rather flat revenue development in 2017, with Property-Casualty and Asset Management revenues advancing, while Life/Health revenues are likely to be under pressure due to our selective focus on profitable growth.

Our operating profit was near the upper end of our target range in 2016, hitting € 10.8 BN. As of 2017, we will update our operating profit definition and exclude restructuring charges from the operating profit unless they are shared with policyholders. Under this updated definition, our operating profit for 2016 would have been € 10.9 BN, with the delta of € 0.1 BN essentially attributable to the Property-Casualty business segment. For 2017, we envisage an operating profit of € 10.8 BN, plus or minus € 0.5 BN, as we expect a slightly negative development in the Property-Casualty and Life/Health business segments and a slightly positive development in the Asset Management and Corporate and Other business segments – all based on the updated operating profit definition.

Our net income attributable to shareholders increased, reaching € 6.9 BN in 2016. Consistent with our disclosure practice in the past and given the susceptibility of our non-operating results to adverse capital market developments, we do not provide a precise outlook for net income. However, since our outlook presumes no major disruptions of capital markets, we anticipate a rather stable net income for 2017.

PROPERTY-CASUALTY INSURANCE

We expect our revenues to increase by approximately 2 % in 2017 (2016: (0.1) %), supported by favorable volume effects and – to a lesser extent – price effects. This growth is supported by the acquisition of the commercial portfolio of Aegon in mid-2016, strengthening our position in the attractive Benelux property-casualty market.

Most of the premium growth in 2017 is expected to come from our European core markets, including the United Kingdom, Germany, and Spain. Top-line development will further be supported by positive trends at Allianz Worldwide Partners, where our B2B2C business activities are bundled.

We believe the overall slow rise in prices we witnessed in a number of markets in 2016 will continue in 2017. However, as in previous years, we will keep our focus on achieving strong underwriting results by adhering to our strict underwriting discipline and will accept a lower top line if target margins cannot be achieved.

In 2016, our combined ratio was 94.3 %. We expect to at least maintain it at this level in 2017, before reaching our 2018 ambition of 94 % or better. This rests on our expectation that the aggregate effect of improvements in pricing, claims management, and productivity will compensate for any underlying claims inflation. Despite the high volatility of natural catastrophes in recent years, we have assumed that impacts will be in line with our historic claims experience.

As the low-interest-rate environment is likely to persist, investment income will remain under pressure due to the rather short duration of investments in the Property-Casualty business segment. We will continue to take measures to adapt our investment strategy to ongoing market conditions.

Overall, we expect our 2017 operating profit to be in the range of € 5.0 BN to € 5.6 BN (2016: € 5.5 BN, based on the updated operating profit definition, i.e. excluding € 0.1 BN restructuring charges).

LIFE/HEALTH INSURANCE

In 2016, our operating profit of € 4.1 BN exceeded our target range. For 2017, we expect operating profit in our Life/Health business segment to be between € 3.7 BN and € 4.3 BN.

As pointed out in 2015, RoE is one of the key performance indicators for the steering of our Life/Health business. In 2017, we expect the RoE of the Life/Health business segment to be between 10.0 % and 12.0 %.

We will remain focused on shifting our new business mix towards capital-efficient, unit-linked, and protection products – thereby addressing customer needs in light of the prolonged low-yield environment – while maintaining strong shareholder returns, and building on our strong track record of product innovation. Furthermore, we will continue to actively manage both our new and in-force business through continuous repricing, expense management, asset/liability management, and crediting strategies in order to mitigate the impacts of difficult market conditions, particularly the low interest rates, and maintain our profitability targets.

It must be noted, however, that market volatility, along with the level of net harvesting, can significantly affect the Life/Health business segment results.

ASSET MANAGEMENT

We see a challenging environment for the asset management industry again in 2017. That said, we expect the positive trend in PIMCO's third-party AuM net inflows that we observed over the last two quarters of 2016 to continue into 2017, supported by net inflows from AllianzGI in 2017. Market returns are expected to contribute moderately to a positive development of total AuM. While performance fees are expected to decrease slightly, an increase in management and loading fees should lead to a slight increase in operating revenues, which should more than offset a moderate increase of operating expenses. Therefore, we envisage our operating profit to be in the range of € 2.0 BN and € 2.6 BN in 2017 (2016: € 2.2 BN).

In 2017, we expect a cost-income ratio of well below 65 % (2016: 63.4 %), supported by our focus on expense discipline and operational excellence. Mid-term we expect our cost-income ratio to be at 60 %.

CORPORATE AND OTHER

Our Corporate and Other business segment recorded an operating loss of € 0.9 BN in 2016. As we expect an improvement in the operating result of the Holding & Treasury reportable segment – mainly attributable to lower administrative expenses –, we predict an operating loss in the range of € 0.7 BN to € 0.9 BN for Corporate and Other (including consolidation) in 2017.

Financing and liquidity development and capitalization

The Allianz Group maintains a healthy liquidity position, combined with superior financial strength and capitalization well above what supervisory authorities currently require.

We expect to have steady access to financial markets at reasonable cost in order to maintain our strong financial flexibility. This is supported by prudent steering of our liquidity resources and a maturity profile focusing on a long-dated average remaining term.

We closely monitor the capital positions of the Group and at the operating entity level. Additionally, we will continue to optimize our interest rate and spread sensitivities through asset/liability management and life product design.

Expected dividend development[1,2]

For 2016, the Board of Management and the Supervisory Board of Allianz SE propose a dividend of € 7.60 per share.

In addition, Allianz SE has decided to launch a share buy-back program with a volume of up to € 3.0 BN as part of a previously announced plan to return unused capital from the Group's external growth budget from the period 2014 to 2016. The buy-back program started in February 2017 and is envisaged to last no longer than 12 months. Allianz SE will cancel all repurchased shares.

Through capital management, Allianz Group aims for a healthy balance between an attractive yield and investment in profitable growth. We will continue to return 50 % of Allianz Group's net income (attributable to shareholders) to shareholders in the form of a regular dividend.

Allianz also aims to keep the regular dividend per share at least at the level paid in the previous year. However, the Board of Management and the Supervisory Board of Allianz SE have decided to simplify Group capital management to make it more flexible. Going forward, Allianz will return capital to its shareholders on a flexible basis, rather than following a formulaic approach. Return of capital to shareholders will no longer be coupled to the unused budget for external growth and a three-year timeframe.

All of the above remains subject to a sustainable Solvency II ratio above 160 %, which is substantially below our current level of 218 % and 20 percentage points lower than our day-to-day Solvency II ratio target range of 180 to 220 %.

Management's overall assessment of the current economic situation of the Allianz Group

Overall, at the date of issuance of this Annual Report and given current information regarding natural catastrophes and capital market trends – in particular foreign currency, interest rates, and equities – the Board of Management has no indication that the Allianz Group is facing any major adverse developments.

1 — This represents the management's current intention and may be revised in the future. Also, the decision regarding dividend payments in any given year is subject to specific dividend proposals by the Management and Supervisory Boards, each of which may elect to deviate if appropriate under the then prevailing circumstances, as well as to the approval of the Annual General Meeting.

2 — For further information on subsequent events, please refer to note 44 to the consolidated financial statements.

Balance Sheet Review

Shareholders' equity[1]

SHAREHOLDERS' EQUITY
€ MN

	as of 31 December 2016	as of 31 December 2015	Delta
Shareholders' equity			
Paid-in capital	28,928	28,928	–
Retained earnings	27,336	24,222	3,114
Foreign currency translation adjustments	(754)	(926)	172
Unrealized gains and losses (net)	11,830	10,920	910
Total	**67,341**	**63,144**	**4,196**

The main driver for the increase in ***shareholders' equity*** was the net income attributable to shareholders, amounting to € 6,883 MN. The increase was supported by an upswing in unrealized gains, primarily on debt securities, which resulted from a further drop in interest rates. It was partly offset, however, by the dividend payout in May 2016, which totaled € 3,320 MN.

Total assets and total liabilities

As of 31 December 2016, total assets amounted to € 883.8 BN and total liabilities were at € 813.4 BN. Compared to year-end 2015, this represented an increase of € 34.9 BN for total assets and of € 30.6 BN for total liabilities.

The following section mainly focuses on our financial investments in debt instruments, equities, real estate, and cash, as these reflect the major developments in our asset base.

STRUCTURE OF INVESTMENTS – PORTFOLIO OVERVIEW

The following portfolio overview covers the Allianz Group assets held for investment, which are mainly driven by our insurance businesses.

ASSET ALLOCATION AND FIXED INCOME PORTFOLIO OVERVIEW

Type of investment	as of 31 December 2016 € BN	as of 31 December 2015 € BN	Delta € BN	as of 31 December 2016 %	as of 31 December 2015 %	Delta %-p
Debt instruments; thereof:	**577.3**	**568.1**	**9.1**	**88.4**	**88.8**	**(0.4)**
Government bonds	213.6	217.5	(4.0)	37.0	38.3	(1.3)
Covered bonds	89.9	98.7	(8.8)	15.6	17.4	(1.8)
Corporate bonds (excl. banks)	189.5	164.9	24.6	32.8	29.0	3.8
Banks	32.9	31.3	1.5	5.7	5.5	0.2
Other	51.4	55.7	(4.3)	8.9	9.8	(0.9)
Equities	**49.9**	**45.7**	**4.3**	**7.6**	**7.1**	**0.5**
Real estate	**11.7**	**12.0**	**(0.2)**	**1.8**	**1.9**	**(0.1)**
Cash/other	**14.2**	**14.3**	**(0.1)**	**2.2**	**2.2**	**(0.1)**
Total	**653.1**	**640.1**	**13.0**	**100.0**	**100.0**	**–**

Our overall asset allocation remained almost unchanged, compared to 31 December 2015. The increase in assets was caused by unrealized gains in debt instruments and – to a lesser extent – in equities, mainly following general market developments in 2016.

Our well-diversified exposure to ***debt instruments*** went up – mainly due to a further decrease in interest rates – from their already low level of year-end 2015. However, the increase was partly offset by realizations. About 94 % of this portfolio was invested in investment-grade bonds and loans.[2] Our ***government bonds*** portfolio contained – amongst others – bonds from Italy, Spain and the United Kingdom, representing shares of our debt instruments portfolio of 4.3 %, 2.0 % and 0.2 %, with unrealized gains (gross) of € 3,862 MN, € 1,188 MN and € 40 MN. Our ***covered bonds*** portfolio contained 41 % (31 December 2015: 42 %) German Pfandbriefe, backed by either public-sector loans or mortgage loans. The portfolio shares of French, Spanish and Italian covered bonds were at 16 %, 9 % and 8 % (31 December 2015: 16 %, 10 % and 8 %).

Our exposure to ***equities*** increased due to positive developments on major equity markets. Our equity gearing[3] remained almost unchanged at 23 % (31 December 2015: 24 %), as the increase in this exposure was accompanied by increases in shareholders' equity and hedging of the risen exposure against share price declines.

1 — This does not include non-controlling interests of € 3,052 MN and € 2,955 MN as of 31 December 2016 and 31 December 2015, respectively. For further information, please refer to note 20 to the consolidated financial statements.
2 — Excluding self-originated German private retail mortgage loans. For 3 %, no ratings were available.
3 — Equity gearing is defined as the ratio of our equity holdings allocated to the shareholder after policyholder participation and hedges to shareholders' equity plus off-balance sheet reserves less goodwill.

LIABILITIES

PROPERTY-CASUALTY LIABILITIES
As of 31 December 2016, the business segment's gross reserves for loss and loss adjustment expenses and discounted loss reserves amounted to € 65.7 BN, compared to € 65.1 BN at year-end 2015. On a net basis, our reserves, including discounted loss reserves were almost unchanged at € 57.3 BN.[1]

LIFE/HEALTH LIABILITIES
Life/Health reserves for insurance and investment contracts increased by € 18.9 BN to € 490.9 BN. The € 5.3 BN increase in aggregate policy reserves and other reserves before foreign currency translation effects was mainly driven by our operations in Germany (€ 7.5 BN) and the United States (€ 6.8 BN, before foreign currency translation effects) and partly offset by the sale of our South Korean business (€ (10.8) BN, before foreign currency translation effects). Reserves for premium refunds increased by € 10.7 BN, due to higher unrealized gains to be shared with policyholders. Favorable foreign currency translation effects mainly resulted from the stronger U.S. Dollar (€ 2.8 BN).

CORPORATE AND OTHER LIABILITIES
In comparison to year-end 2015, we recorded a drop in liabilities to banks and customers amounting to € 13.4 BN, and an upswing in liabilities of disposal groups classified as held for sale of € 13.3 BN. This shift was primarily driven by the classification of the Oldenburgische Landesbank AG as held for sale. Other liabilities increased by € 1.0 BN, mainly due to higher liabilities from cash pooling. The € 1.3 BN increase in subordinated liabilities was mainly caused by the issuance of a subordinated bond. Certificated liabilities decreased by € 1.5 BN.

Off-balance sheet arrangements

In the normal course of business, the Allianz Group may enter into arrangements that do not lead to the recognition of assets and liabilities in the consolidated financial statements under IFRS. Since the Allianz Group does not rely on off-balance sheet arrangements as a significant source of revenue or financing, our off-balance sheet exposure to loss is immaterial relative to our financial position.

The Allianz Group enters into various commitments including loan and leasing commitments, purchase obligations and other commitments. Please refer to note 39 to the consolidated financial statements for more details.

The Allianz Group has also entered into contractual relationships with various types of structured entities. They have been designed in such a way that their relevant activities are directed by means of contractual arrangements instead of voting or similar rights. Typically, structured entities have been set up in connection with asset-backed financings and certain investment fund products. For more details on our involvement with structured entities, please refer to note 37 to the consolidated financial statements.

Please refer to the Risk and Opportunity Report from page 62 onwards for a description of the main concentrations of risk and other relevant risk positions.

Regulatory capital adequacy

For details on the regulatory capitalization of the Allianz Group, please refer to the Risk and Opportunity Report from page 62 onwards.

1 — For further information about changes in the reserves for loss and loss adjustment expenses for the Property-Casualty business segment, please refer to note 15 to the consolidated financial statements.

Liquidity and Funding Resources

Organization

The Allianz Group's liquidity management is based on policies and guidelines approved by the Allianz SE Board of Management. Allianz SE and each of the operating entities are responsible for managing their respective liquidity positions, while Allianz SE provides central cash pooling for the Group. Capital allocation is steered by Allianz SE for the entire Group. This structure allows the efficient use of liquidity and capital resources and enables Allianz SE to achieve the desired liquidity and capitalization levels for the Group and its operating entities.

Liquidity management of our operating entities

INSURANCE OPERATIONS

The major sources of liquidity for our operational activities are primary and reinsurance premiums received, reinsurance receivables collected, investment income, and proceeds generated from the maturity or sale of investments. These funds are mainly used to pay claims arising from the Property-Casualty insurance business and related expenses, life policy benefits, surrenders and cancellations, acquisition costs, and operating costs.

We receive a large part of premiums before payments of claims or policy benefits are required, generating solid cash flows from our insurance operations. This allows us to invest the funds in the interim to create investment income.

Our insurance operations also carry a high proportion of liquid investments, which can be converted into cash to pay for claims. Generally, our investments in fixed income securities are sequenced to mature when funds are expected to be needed.

The overall liquidity of our insurance operations depends on capital market developments, interest rate levels, and our ability to realize the market value of our investment portfolio to meet insurance claims and policyholder benefits. Other factors affecting the liquidity of our Property-Casualty insurance operations include the timing, frequency, and severity of losses underlying our policies and policy renewal rates. In our Life operations, liquidity needs are generally influenced by trends in actual mortality rates compared to the assumptions underlying our life insurance reserves. Market returns, crediting rates and the behavior of our life insurance clients – for example regarding the level of surrenders and withdrawals – can also have significant impacts.

ASSET MANAGEMENT OPERATIONS

Within our Asset Management operations, the most important sources of liquidity are fees generated from asset management activities. These are primarily used to cover operating expenses.

BANKING OPERATIONS

The major sources of liquidity in our Banking operations include customer deposits, interbank loans, and interest and similar income from our lending transactions. The most important uses of funds are the issuance of new loans and investments in fixed income securities. The liquidity of our Banking operations is largely dependent on the ability of our private and corporate customers to meet their payment obligations arising from loans and other outstanding commitments. Our ability to retain our customers' deposits is equally important to us.

Liquidity management and funding of Allianz SE

The responsibility for managing the funding needs within the Group, maximizing access to liquidity sources, and minimizing borrowing costs lies with Allianz SE. We therefore comment on the liquidity and funding resources of Allianz SE in the following sections. Restrictions on the transferability of capital within the Group result mainly from the capital maintenance rules under applicable company laws as well as from the regulatory solvency capital requirements for regulated Group companies.

LIQUIDITY RESOURCES AND USES

Allianz SE ensures adequate access to liquidity and capital for our operating subsidiaries. The main sources of liquidity available for Allianz SE are dividends received from subsidiaries and funding provided by capital markets. Liquidity resources are defined as readily available assets – specifically cash, money market investments, and highly liquid government bonds. Our funds are primarily used for interest payments on our debt funding, operating costs, internal and external growth investments, and dividends to our shareholders.

FUNDING SOURCES

Allianz SE's access to external funds depends on various factors such as capital market conditions, access to credit facilities, credit ratings, and credit capacity. The financial resources available to Allianz SE in the capital markets for short-, mid- and long-term funding needs are described below. In general, mid- to long-term financing is covered by issuing senior or subordinated bonds or ordinary shares.

EQUITY FUNDING

As of 31 December 2016, the issued capital registered at the Commercial Register was € 1,169,920,000. This was divided into 457,000,000 registered shares with restricted transferability. As of 31 December 2016, the Allianz Group held 1,932,263 (2015: 2,176,362) own shares.

Allianz SE has the option to increase its equity capital base according to authorizations provided by our shareholders. The following table outlines Allianz SE's capital authorizations as of 31 December 2016:

CAPITAL AUTHORIZATIONS OF ALLIANZ SE

Capital authorization	Nominal amount	Expiry date of the authorization
Authorized Capital 2014/I	€ 550,000,000 (214,843,750 shares)	6 May 2019
Authorized Capital 2014/II	€ 13,720,000 (5,359,375 shares)	6 May 2019
Authorization to issue bonds carrying conversion and/or option rights	€ 10,000,000,000 (nominal bond value)	6 May 2019 (issuance of bonds)
Conditional Capital 2010/2014	€ 250,000,000 (97,656,250 shares)	No expiry date for Conditional Capital 2010/2014 (issuance in case option or conversion rights are exercised)

For further information on our share capital and regarding authorizations to issue and repurchase shares, please refer to the chapter Takeover-related Statements and Explanations (part of the Group Management Report) starting on page 21.

LONG-TERM DEBT FUNDING

As of 31 December 2016, Allianz SE had senior and subordinated bonds with a variety of maturities outstanding, reflecting our focus on long-term financing. As the cost and availability of external funding may be negatively affected by general market conditions or by matters specific to the financial services industry or the Allianz Group, we seek to reduce refinancing risk by actively steering the maturity profile of our funding structure.

MATURITY STRUCTURE OF ALLIANZ SE'S SENIOR AND SUBORDINATED BONDS[1]
€ MN

	Contractual maturity date		
as of 31 December	Up to 1 year	> 1 year up to 5 years	Over 5 years
2016			
Senior bonds	–	2,734	3,840
Subordinated bonds	1,400 [2]	–	12,086
Total	**1,400**	**2,734**	**15,925**
2015			
Senior bonds	1,498	1,985	3,227
Subordinated bonds	–	–	11,962
Total	**1,498**	**1,985**	**15,189**

1 — Based on carrying value.
2 — € 1.4 BN subordinated bond called for redemption effective 17 February 2017.

Interest expenses on senior bonds decreased, mainly due to the depreciation of the British Pound against the Euro. For subordinated bonds, the increase of interest expenses was primarily driven by higher outstanding volumes on average in 2016.

SENIOR AND SUBORDINATED BONDS ISSUED OR GUARANTEED BY ALLIANZ SE[1]

as of 31 December	Nominal value € MN	Carrying value € MN	Interest expense € MN	Weighted average interest rate[2] %
2016				
Senior bonds	6,629	6,574	262	3.5
Subordinated bonds	13,537	13,485	584	4.6
Total	**20,165**	**20,059**	**845**	**4.2**
2015				
Senior bonds	6,716	6,711	270	4.0
Subordinated bonds	12,080	11,962	560	4.8
Total	**18,797**	**18,673**	**830**	**4.5**

1 — For further information on Allianz SE debt (issued or guaranteed) as of 31 December 2016, please refer to note 19 to the consolidated financial statements.
2 — Based on nominal value.

The table below details the long-term debt issuances and redemptions of Allianz SE during 2016 and 2015:

ISSUANCES AND REDEMPTIONS OF ALLIANZ SE'S SENIOR AND SUBORDINATED BONDS
€ MN

as of 31 December	Issuances[1]	Redemptions[1]	Issuances net of redemptions
2016			
Senior bonds	1,500	1,500	–
Subordinated bonds	1,422	–	1,422
2015			
Senior bonds	–	–	–
Subordinated bonds	1,500	1,000	500

1 — Based on nominal value.

Funding in non-Euro currencies enables us to diversify our investor base or to take advantage of favorable funding costs in those markets. Funds raised in non-Euro currencies are incorporated in our general hedging strategy. As of 31 December 2016, approximately 18.4 % (2015: 12.5 %) of long-term debt was issued or guaranteed by Allianz SE in currencies other than the Euro.

CURRENCY ALLOCATION OF ALLIANZ SE'S SENIOR AND SUBORDINATED BONDS[1]
€ MN

as of 31 December	Euro	Non-Euro	Total
2016			
Senior and subordinated bonds	16,450	3,715	20,165
2015			
Senior and subordinated bonds	16,450	2,347	18,797

1 — Based on nominal value.

SHORT-TERM DEBT FUNDING

Short-term funding sources available are the Medium-Term Note Program and the Commercial Paper Program. Money market securities decreased in the use of commercial paper compared to the previous year-end. Interest expenses on money market securities increased mainly due to higher funding costs on average in 2016.

MONEY MARKET SECURITIES OF ALLIANZ SE

	Carrying value	Interest expense	Average interest rate
as of 31 December	€ MN	€ MN	%
2016			
Money market securities	1,041	9	0.7
2015			
Money market securities	1,276	6	0.4

The Group maintained its A-1+/Prime-1 ratings for short-term issuances. Thus we can continue funding our liquidity under the Euro Commercial Paper Program at an average rate for each tranche below Euribor, and under the U.S. Dollar Commercial Paper Program at an average rate for each tranche below U.S. Libor.

Further potential sources of short-term funding allowing the Allianz Group to fine-tune its capital structure are letter of credit facilities and bank credit lines.

Allianz Group consolidated cash flows

ANNUAL CHANGES IN CASH AND CASH EQUIVALENTS
€ MN

	2016	2015	Delta
Net cash flow provided by operating activities	21,461	23,663	(2,202)
Net cash flow used in investing activities	(19,765)	(20,394)	629
Net cash flow used in financing activities	(1,732)	(2,837)	1,105
Change in cash and cash equivalents[1]	16	979	(963)

1 — Includes effects of exchange rate changes on cash and cash equivalents of € 52 MN and € 548 MN in 2016 and 2015, respectively.

Net cash flow provided by operating activities decreased in 2016. This consists of net income plus adjustments for non-cash charges, credits and other items included in net earnings, and cash flows related to the net change in operating assets and liabilities. Net income after adding back non-cash charges and similar items went down by € 1.4 BN to € 9.1 BN in 2016. In addition, operating cash flows from net changes in operating assets and liabilities, including other items, fell by € 0.8 BN to € 12.4 BN. This was driven by net cash outflows (after net cash inflows in 2015) from repurchase agreements and collateral received from securities lending transactions – in particular at Allianz SE. Higher reserves for insurance and investment contracts in our Life/Health business segment, mainly in the United States, Germany and France, partially offset this effect.

Net cash outflow used in investing activities declined compared to the previous year. This was primarily a consequence of net cash inflows (after net cash outflows in 2015) from financial assets and liabilities designated at fair value through income, especially in our Life/Health business segment in Germany and France. Moreover, we recorded lower net cash outflows from our activities in real estate held for investment, in particular from our German Life/Health business segment. Lower net cash inflows from loans and advances to banks and customers partly compensated these effects.

Net cash outflow used in financing activities decreased, mainly due to higher net cash inflows from our refinancing activities[1] as well as higher net cash inflows from liabilities to banks and customers, especially from our banking business. Higher dividend payments to our shareholders partly offset these effects.

Cash and cash equivalents, including cash and cash equivalents reclassified to assets of disposal groups held for sale, increased in 2016.

For further information on the consolidated statements of cash flows, please refer to page 82.

1 — Refers to cash flows from certified liabilities and subordinated liabilities.

Reconciliations

The previous analysis in our Group Management Report is based on our consolidated financial statements and should be read in conjunction with them. In addition to our figures stated in accordance with the International Financial Reporting Standards (IFRS), the Allianz Group uses operating profit and internal growth to enhance the understanding of our results. These additional measures should be viewed as complementary to, rather than a substitute for, our figures determined according to IFRS.

For further information, please refer to note 5 to the consolidated financial statements.

Composition of total revenues

Total revenues comprise statutory gross premiums written in Property-Casualty and Life/Health, operating revenues in Asset Management, and total revenues in Corporate and Other (Banking).

COMPOSITION OF TOTAL REVENUES
€ MN

	2016	2015
Property-Casualty		
Gross premiums written	51,535	51,597
Life/Health		
Statutory premiums	64,636	66,903
Asset Management		
Operating revenues	6,022	6,479
consisting of:		
Net fee and commission income	6,019	6,488
Net interest income[1]	(5)	(5)
Income from financial assets and liabilities carried at fair value through income (net)	6	(8)
Other income	3	4
Corporate and Other		
thereof: Total revenues (Banking)	551	577
consisting of:		
Interest and similar income	474	546
Income from financial assets and liabilities carried at fair value through income (net)[2]	14	16
Fee and commission income	540	565
Interest expenses, excluding interest expenses from external debt	(172)	(212)
Fee and commission expenses	(308)	(340)
Consolidation effects within Corporate and Other	2	2
Consolidation	(328)	(365)
Allianz Group total revenues	**122,416**	**125,190**

1 — Represents interest and similar income less interest expenses.
2 — Includes trading income.

Composition of total revenue growth

We believe that an understanding of our total revenue performance is enhanced when the effects of foreign currency translation as well as acquisitions, disposals, and transfers (or "changes in scope of consolidation") are analyzed separately. Accordingly, in addition to presenting nominal total revenue growth, we also present internal growth, which excludes these effects.

RECONCILIATION OF NOMINAL TOTAL REVENUE GROWTH TO INTERNAL TOTAL REVENUE GROWTH
%

	Internal growth	Changes in scope of consolidation	Foreign currency translation	Nominal growth
2016				
Property-Casualty	3.1	(1.0)	(2.2)	(0.1)
Life/Health	(3.1)	0.2	(0.5)	(3.4)
Asset Management	(7.5)	0.3	0.1	(7.1)
Corporate and Other	(4.4)	0.0	0.0	(4.4)
Allianz Group	**(0.8)**	**(0.3)**	**(1.2)**	**(2.2)**
2015				
Property-Casualty	2.9	0.7	3.2	6.8
Life/Health	(4.9)	0.0	4.2	(0.6)
Asset Management	(11.4)	0.0	12.8	1.4
Corporate and Other	4.5	(0.7)	0.0	3.7
Allianz Group	**(2.1)**	**0.3**	**4.2**	**2.4**

Life/Health Insurance Operations

OPERATING PROFIT

The reconciling item *scope* comprises the effects from out-of-scope entities in the profit sources reporting compilation. Operating profit from operating entities that are not in-scope entities is included in the investment margin. Currently, 20 entities comprising 97.5 % of Life/Health total statutory premiums are in scope.

EXPENSES

Expenses comprise acquisition expenses and commissions as well as administrative and other expenses.

The delta shown as *definitions* in acquisition expenses and commissions represents commission clawbacks, which are allocated to the technical margin. The delta shown as *definitions* in administrative and other expenses mainly represents restructuring charges, which are stated in a separate line item in the group income statement.

ACQUISITION, ADMINISTRATIVE, CAPITALIZATION, AND AMORTIZATION OF DAC[1]
€ MN

	2016	2015
Acquisition expenses and commissions[2]	(4,927)	(4,754)
Definitions	13	16
Scope	(390)	(524)
Acquisition costs incurred and commissions	(5,304)	(5,262)
Capitalization of DAC[2]	1,868	1,721
Definition: URR capitalized	509	528
Definition: policyholder participation[3]	1,022	880
Scope	187	236
Capitalization of DAC	3,586	3,364
Amortization, unlocking and true-up of DAC[2]	(1,916)	(1,878)
Definition: URR amortized	64	(175)
Definition: policyholder participation[3]	(881)	(1,006)
Scope	(409)	(374)
Amortization, unlocking and true-up of DAC	(3,142)	(3,432)
Commissions and profit received on reinsurance business ceded	77	115
Acquisition costs[4]	**(4,782)**	**(5,215)**
Administrative and other expenses[2]	(1,760)	(1,636)
Definitions	139	119
Scope	(213)	(194)
Administrative expenses on reinsurance business ceded	4	4
Administrative expenses[4]	**(1,829)**	**(1,707)[5]**

1 — Prior year figures changed in order to reflect the roll out of profit source reporting to China.
2 — As per Group Management Report.
3 — For German Speaking Countries, policyholder participation on revaluation of DAC/URR capitalization/amortization.
4 — As per notes to the consolidated financial statements.
5 — Excluding one-off effects from pension revaluation.

IMPACT OF CHANGE IN DEFERRED ACQUISITION COSTS (DAC)

Impact of change in DAC includes effects of change in DAC, unearned revenue reserves (URR), and value of business acquired (VOBA), and is the net impact of the deferral and amortization of acquisition costs and front-end loadings on operating profit.

URR capitalized: Capitalization amount of unearned revenue reserves (URR) and deferred profit liabilities (DPL) for FAS 97 LP.

URR amortized: Total amount of URR amortized includes scheduled URR amortization, true-up and unlocking.

Both capitalization and amortization is included in the line item premiums earned (net) in the group income statement.

Policyholder participation is included within change in reserves for insurance and investment contracts (net) in the group income statement.

RECONCILIATION TO NOTES[1]
€ MN

	2016	2015
Acquisition expenses and commissions[2]	(4,927)	(4,754)
Administrative and other expenses[2]	(1,760)	(1,636)
Capitalization of DAC[2]	1,868	1,721
Amortization, unlocking and true-up of DAC[2]	(1,916)	(1,878)
Acquisition and administrative expenses	**(6,735)**	**(6,548)**
Definitions	867	362
Scope	(825)	(855)
Commissions and profit received on reinsurance business ceded	77	115
Administrative expenses on reinsurance business ceded	4	4
Acquisition and administrative expenses (net)[3]	**(6,612)**	**(6,922)[4]**

1 — Prior year figures changed in order to reflect the roll out of profit source reporting to China.
2 — As per Group Management Report.
3 — As per notes to the consolidated financial statements.
4 — Excluding one-off effects from pension revaluation.

Risk and Opportunity Report

Target and strategy of risk management

For the benefit of shareholders and policyholders alike, Allianz's aim is to ensure that the Group is adequately capitalized at all times and that all operating entities at least meet their respective regulatory capital requirements. Furthermore, risk capital – reflecting our risk profile – and cost of capital are important aspects taken into account in business decisions.

In addition, we take into account the requirements of regulators and rating agencies. While capital requirements imposed by regulators constitute a binding constraint, meeting rating agencies' capital requirements and maintaining strong credit ratings are strategic business objectives of the Allianz Group.

We closely monitor the capital position of the Group and its operating entities along each of these dimensions, and apply regular stress tests (standardized, historical, and reverse stress test scenarios as well as monthly stress scenarios focusing on current and possible future developments). This allows us to take appropriate measures to ensure our continued capital and solvency strength.

For this the risk management system described in the following is applied.

Risk governance

RISK MANAGEMENT FRAMEWORK

As a provider of financial services, we consider risk management to be one of our core competencies. It is therefore an integral part of our business process. Our risk management framework is risk-based and covers all operations including IT, processes, products, and departments as well as subsidiaries within the Group. The key elements of our risk management framework are:

- Promotion of a strong risk management culture, supported by a robust risk governance structure.
- Consistent, proportional application of an integrated risk capital framework across the Group to protect our capital base and support effective capital management.
- Integration of risk considerations and capital needs into management and decision-making processes by attributing risk and allocating capital to the various business segments, products, and strategies.

This comprehensive framework ensures that risks are identified, analyzed, assessed, and managed consistently across the Group. Our risk appetite is defined by a clear limit structure and a risk strategy consistent with the underlying business strategy of the Group. Close risk monitoring and reporting allows us to detect potential deviations from our risk tolerance at an early stage at both the Group and operating entity levels.

Our risk management system is based on the following four essential elements:

Risk underwriting and identification: A sound risk underwriting and identification framework forms the foundation for adequate risk-taking and management decisions such as individual transaction approvals, new product approvals, and strategic asset allocations. The framework includes risk assessments, risk standards, valuation methods, and clear minimum standards for underwriting.

Risk strategy and risk appetite: Our risk strategy clearly defines our risk appetite. It ensures that rewards are appropriate considering the risks taken and that the delegated authorities are in line with our overall risk-bearing capacity. The risk-return profile is improved by integrating the risk considerations and capital needs into decision-making processes. This also keeps risk strategy and business objectives consistent with each other and allows us to take opportunities within our risk tolerance.

Risk reporting and monitoring: Our comprehensive qualitative and quantitative risk reporting and monitoring framework provides senior management with the transparency and risk indicators to help them decide on our overall risk profile and assess whether it falls within delegated limits and authorities. For example, risk dashboards, internal risk allocation, and limit consumption reports are regularly prepared, communicated and monitored.

Communication and transparency: Finally, transparent and robust risk disclosure provides the basis for communicating this strategy to our internal and external stakeholders, ensuring a sustainable positive impact on valuation and financing. It also strengthens the risk awareness and risk culture throughout the entire Group.

OUR STRATEGY

OUR BUSINESS ASPIRATIONS

The Allianz Group seeks to position itself as the world's most trusted financial institution through a focus on the following:

- portfolio strength: establishing a strong and high-quality portfolio in large and attractive markets,
- market leadership: maintaining a commanding position in each market with superior skills and scale,
- customer centricity: practicing relentless execution centered on customers while outperforming competition.

These aspirations have been translated into clear ambitions for 2018. With regard to financial performance, we strive for a return on equity (excluding unrealized gains/losses on bonds net of shadow accounting) of 13 %, while growing our earnings per share at a compound annual growth rate of 5 %. To ensure the sustainability of our performance, we have set ourselves health targets for customer loyalty and employee engagement: We expect at least 75 % of our businesses to be or become rated by their customers as Loyalty Leader or above-market in terms of Net Promoter Score (NPS). At the same time, we aim to increase our Inclusive Meritocracy Index to 72 % (2016: 70 %). We are making good progress in achieving these objectives.

OUR BUSINESS STRATEGY

In order to achieve these aspirations the Board of Management of Allianz SE has defined a clear business strategy consisting of five pillars:

1. True Customer Centricity: making superior customer experience the top priority for all our actions,
2. Digital by Default: moving from selected leading assets to become “Digital by Default” everywhere,
3. Technical Excellence: creating superior margins, innovation, and growth through best talents and state-of-the-art skills,
4. Growth Engines: systematically exploiting new sources for profitable growth,
5. Inclusive Meritocracy: re-inforcing a culture where both people and performance matter.

The Board of Management of Allianz SE has also defined a strategy for the management of risks that the Allianz Group faces during the pursuit of its business strategy. This risk strategy places particular emphasis on protecting the Allianz brand and reputation, remaining solvent even in the event of extreme worst-case scenarios, maintaining sufficient liquidity to always meet financial obligations, and providing resilient profitability.

RISK GOVERNANCE STRUCTURE

SUPERVISORY BOARD AND BOARD OF MANAGEMENT

Within our risk governance system, the Supervisory Board and Board of Management of Allianz SE have both, Allianz SE and group-wide responsibilities and have set up committees to provide them with support. Examples include:

Supervisory Board

The Risk Committee of the Supervisory Board monitors the effectiveness of the Allianz risk management and monitoring framework. Furthermore, it focuses on risk-related developments as well as general risks and specific risk exposures.

Board of Management

The Board of Management formulates business objectives and a corresponding, consistent risk strategy. The core elements of the risk framework are set out in the Allianz Group Risk Policy, which is approved by the Board of Management.

The Group Finance and Risk Committee (GFRC) ensures oversight of the Group’s and Allianz SE’s risk management framework, acting as a primary early-warning function by monitoring the Allianz Group’s and Allianz SE’s risk profiles as well as the availability of capital. The GFRC also ensures that an adequate relationship between return and risk is maintained. Additionally, the GFRC defines risk standards, forms the limit-setting authority within the framework set by the Board of Management and approves major financing and reinsurance transactions. Finally, the GFRC supports the Board of Management with recommendations regarding the capital structure, and the capital allocation and investment strategy, including strategic asset allocation.

OVERALL RISK ORGANIZATION AND ROLES IN RISK MANAGEMENT

A comprehensive system of risk governance is achieved by setting standards related to organizational structure, risk strategy and appetite, written policies, limit systems, documentation, and reporting. These standards ensure the accurate and timely flow of risk-related information and a disciplined approach towards decision-making and execution at both the global and local level.

As a general principle, the “first line of defense” rests with business managers in the local operating entities and Allianz Investment Management units. They are responsible, in the first instance, for both the risks of and returns on their decisions. Our “second line of defense” is made up of our independent, global oversight functions such as Risk, Actuarial, Compliance and Legal. Audit forms the “third line of defense”. On a periodic basis, Group Audit independently reviews risk governance implementation, as well as compliance with risk principles, performs quality reviews of risk processes, and tests adherence to business standards, including the internal control framework.

Group Risk

Group Risk is managed by the Group Chief Risk Officer, who reports to the board member responsible for Finance, Controlling, and Risk. Group Risk supports the aforementioned Allianz Group committees responsible for risk oversight through the analysis and communication of risk management-related information and by facilitating the communication and implementation of committee decisions. For example, Group Risk is operationally responsible for monitoring the limits for risks that accumulate, including natural disasters and exposures to financial markets and counterparties.

In addition, Group Risk independently supports the adequacy of the operating entities’ risk management through the development of a common risk management framework and by monitoring adherence to Group minimum requirements for methods and processes. Group Risk strengthens the Group’s risk network through regular and close interaction with the operating entities’ management and with key areas such as the local finance, risk, actuarial, and investment departments.

Operating entities

Operating entities are responsible for their own risk management, including adherence to both external requirements (for example, those imposed by local regulators) and internal group-wide standards. The operating entities’ Boards of Management are responsible for setting and approving a local risk strategy during the annual Strategic and Planning Dialogues with the Group and for ensuring operating entities’ adherence to their risk strategy.

In addition, a risk function which is independent from the business line management is established by each operating entity. This function operates under the direction of the operating entity’s Chief Risk Officer. In addition, a local Risk Committee supports both the operating entity’s Board of Management and the Chief Risk Officer by acting as the primary risk controlling body. Group Risk is also represented on the local Risk Committees to enhance the risk dialogue between the Group and the operating entities.

Other functions and bodies

In addition to Group Risk and the operating entities' risk functions, legal and compliance and actuarial functions have been established at both the Group and operating entity level, constituting additional components of the "second line of defense".

Group Legal and Compliance seeks to mitigate legal risks with support from other departments. The objectives of Group Legal and Compliance are to ensure that laws and regulations are observed, to react appropriately to all impending legislative changes or new court rulings, to attend to legal disputes and litigation, and to provide legally appropriate solutions for transactions and business processes. In addition, Group Legal and Compliance is responsible for integrity management, which aims to protect the Allianz Group, our operating entities and employees from regulatory risks.

Group Actuarial contributes towards assessing and managing risks in line with regulatory requirements. These risks stem from the risk-taking/mitigating activities involving professional actuarial experience. The range of tasks includes, among others, the calculation and monitoring of technical provisions, technical actuarial assistance in business planning, reporting and monitoring the results, and supporting the effective implementation of the risk management system.

In order to adapt to a continually changing environment, the Global Issues Forum (GIF) supports the Group in the assessment of long-term trend changes in the risk landscape on a timely basis.

Risk based steering and risk management

The Allianz Group is exposed to a variety of risks through its core insurance and asset management activities. These include market, credit, underwriting, business, operational, strategic, liquidity, and reputational risks.

With Solvency II being the binding regulatory regime since 1 January 2016 and the approval of our partial internal model[1], risk is measured and steered based on the risk profile underlying our regulatory capital requirement. We introduced capitalization limits defining a target capitalization according to Solvency II after applying shock scenarios on both the Group and the operating entity level. By that we allow for a consistent view on risk steering and capitalization under the Solvency II framework. This is supplemented by economic scenarios and sensitivities.

Allianz steers its portfolio using a comprehensive view of risk and return, i.e. results based on the partial internal risk model including scenario-based analysis are actively used for decision-making: On the one hand, economic risk and concentrations are actively restricted by the limits outlined above; on the other hand, there is a comprehensive analysis of the return on risk capital (RoRC). The latter allows us to identify profitable lines of business and products on a sustainable basis, which provide reasonable profits on allocated risk capital over the life time of the products. Therefore, it is a key criterion for capital allocation decisions.

As an integrated financial services provider, we consider diversification across different business segments and regions to be a key element in managing our risks efficiently by limiting the economic impact of any single event and by contributing to relatively stable results and risk profile in general. Therefore, our aim is to maintain a balanced risk profile without bearing any disproportionately large risk concentrations and accumulations.

In addition, central elements of Allianz's dividend policy are linked to the Solvency II capitalization based on our partial internal model. This shows that the partial internal model is fully integrated in the business steering of Allianz and that the application of the partial internal model satisfies the so-called "use-test" under Solvency II.

1 — From a formalistic perspective, the German Supervisory Authority deems our model to be "partial" because it does not cover all of our operations: some of our smaller operations report under the standard model and others under the deduction and aggregation approach.

MARKET RISK

With respect to investments, top-down indicators such as strategic asset allocations are defined and closely monitored to ensure balanced investment portfolios. Furthermore, we have a limit system in place which is defined at Group level – separately for the Life/Health and the Property-Casualty business segments – as well as at operating entity level. The limits comprise economic limits, in particular financial Value-at-Risk (VaR) and credit VaR as derived from the internal risk capital framework, complemented by stand-alone interest rate and equity sensitivity limits as well as by limits on foreign exchange exposures.

In order to further limit the impact of any financial market changes and to ensure that assets adequately back policyholder liabilities, we have additional measures in place. One of these is asset/liability management, linked to the internal risk capital framework, which incorporates risks as well as return aspects stemming from our insurance obligations. In addition, we are using derivatives mostly to either hedge our portfolio against adverse market movements or reduce our reinvestment risk – for example, by using forwards or swaptions. In addition, guidelines are derived by the Group center for certain investments – for example, concerning the use of derivatives – and compliance with the guidelines is controlled by the respective risk and controlling functions.

Furthermore, we have put in place standards for hedging activities due to exposures to fair value options embedded in life insurance products.

CREDIT RISK

The Allianz Group monitors and manages credit risk exposures and concentrations to ensure we are able to meet policyholder obligations when they are due. Credit risks are reflected by the internal credit risk model as well as the obligor group limit management system. Group-wide credit data is collected following a centralized process and using standard obligor and obligor group mappings.

The internal credit risk capital model considers the major drivers of credit risk for each instrument, such as exposure at default, ratings, seniority, collateral, and maturity. Additional parameters assigned to obligors are migration probabilities and obligor asset correlations reflecting dependencies within the portfolio. Ratings are assigned to single obligors via an internal rating approach which is based on long-term ratings from rating agencies. It is dynamically adjusted using market-implied ratings and the most recently available qualitative information.

The loss profile of a given portfolio is obtained through a Monte Carlo simulation, taking into account interdependencies and exposure concentrations per obligor segment. To reflect portfolio-specific diversification effects, the loss profiles are calculated at different levels of the Allianz Group structure (pre-diversified). They are then fed into the overall partial internal risk capital model for further aggregation across sources of risk to derive group-diversified internal credit risk.

Our credit insurance portfolio is modeled by Euler Hermes based on a proprietary model component, which is a local adaptation of the central internal credit risk module and is reviewed by Group Risk. Euler Hermes's loss profile is integrated in the Group's internal credit risk model to capture the concentration and diversification effects. In our credit insurance business, proactive credit management offers opportunities to keep losses from single credit events below expected levels and therefore strongly supports writing business that contributes to a balanced Group credit portfolio.

To ensure effective credit risk management, credit VaR limits are derived from our internal risk capital framework, as well as from rating bucket benchmarks which define our risk appetite for exposures in the lower investment grade and non-investment grade area.

Our group-wide country and obligor group limit management framework (CRisP[1]) allows us to manage counterparty concentration risk. It covers credit and equity exposures and is based on data used by the investment and risk experts at the Group and operating entity levels. This limit framework forms the basis for discussions on credit actions and provides notification services with a quick and broad communication of credit-related decisions across the Group. Clearly defined processes ensure that exposure concentrations and limit utilizations are appropriately monitored and managed. The setting of country and obligor exposure limits from the Group's perspective (i.e. the maximum concentration limit) takes into account the Allianz Group's portfolio size and structure as well as our overall risk strategy.

UNDERWRITING RISK

PROPERTY-CASUALTY

Our Property-Casualty insurance businesses are mainly exposed to premium risk and reserve risks as part of the underwriting risk.

Premium risk is subdivided into natural catastrophe risk, terror risk, and non-catastrophe risk. We calculate premium risk based on actuarial models that are used to derive loss distributions. Premium risk is actively managed by the Allianz Group and its local operating entities. The assessment of risks as part of the underwriting process are key elements of our risk management framework. There are clear underwriting limits and restrictions, centrally defined and in place across the Group. In addition to the underwriting limits which are defined centrally, local operating entities have limits in place that take into account their business environments. Excessive risks are mitigated by external reinsurance agreements. All these measures contribute to a limitation on risk accumulation.

We also monitor concentrations and accumulation of non-market risks on a stand-alone basis (i.e. before diversification effects) within a global limit framework in order to avoid substantial losses from single events such as natural catastrophes and from man-made catastrophes such as terror or large industrial accumulations.

Natural disasters, such as earthquakes, storms and floods, represent a significant challenge for risk management due to their accumulation potential and occurrence volatility. In order to measure such risks and better estimate the potential effects of natural disasters, we use special modeling techniques in which we combine portfolio data (such as the geographic distribution and characteristics of insured objects and their values) with simulated natural disaster scenarios to estimate the magnitude and frequency of potential losses. Where such stochastic models do not exist, we use deterministic, scenario-based approaches to estimate potential losses. Similar models and scenario-based approaches are used to evaluate risk concentrations and man-made catastrophes, including losses from terrorism and industrial concentrations, etc.

In general, our operating entities constantly monitor the development of reserves for insurance claims on a line-of-business level.[2] In addition, the operating entities generally conduct annual reserve uncertainty analyses. Allianz SE performs regular independent reviews of these analysis and Allianz SE representatives participate in the local reserve committees' meetings.

LIFE/HEALTH

Underwriting risks in our Life/Health operations (biometric risks) include mortality, disability, morbidity, and longevity risks. Mortality, disability, and morbidity risks are associated with the unexpected increase in the occurrence of death, disability, or medical claims on our insurance products. Longevity risk is the risk that, due to changing biometric assumptions, the reserves covering life annuities and group pension products might not be sufficient.

We measure these risks within our partial internal risk capital model by distinguishing between the different sub-components whenever relevant or material: absolute level, trend, volatility around best-estimate assumptions, and pandemic risks. Depending on the nature and complexity of the risk involved, our health business is represented in the partial internal model, according to Property-Casualty or Life/Health calculation methods, and is therefore included in the relevant Property-Casualty and Life/Health figures accordingly. However, most of our health business is attributable to the Life/Health business segment.

OPERATIONAL RISK

Allianz has developed a consistent group-wide operational risk management framework that focuses on the early recognition and proactive management of operational risks in all "first line of defense" functions. Local risk managers as the "second line of defense" ensure this framework is implemented in their respective operating entities.

They identify and evaluate relevant operational risks and control weaknesses via a dialogue between the "first line of defense" and the risk function. Furthermore, operational risk events are collected in a central risk event database. Since 2015, Allianz also delivers anonymized internal loss data to the "Operational Riskdata eXchange Association (ORX)", a global operational loss data insurance consortium, to improve our internal control system and to validate operational risk parameters.

The risks related to non-compliance or other misconduct are addressed via various dedicated compliance programs. Written policies detail the Allianz Group's approach towards the management of these areas of risk. The implementation and communication of those compliance programs are monitored by the Group Compliance function at Allianz SE. In close cooperation with the Risk function of the Group, risk-mitigating measures are taken and enforced by a global network of dedicated compliance functions throughout the Allianz Group. With respect to financial statements, our internal control system is designed to mitigate operational risks.[3]

1 — Credit Risk Platform.

2 — For further information, please refer to note 15 to the consolidated financial statements.

3 — For additional information regarding our internal controls over financial reporting, please refer to Controls over Financial Reporting from page 75 onward.

Major failures and disasters at our outsourcing providers which could cause a severe disruption to our working environment may represent significant operational risks for the Allianz Group. Our Business Continuity and Crisis Management framework strives to protect critical business functions from these events and enables them, for example, to carry out their core tasks on time and at the highest standard also in a crisis event.

Allianz works on a Cyber and Information Security program on an ongoing basis, in order to better respond to external developments and to further strengthen the internal control environment for related operational risks.

OTHER RISKS

There are certain risks that cannot be fully quantified across the Group using our partial internal risk capital model. For these risks we also pursue a systematic approach with respect to identification, analysis, assessment, monitoring, and steering. In general, the risk assessment is based on qualitative criteria or scenario analyses. The most important of these other risks are strategic, liquidity and reputational risk.

STRATEGIC RISK

Strategic risks are evaluated and analyzed in the strategic and planning dialogue between the Allianz Group and its operating entities and controlled by monitoring the respective business goals. We also monitor market and competitive conditions, capital market requirements, regulatory conditions, etc., to decide whether to make strategic adjustments.

LIQUIDITY RISK

The main goal of planning and managing Allianz SE's liquidity position is to ensure that we are always able to meet payment obligations. To comply with this objective, the liquidity position of Allianz SE is monitored and forecast on a daily basis. Strategic liquidity planning over time horizons of 12 months and three years is reported to the Board of Management regularly.

The accumulated short-term liquidity forecast is updated daily and is subject to an absolute minimum strategic cushion amount and an absolute minimum liquidity target. Both are defined for the Allianz SE cash pool in order to be protected against short-term liquidity crises. As part of our strategic planning, contingent liquidity requirements and sources of liquidity are taken into account to ensure that Allianz SE is able to meet any future payment obligations even under adverse conditions. Major contingent liquidity requirements include non-availability of external capital markets, combined market and catastrophe risk scenarios for subsidiaries, as well as lower-than-expected profits and dividends from subsidiaries.

Our insurance operating entities manage liquidity risk locally, using asset/liability management systems designed to ensure that assets and liabilities are adequately matched. In the course of standard liquidity planning, we reconcile the cash flows from our investment portfolio – containing a significant portion of liquid assets (e.g. government bonds or mortgage bonds with a very good credit rating) – with the estimated liability cash flows. These analysis are performed at the operating entity level and aggregated at the Group level.

In 2016, we rolled out a newly developed group-wide liquidity risk framework in order to further strengthen the Allianz liquidity risk management within Allianz Group and the resilience to stress scenarios. This framework considers liquidity sources (e.g. cash flows from investments and premiums) and liquidity needs (e.g. payments due to insurance claims) and explicitly takes stress situations for liquidity sources and needs into account to assess the liquidity and allows for a group-wide consistent view on liquidity risks.

REPUTATIONAL RISK

Allianz's reputation as a well-respected and socially aware provider of financial services is influenced by our behavior in a range of areas such as product quality, corporate governance, financial performance, customer service, employee relations, intellectual capital, and corporate responsibility.

With the support of Group Communications and Corporate Responsibility (GCORE), Group Compliance, and the ESG Office[1], Group Risk defines sensitive business areas and applicable risk guidelines which are mandatory for all operating entities in the Allianz Group. All Group and operating entity functions affected cooperate in the identification of reputational risk. GCORE is responsible for risk assessment based on a group-wide methodology. Since 2015, Allianz has embedded conduct risk triggers for fair products and services into the reputational risk management process.

The identification and assessment of reputational risks are part of a yearly Top Risk Assessment, during which senior management also decides on a risk management strategy and related actions. This is supplemented by quarterly updates. In addition, reputational risk is managed on a case-by-case basis. Single cases with a potential impact on other operating entities or the Group have to be reported to the Allianz Group for pre-approval.

Internal risk capital framework

We define internal risk capital as the capital required to protect us against unexpected, extreme economic losses, which forms the basis for determining our Solvency II regulatory capitalization and the associated risk profile. On a quarterly basis, we calculate and consistently aggregate internal risk capital across all business segments. We also project risk capital requirements on a bi-weekly basis during periods of financial market turbulence.

GENERAL APPROACH

We utilize an approach for the management of our risk profile and solvency position that reflects the Solvency II rules. This comprises our approved partial internal model covering all major insurance operations.[2] Other entities are reflected based on their standard model results as well as on sectoral or local requirements, in accordance with the Solvency II framework.

1 — The Allianz Environmental, Social, Governance (ESG) Board and ESG office are constituted as advisor to the Board of Management of Allianz SE and will further elevate environmental, social, and governance aspects in corporate governance and decision-making processes at the Allianz Group.

2 — Allianz Life US included based on third country equivalence with 150% of RBC CAL since 30 September 2015.

INTERNAL RISK CAPITAL MODEL

Our partial internal risk capital model is based on a VaR approach using a Monte Carlo simulation. Following this approach, we determine the maximum loss in the portfolio value of our businesses in the scope of the model within a specified timeframe ("holding period") and probability of occurrence ("confidence level"). We assume a confidence level of 99.5 % and apply a holding period of one year. In the risk simulation, we consider risk events from all modeled risk categories ("sources of risk") and calculate the portfolio value based on the net fair value of assets and liabilities under potentially adverse conditions, including risk mitigating measures like reinsurance contracts or derivatives.

Risk capital is defined as the difference between the current portfolio value and the portfolio value under adverse conditions dependent on the 99.5 % confidence level. Because we consider the impact of a negative or positive event on all sources of risks and covered businesses at the same time, diversification effects across products and regions are taken into account. The results of our Monte Carlo simulation allow us to analyze our exposure to each source of risk, both separately and in aggregate. In addition, in particular for market risks, we analyze several pre-defined stress scenarios, based on either historically observed market movements or hypothetical market movement assumptions. This modeling approach, therefore, also enables us to identify scenarios that may have a positive impact on our solvency situation.

Furthermore, there are monthly stress test meetings where world-wide political and financial developments are examined in order to understand their potential effects on the Group and to provide appropriate actions or recommendations to management.

COVERAGE OF THE RISK CAPITAL CALCULATIONS

Allianz's partial internal risk capital model covers all major insurance operations[1]. This includes the relevant assets (including bonds, loans, mortgages, investment funds, equities, and real estate) and liabilities (including the cash flow run-off profile of all technical reserves as well as deposits, issued debt, and other liabilities). For with-profit products in the Life/Health business segment, options and guarantees embedded in insurance contracts – including policyholder participation rules – are taken into account.[2]

Smaller entities within the European Economic Area which are not covered by the partial internal model are reflected based on their standard model results. At Group level, the capital requirements for smaller insurance operating entities outside the European Economic Area that have only an immaterial impact on the Group's risk profile are treated with book value deduction[3].

Risk capital related to our European banking operations is allocated to the Corporate and Other business segment, based on the approach applied by banks under the local requirements with respect to the Basel regulation (Basel standards). Capital requirements for banks represent an insignificant amount of approximately 1.7 % (2015: 1.5 %) of our total pre-diversified risk. Therefore, risk management with respect to banking operations is not discussed in more detail.

For our Asset Management business segment, we assign internal risk capital requirements based on the sectorial regulatory capital requirements as defined under Solvency II. The Asset Management business is mainly affected by operational risks. However, since most of our Asset Management business is not located within the Eurozone, at the Group level it also bears foreign exchange rate risk. Our Asset Management business is covered by adequate risk controlling processes, including regular reporting and qualitative risk assessments (such as Top Risk Assessment) to the Group. However, since it is mainly affected by the two risk types previously mentioned (operational and foreign exchange rate), and due to the fact that the impact on total pre-diversified risk capital is minor, risk management with respect to Asset Management is not discussed in more detail.

ASSUMPTIONS AND LIMITATIONS

YIELD CURVE AND VOLATILITY ADJUSTMENT ASSUMPTIONS

When calculating the fair values of assets and liabilities, the assumptions regarding the underlying risk-free yield curve are crucial in determining and discounting future cash flows. We apply the methodology provided by the European Insurance and Occupational Pensions Authority (EIOPA) within the technical documentation (EIOPA-BoS-15/035) for the extension of the risk-free interest rate curves beyond the last liquid tenor.[4]

In addition, we adjust the risk-free yield curves by a volatility adjustment in most markets where a volatility adjustment is defined by EIOPA and approved by the local regulator. This is done to better reflect the underlying economics of our business, as the cash flows of our insurance liabilities are, to a large degree, predictable. The advantage of being a long-term investor, therefore, is the opportunity to invest in bonds yielding spreads over the risk-free return and earning this additional yield component over the duration of the bonds. Being a long-term investor considerably mitigates the risk of forced selling of debt instruments at a loss prior to maturity. Therefore, we reflect this mitigation using a volatility adjustment spread risk offset, and view the more relevant risk to be default risk rather than credit spread risk.

VALUATION ASSUMPTIONS: REPLICATING PORTFOLIOS

Since efficient valuation and complex, timely analysis are required within the context of our partial internal model, we replicate the liabilities of our Life/Health insurance business as well as for our internal pension obligations. This technique enables us to represent all product related options and guarantees, both contractual and discretionary, by means of standard financial instruments. In the risk calculation we use the replicating portfolio to determine and revalue these liabilities under all potentially adverse Monte Carlo scenarios.

DIVERSIFICATION AND CORRELATION ASSUMPTIONS

Our partial internal risk capital model considers concentration, accumulation, and correlation effects when aggregating results at Group level. This reflects the fact that not all potential worst-case losses are likely to materialize at the same time. This effect is known as diversification and forms a central element of our risk management framework.

1 — As mentioned under Internal risk capital framework, Allianz Life US is based on third country equivalence.
2 — For further information about participating life business, please refer to note 16 to the consolidated financial statements.
3 — Under book value deduction, the book value of the respective entity is deducted from eligible own funds of the Group.
4 — Due to late availability of the EIOPA publication, the risk-free interest rate term structure used might slightly differ from the one published by EIOPA.

Where possible, we derive correlation parameters for each pair of market risks through statistical analysis of historical market data, considering quarterly observations over several years. In case historical market data or other portfolio-specific observations are insufficient or not available, correlations are set according to a well-defined group-wide process. Correlations are determined by the Correlation Settings Committee, which combines the expertise of risk and business experts. In general, we set the correlation parameters to represent the joint movement of risks under adverse conditions. Based on these correlations, we use an industry-standard approach, the Gaussian copula approach, to determine the dependency structure of quantifiable sources of risk within the applied Monte Carlo simulation.

ACTUARIAL ASSUMPTIONS

Our partial internal risk capital model also includes assumptions on claims trends, liability inflation, mortality, longevity, morbidity, policyholder behavior, expense, etc. We use our own internal historical data for actuarial assumptions wherever possible, and also consider recommendations from the insurance industry, supervisory authorities, and actuarial associations. The derivation of our actuarial assumptions is based on generally accepted actuarial methods. Within our internal risk capital and financial reporting framework, comprehensive processes and controls exist for ensuring the reliability of these assumptions.

LIMITATIONS

Because of the 99.5 % confidence level, there is a low statistical probability of 0.5 % that actual losses could exceed this threshold at Group level in the course of one year.

We use model and scenario parameters derived from historical data, where available, to characterize future possible risk events. If future market conditions differ substantially from the past, for example in an unprecedented crisis, our VaR approach may be too conservative or too liberal in ways that are difficult to predict. In order to mitigate reliance on historical data, we complement our VaR analysis with stress testing.

Furthermore we validate the model and parameters through sensitivity analyses, independent internal peer reviews and, where appropriate, independent external reviews, focusing on methods for selecting parameters and control processes. To ensure proper validation we established an Independent Validation Unit (IVU) within Group Risk responsible for validating our partial internal model within a comprehensive model validation process. Overall, we believe that to the extent possible our validation efforts are effective and that the model adequately assesses the risks to which we are exposed.

The construction and application of the mentioned replicating portfolios is subject to the set of available replicating instruments and might, therefore, be too simple or too restrictive to capture all factors affecting the change in value of liabilities. As with other model components, the replications are subject to independent validation and to suitability assessments as well as to stringent data and process quality controls. Therefore, we believe that the liabilities are adequately represented by the replicating portfolios.

Since the partial internal risk capital model takes into account the change in the economic fair value of our assets and liabilities, it is crucial to estimate the market value of each item accurately. For some assets and liabilities it may be difficult, if not impossible – notably in distressed financial markets – to either obtain a current market price or apply a meaningful mark-to-market approach. For such assets we apply a mark-to-model approach. For some of our liabilities, the accuracy of their values also depends on the quality of the actuarial cash flow estimates. Despite these limitations, we believe the estimated fair values are appropriately assessed.

MODEL CHANGES IN 2016

At the beginning of the year, a regulatory change in the tax treatment for the German life sector resulted in a decrease of the risk capital requirement of € 0.3 BN. There were no major model changes in 2016. Minor and immaterial model changes during the year slightly decreased the capital requirement by € 0.4 BN, leading to an overall negative impact of regulatory and model changes of € 0.7 BN.

Allianz risk profile and management assessment

RISK PROFILE AND MARKET ENVIRONMENT

As mentioned earlier, the Allianz Group is exposed to a variety of risks. The largest risks in terms of their contribution to Allianz's risk profile are:

- Market risk, especially interest rate risk, due to the duration mismatch between assets and liabilities for long-term savings products, equity risk, credit and credit spread risks driven by assets backing long-term liabilities, which we take to benefit from the expected risk premium;
- Property-casualty premium and reserve risks resulting from natural and man-made catastrophes as well as from claims uncertainty.

The risk profile and relative contributions have changed in 2016, predominantly due to changes in the market environment and management actions such as the disposal of our South Korean life business.

FINANCIAL MARKETS AND OPERATING ENVIRONMENT

Financial markets are characterized by historically low interest rates and risk premiums, prompting investors to look for higher-yielding – and potentially higher-risk – investments. In addition to sustained low interest rates, the challenges of implementing long-term structural reforms in key Eurozone countries and the uncertainty about the future path of monetary policy may lead to continued market volatility. This could be accompanied by a flight to quality, combined with falling equity and bond prices due to rising spread levels, even in the face of potentially lower interest rates. Also, possible asset bubbles (as observed in the Chinese equity market) might spill over to other markets, contributing to increasing volatility. Therefore, we continue to closely monitor the political and financial developments in the Eurozone – such as Brexit in the United Kingdom and the "No" vote to constitutional reforms in Italy – in order to manage our overall risk profile to specific event risks.

REGULATORY DEVELOPMENTS

Following the approval of our partial internal model in November 2015, the model has been fully applied since the beginning of 2016, starting with the Solvency II day one reporting. Nevertheless, some uncertainty about the future capitalization requirements of Allianz remains, since the future capital requirements applicable for Global Systemically Important Insurers (so-called G-SII) are still not finalized. Finally, the potential for a multiplicity of different regulatory regimes, capital standards, and reporting requirements will increase operational complexity and costs.

MANAGEMENT ASSESSMENT

The Allianz Group's management feels comfortable with the Group's overall risk profile and has confidence in the effectiveness of its risk management framework to meet the challenges of a rapidly changing environment as well as day-to-day business needs. This confidence is based on several factors, which are summarized below:

- Due to its effective capital management, the Allianz Group is well capitalized and met its internal-, rating agency- and regulatory-solvency targets as of 31 December 2016. Allianz is also confident that it will be able to meet the capital requirements under new regulatory regimes. Allianz remains one of the highest rated insurance groups in the world, as reflected by our external ratings.

- The Group's management also believes that Allianz is well positioned to deal with potentially adverse future events, in part due to our strong internal limit framework defined by the Group's risk appetite and risk management practices including our approved partial internal model.

- The Group has a conservative investment profile and disciplined business practices in the Property-Casualty, Life/Health, and Asset Management business segments, leading to sustainable operating earnings with a well-balanced risk-return profile.

- Finally, the Group has the additional advantage of being well diversified, both geographically and across a broad range of businesses and products.

SOLVENCY II REGULATORY CAPITALIZATION

The Allianz Group's own funds and capital requirements are based on the market value balance sheet approach as the major economic principle of Solvency II rules.[1] Our regulatory capitalization is shown in the following table.

ALLIANZ GROUP: SOLVENCY II REGULATORY CAPITALIZATION

as of 31 December		2016	2015
Own funds	€ BN	75.3	72.7
Capital requirement	€ BN	34.6	36.4
Capitalization ratio	%	218	200 [1]

1 — Changed regulatory tax treatment of German life sector reduced our year-end Solvency II capitalization ratio from 200 % to 196 % on 1 January 2016.

Compared to year-end 2015, our Solvency II capitalization increased by 18 percentage points to 218 %. This was driven by an increase in own funds mainly due to strong Solvency II earnings and the sale of our South Korean life business. This was partly offset by market movements mainly due to decreased interest rates, as well as by dividend accrual and changes in transferable amount of own funds resulting from changed risk capital requirements. A decrease in risk capital also contributed to the overall increase in Solvency II capitalization. This was predominantly due to management actions like the disposal of our South Korean life business but also to measures taken to reduce our exposure to market risks, including hedging of equity exposure and improving our interest rate risk profile. In addition, changes in the regulatory tax treatment of the German life sector as well as minor model changes also slightly contributed to a decreased capital requirement. This effect, however, was partly offset by market movements as well as higher exposure due to business growth.

On a pro-forma basis, the recognition of negative interest rates on solvency capital calculations would have had a negative impact on the Solvency ratio of around 3 percentage points as of 31 December 2016.

The following table summarizes our Solvency II regulatory capitalization ratios as disclosed over the course of the year 2016.

ALLIANZ GROUP: SOLVENCY II REGULATORY CAPITALIZATION RATIOS
%

	31 December 2016	30 September 2016	30 June 2016	31 March 2016	31 December 2015
Capitalization ratio	218	186	186	186	200

The following table presents the sensitivity of our predicted Solvency II capitalization ratio under certain standard financial scenarios.

ALLIANZ GROUP: PREDICTED SOLVENCY II REGULATORY CAPITALIZATION AFTER STRESS SCENARIOS
%

as of 31 December	2016	2015
Base capitalization ratio	218	200
Interest rates up by 0.5 %[1]	220	208
Interest rates down by 0.5 %[1]	207	185
Equity prices up by 30 %	224	208
Equity prices down by 30 %	216	190
Combined scenario: Interest rate down by 0.5 %[1] Equity prices down by 30 %	203	176

1 — Non-parallel interest rate shifts due to extrapolation of the yield curve beyond the last liquid point in line with Solvency II rules.

The Allianz Group is a financial conglomerate within the scope of the Financial Conglomerate Directive (FCD). The FCD does not impose a materially different capital requirement on Allianz Group compared to Solvency II.

Quantifiable risks and opportunities by risk category

This Risk and Opportunity Report outlines the Group's risk figures, reflecting its risk profile based on pre-diversified risk figures and group diversification effects. Pre-diversified risk figures reflect the diversification effect within each modeled risk category (i.e. market, credit, underwriting, business, and operational risk) but does not comprise the diversification effects across risk categories. Group-diversified risk figures also capture the diversification effect across all risk categories. As of 31 December 2016, the group-diversified risk reflecting our risk profile before non-controlling interests of € 34.6 BN (2015: € 36.4 BN) represented a diversification benefit[2] of approximately 25 % (2015: 27 %) across risk categories and business segments.

1 — Own funds and capital requirement are calculated under consideration of volatility adjustment and yield curve extension, as described in Yield curve and volatility adjustment assumptions on page 67.

2 — Diversification before tax.

With the exception of the Asset Management business segment, all business segments are exposed to the full range of risk categories stated. By contrast, the Asset Management business segment is mainly exposed to operational and market risk and to a lesser extent to credit risk. The group-diversified risk is broken down as follows:

ALLIANZ GROUP: ALLOCATED RISK ACCORDING TO THE RISK PROFILE (TOTAL PORTFOLIO BEFORE NON-CONTROLLING INTERESTS)
€ MN

	Market risk		Credit risk		Underwriting risk		Business risk		Operational risk		Diversification		Total	
as of 31 December	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
Property-Casualty	5,805	5,690	2,502	2,406	10,307	10,101	937	937	2,248	2,274	(6,606)	(6,663)	15,193	14,745
Life/Health	12,824	16,516	5,550	6,141	1,323	1,502	3,536	3,687	2,028	2,019	(5,713)	(7,784)	19,549	22,081
Asset Management	163	146	29	26	–	–	–	–	768	686	–	–	960	857
Corporate and Other	2,753	2,922	683	667	179	355	–	–	617	580	(689)	(924)	3,543	3,600
Total Group	**21,546**	**25,274**	**8,763**	**9,240**	**11,809**	**11,958**	**4,473**	**4,623**	**5,661**	**5,559**	**(13,008)**	**(15,371)**	**39,244**	**41,283**
										Tax			(4,664)	(4,860)
										Total Group			**34,580**	**36,423**

The following sections outline the evolution of the risk profile per risk category modeled. All risks are presented on a pre-diversified basis and concentrations of single sources of risk are discussed accordingly.

MARKET RISK

As an inherent part of our insurance operations, we collect premiums from our customers and invest them in a wide variety of assets. The resulting investment portfolios back future claims and benefits to our customers. In addition, we invest shareholders' capital, which is required to support the risks underwritten. As the fair values of our investment portfolios depend on financial markets, which may change over time, we are exposed to market risks. The following table presents our group-wide risk figures related to market risks by business segment and source of risk.

ALLIANZ GROUP: RISK PROFILE – MARKET RISK BY BUSINESS SEGMENT AND SOURCE OF RISK (TOTAL PORTFOLIO BEFORE TAX AND NON-CONTROLLING INTERESTS)
pre-diversified, € MN

	Interest rate		Inflation		Credit spread		Equity		Real estate		Currency		Total	
as of 31 December	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
Property-Casualty	412	415	2,600	2,931	905	739	1,215	996	604	554	69	55	5,805	5,690
Life/Health	2,884	4,129	61	237	3,780	4,694	4,973	6,085	1,025	1,326	101	45	12,824	16,516
Asset Management	22	20	–	–	–	–	22	20	22	20	96	86	163	146
Corporate and Other	557	643	364	451	796	541	680	977	95	86	261	224	2,753	2,922
Total Group	**3,876**	**5,207**	**3,025**	**3,618**	**5,481**	**5,975**	**6,891**	**8,078**	**1,746**	**1,986**	**527**	**410**	**21,546**	**25,274**
									Share of total Group pre-diversified risk				41.2%	44.6%

Our total pre-diversified market risk showed a decrease of € 3.7 BN mainly driven by interest rate and equity risk in the Life/Health business segment. The decrease in interest rate risk was driven by the disposal of our South Korean life business as well as by management actions to improve our interest rate risk profile by asset/liability management (ALM) measures. Equity risk also decreased due to management actions, in particular derivative hedging programs. For credit spread risk, the decrease was driven by exposure changes, due to ALM measures, and the corresponding effects on the liability side.

INTEREST RATE RISK

As interest rates may fall below the rates guaranteed to policyholders in some Life/Health markets, and given the long duration of insurance obligations, we are specifically exposed to interest rate risk because we have to reinvest maturing assets prior to the maturity of life contracts. This interaction of our investment strategy and obligations to policyholders forms an integral part of our internal risk capital framework. In addition, our ALM approach is closely linked to the internal risk capital framework and designed to achieve investment returns over the long term in excess of the obligations related to insurance and investment contracts.

We manage interest rate risk from a comprehensive corporate perspective: While the potential payments related to our liabilities in the Property-Casualty business segment are typically shorter in maturity than the financial assets backing them, the opposite usually holds true for our Life/Health business segment, due to the long-term life insurance contracts. In part, this provides us with a natural hedge on an economic basis at the Group level. As of 31 December 2016, our interest-rate-sensitive investments excluding unit-linked business – amounting to a market value of € 428.5 BN[1] – would have gained € 31.4 BN or lost € 36.1 BN in value in the event of interest rates changing by (100) and +100 basis points, respectively.

As described above, the risk related to interest rates lies in the fact that, in the long run, yields that can be achieved by reinvesting may not be sufficient to cover the guaranteed rates. In contrast, opportunities may materialize when interest rates increase. This may result in higher returns from reinvestments than the guaranteed rates.

INFLATION RISK

As an insurance company we are exposed to changing inflation rates, predominantly due to our non-life insurance obligations. In addition, internal pension obligations contribute to our exposure to inflation. Since inflation increases both claims and costs, higher inflation rates will lead to greater liabilities. Inflation assumptions are already taken into account in our product development and pricing, and the risk of changing inflation rates is incorporated in our partial internal model. In case future inflation rates (sustainably) fall short of assumptions, liabilities would be less than anticipated.

EQUITY RISK

Risks from changes in equity prices are normally associated with decreasing share prices and increasing equity price volatilities. As stock-market prices also might increase, opportunities may arise from equity investments. As of 31 December 2016, our investments excluding unit-linked business that are sensitive to changing equity markets – amounting to a market value of € 47.0 BN[2] – would have lost € 12.4 BN in value assuming equity markets declined by 30 %.

CREDIT SPREAD RISK

Our internal risk capital framework fully acknowledges the risk of declining market values for our fixed income assets, such as bonds, due to the widening of credit spreads. However, for our risk management and appetite we also take into account the underlying economics of our business model; for example, the application of the volatility adjustment in our internal risk capital framework to partially mitigate spread risk, as described in the section on yield curve and volatility adjustment assumptions.

CURRENCY RISK

As our operating entities are typically invested in assets of the same currency as their liabilities, the major part of foreign currency risk results from the economic value of our non-Euro operating entities. If non-Euro foreign exchange rates decline against the Euro from a Group perspective, the Euro-equivalent net asset values also decrease. However, at the same time the capital requirements in Euro terms from the respective non-Euro entity also decrease, partially mitigating the total impact on our capitalization.

REAL ESTATE RISK

Despite the risk of decreasing real estate values, real estate is a suitable addition to our investment portfolio, due to good diversification benefits as well as to the contribution of relatively predictable cash-flows in the long term. As of 31 December 2016, about 3.3 % (2015: 3.5 %) of the total pre-diversified risk was related to real estate exposures.

CREDIT RISK

Credit risk is measured as the potential economic loss in the value of our portfolio that is due to either changes in the credit quality of our counterparts ("migration risk") or the inability or unwillingness of the counterparty to fulfill contractual obligations ("default risk"). Credit risk arises from our fixed income investments, cash positions, derivatives, structured transactions, receivables from Allianz agents and other debtors, credit insurance, and reinsurance recoverables. The following table presents our group-wide risk figures related to credit risks.

ALLIANZ GROUP: RISK PROFILE – ALLOCATED CREDIT RISK BY BUSINESS SEGMENT (TOTAL PORTFOLIO BEFORE TAX AND NON-CONTROLLING INTERESTS)
pre-diversified

as of 31 December		2016	2015
Property-Casualty	€ MN	2,502	2,406
Life/Health	€ MN	5,550	6,141
Asset Management	€ MN	29	26
Corporate and Other	€ MN	683	667
Total Group	€ MN	**8,763**	**9,240**
Share of total Group pre-diversified risk	%	16.8	16.3

Throughout 2016 the credit environment was mostly stable. Overall credit risk for the Group decreased compared to last year, primarily driven by the Life/Health business segment due to the disposal of our South Korean life business as well as an increased loss-absorbing capacity of technical provisions in the traditional life business, which decreased the credit risk after policyholder participation. Additionally, active de-risking measures were taken to reduce sovereign counterparty exposure concentrations. Annual updates based on extended time series were performed for credit risk parameters like the transition matrix and asset correlations, which also had a slightly positive effect on credit risk. These effects were partially offset by the declining interest rate environment, which generally increased credit risk exposures and correspondingly credit risk.

Credit risk comprises risks resulting from the investment portfolio, from the reinsurance portfolio, and from our credit insurance business.

CREDIT RISK – INVESTMENT

We invest premiums from our customers into a variety of assets, which largely consist of fixed income instruments. As the portfolio value of our investments depends on the credit quality of the portfolio, we are exposed to credit risk. However, for certain life insurance products, losses due to credit events can be shared with the policyholder.

1 — The stated market value includes all investments whose market value is sensitive to interest rate movements (excluding unit-linked business) in line with the Solvency II framework, and therefore is not based on classifications given by accounting principles.
2 — The stated market value includes all investments whose market value is sensitive to equity movements (excluding unit-linked business) in line with the Solvency II framework, and therefore is not based on classifications given by accounting principles.

As of 31 December 2016, the credit risk arising from our investment portfolio accounted for 86.4 % (2015: 88.2 %) of our total Group pre-diversified internal credit risk. Credit Risk in the Life/Health business segment is primarily driven by long-term assets covering long-term liabilities. Typical investments are government bonds, senior corporate bonds, covered bonds, self-originated mortgages and loans, as well as a modest amount of derivatives. Due to the nature of the business, the fixed income securities in the Property-Casualty business segment tend to be short- to mid-term, which explains the lower Credit Risk consumption in this segment.[1]

The counterparty credit risk arising from derivatives is low, since derivatives usage is governed by the group-wide internal guidelines for collateralization of derivatives that stipulate master netting and collateral agreements with each counterparty and require high quality and liquid collateral. In addition, Allianz closely monitors the credit ratings of counterparties and exposure movements.

As of 31 December 2016, the rating distribution based on issue (instrument) ratings of our fixed income portfolio was as follows:

RATING DISTRIBUTION OF ALLIANZ GROUP'S FIXED INCOME PORTFOLIO[1] — FAIR VALUE
€ BN

Type of issuer	Government & agency		Covered bond		Corporate		Banks		ABS/MBS		Short-term loan		Other		Total	
as of 31 December	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
AAA	42.3	44.8	57.9	57.7	1.5	2.4	1.6	1.1	17.5	16.0	0.1	0.1	–	–	120.9	122.1
AA	95.0	95.9	18.6	23.8	20.9	11.3	6.0	6.2	2.3	3.0	1.1	1.1	–	0.1	144.0	141.4
A	17.1	15.8	8.8	11.4	55.8	49.8	15.4	14.6	0.9	1.7	0.2	0.6	0.7	0.8	98.9	94.6
BBB	49.8	52.9	4.2	5.0	93.9	81.9	8.3	7.3	0.5	0.6	0.8	0.5	0.3	0.5	157.8	148.7
BB	5.3	3.9	0.3	0.5	6.5	9.5	0.9	1.6	0.1	0.1	0.2	0.2	–	–	13.3	15.8
B	2.1	1.6	–	–	1.3	3.0	–	0.1	0.1	0.1	–	–	–	–	3.6	4.8
CCC	–	–	–	–	0.7	0.3	–	–	0.1	–	–	–	–	–	0.8	0.4
CC	–	–	–	–	0.1	0.1	–	0.1	0.1	0.1	–	–	–	–	0.1	0.2
C	–	–	–	–	–	0.1	–	–	–	–	–	–	–	–	0.1	0.1
D	–	0.1	–	–	0.1	0.4	–	–	–	–	–	–	–	–	0.1	0.5
Not rated	1.9	2.5	0.1	0.3	8.7	6.2	0.6	0.4	–	–	1.2	0.5	3.7	2.8	16.3	12.7
Total	**213.6**	**217.5**	**90.0**	**98.7**	**189.5**	**164.9**	**32.9**	**31.3**	**21.6**	**21.6**	**3.7**	**3.0**	**4.7**	**4.3**	**555.8**	**541.4**

1 — In accordance with the Group Management Report, figures stated include investments of Banking and Asset Management. Table excludes private loans. Stated market values include investments not in scope of the Solvency II framework. Predominantly based on external ratings. For some cases where no external rating is available internal ratings are applied.

CREDIT RISK – REINSURANCE

Credit risk to external reinsurers arises when we transfer insurance risk exposures to external reinsurance companies to mitigate insurance risks. Potential losses can arise either due to non-recoverability of reinsurance receivables already present at the as-of date or due to default on benefits under in-force reinsurance treaties.

As of 31 December 2016, 0.5 % (2015: 0.4 %) of our total Group pre-diversified internal credit risk was allocated to reinsurance exposures – of which 46.8 % (2015: 52.0 %) was related to reinsurance counterparties in the United States and Germany.

We focus on companies with strong credit profiles. We may also require letters of credit, cash deposits, or other financial measures to further mitigate our exposure to credit risk. As of 31 December 2016, 84.0 % (2015: 86.0 %) of the Allianz Group's reinsurance recoverables were distributed among reinsurers that had been assigned at least an "A-" rating by Standard & Poor's or A.M. Best. As of 31 December 2016, reinsurance recoverables not rated represented 15.1 % (2015: 13.3 %).

REINSURANCE RECOVERABLES BY RATING CLASS[1]
€ BN

as of 31 December	2016	2015
AAA	0.04	0.04
AA+ to AA-	6.41	6.64
A+ to A-	4.62	4.68
BBB+ to BBB-	0.12	0.08
Non-investment grade	–	–
Not assigned	1.99	1.76
Total	**13.18**	**13.19**

1 — Represents gross exposure broken down by reinsurer.

CREDIT RISK – CREDIT INSURANCE

Credit risk arises from potential claim payments on limits granted by Euler Hermes to its policyholders. Euler Hermes protects its policyholders (partially) from credit risk associated with short-term trade credits advanced to clients of the policyholder. If the client of the policyholder is unable to meet its payment obligations, Euler Hermes indemnifies the loss to the policyholder.

1 — Additionally, 5.7 % (2015: 4.8 %) of our total Group pre-diversified internal credit risk is allocated to receivables, potential future exposure for derivatives and reinsurance, and other off-balance sheet exposures.

As of 31 December 2016, 7.4 % (2015: 6.5 %) of our total Group pre-diversified internal credit risk was allocated to Euler Hermes credit insurance exposures, for which the relative increase is primarily driven by the lower credit risk of the investment portfolio.

UNDERWRITING RISK

Underwriting risk consists of premium and reserve risks in the Property-Casualty business segment as well as biometric risks in the Life/Health business segment. For the Asset Management business segment and our banking operations, underwriting risks are not relevant.

The following table presents the pre-diversified risk calculated for underwriting risks stemming from our insurance business.

ALLIANZ GROUP: RISK PROFILE – ALLOCATED UNDERWRITING RISK BY BUSINESS SEGMENT AND SOURCE OF RISK (TOTAL PORTFOLIO BEFORE NON-CONTROLLING INTERESTS)[1]
pre-diversified, € MN

	Premium natural catastrophe		Premium terror		Premium non-catastrophe		Reserve		Biometric		Total	
as of 31 December	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
Property-Casualty	616	543	24	17	4,410	4,579	5,233	4,926	24	37	10,307	10,101
Life/Health	–	–	–	–	–	–	–	–	1,323	1,502	1,323	1,502
Asset Management	–	–	–	–	–	–	–	–	–	–	–	–
Corporate and Other	–	–	–	–	–	–	–	–	179	355	179	355
Total Group	**616**	**543**	**24**	**17**	**4,410**	**4,579**	**5,233**	**4,926**	**1,526**	**1,894**	**11,809**	**11,958**
							Share of total Group pre-diversified risk				22.6 %	21.1 %

1 — As risks are measured in an integrated approach and on an economic basis, internal risk profile takes reinsurance effects into account.

Property-Casualty risk changes are mainly driven by exposure and model updates as well discounting effects. For biometric risk there was a slight reduction, mainly driven by a minor model change and the sale of our South Korean life business.

PROPERTY-CASUALTY

Our Property-Casualty insurance businesses are exposed to premium risk related to the current year's new and renewed business, as well as reserve risks related to the business in force.

Premium risk

As part of our Property-Casualty business operations, we receive premiums from our customers and provide insurance protection in return. Changes in profitability over time are measured based on loss ratios and their fluctuations.

We face the risk that underwriting profitability is lower than expected. The volatility of the underwriting profitability measured over one year defines our premium risk for the Allianz Group.

PROPERTY-CASUALTY LOSS RATIOS[1] FOR THE PAST TEN YEARS
%

	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007
Loss ratio	65.6	66.2	66.0	65.9	68.3	69.9	69.1	69.5	68.0	66.1
Loss ratio excluding natural catastrophes	64.2	64.6	65.1	63.0	66.6	65.5	65.9	68.4	66.3	64.1

1 — Represents claims and insurance benefits incurred (net), divided by premiums earned (net).

The top five perils contributing to the natural catastrophe risk as of 31 December 2016 were: a windstorm in Europe, a flood in Germany, a hurricane in the U.S., a hailstorm in Germany, and an earthquake in Australia.

Reserve risk

We estimate and hold reserves for claims resulting from past events that have not yet been settled. If our reserves turn out not the be sufficient to cover claims to be settled in the future, due to unexpected changes, we will experience losses. Conversely, if reserves turn out to be too conservative there is a chance of positive returns. The volatility of past claims measured over a one-year time horizon defines our reserve risk.

LIFE/HEALTH

Life/Health underwriting risk arises from profitability being lower than expected due to changes in actuarial parameters. As profitability calculations are based on several parameters – such as historical loss information, assumptions on inflation or on mortality, and morbidity – the realized parameters may differ from the ones used for calculation. For example, inflation which is higher than what we incorporated in the calculations may lead to a loss. However, deviations can also be beneficial and lead to additional profit. For example, a lower morbidity rate than expected will most likely result in lower claims.

Due to effective product design and the diversity of our products, there were no significant concentrations of underwriting risks within our Life/Health business segment as of 31 December 2016.[1]

1 — For further information about insurance risk in the Life/Health business segment, please refer to note 16 to the consolidated financial statements.

BUSINESS RISK

Business risks include cost risks and policyholder behavior risks and are mostly driven by the Life/Health business segment and to a lesser extent by the Property-Casualty business segment. Cost risks are associated with the risk that expenses incurred in administering policies are higher than expected or that new business volume decreases to a level that does not allow Allianz to absorb its fixed costs.

In the Life/Health business segment, policyholder behavior risks are risks related to the unpredictability and adverse behavior of policyholders in exercising their different contractual options: early termination of contracts, surrenders, partial withdrawals, renewals, and annuity take-up options. Assumptions on policyholder behavior are set in line with accepted actuarial methods and are based on our own historical data, to the extent available. If data is not available, assumptions are based on industry data or expert judgment.

There was a minor movement in business risk for our Life/Health business segment, driven by the sale of our South Korean life business.

As for underwriting risks, a positive deviation from the underlying parameters will lead to additional returns. For example, lower-than-expected expenses in our Property-Casualty business will lead to an improved combined ratio.

OPERATIONAL RISK

Operational risks represent losses resulting from inadequate or failed internal processes, from personnel and systems, or from external events – including legal and compliance risk, but excluding losses from strategic and reputational risk. The operational risk capital is calculated on a scenario-based approach. Operational internal and external loss data is used, among others, for the selection of the risk driving scenarios and is applied for validation purposes.

The decrease shown in the operational risk is driven by the regular update of local parameters. Foreign currency translation effects (mainly Euro/U.S. Dollar) play a secondary role. There were no central operational risk model changes in 2016.

LIQUIDITY RISK

Liquidity risk is defined as the risk that requirements from current or future payment obligations cannot be met or can only be met on the basis of adversely altered conditions. Liquidity risk can arise primarily if there are mismatches in the timing of cash flows on the asset and liability side. Detailed information regarding the Allianz Group's liquidity risk exposure, liquidity, and funding – including changes in cash and cash equivalents – is provided in Liquidity and Funding Resources from page 57 onwards and in notes 13, 19 and 35 to the consolidated financial statements.

As inferred from the section on management of liquidity risks and interest rate risks, they are properly managed and monitored but not quantified.

Controls over Financial Reporting

The following information is given pursuant to § 289 (5) and § 315 (2) no. 5 of the German Commercial Code ("Handelsgesetzbuch – HGB").

In line with both our prudent approach to risk governance and compliance with regulatory requirements, we have created a structure to identify and mitigate the risk of material errors in our consolidated financial statements (this also includes market value balance sheet and risk capital controls). Our internal control system over financial reporting (ICOFR) is based on the revised framework developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in 2013 and is regularly reviewed and updated. Our approach also includes the following five interrelated components: control environment, risk assessment, control activities, information and communication, and monitoring. These five components are covered by an Entity-Level Control Assessment Process (ELCA), IT General Controls (ITGC) and controls at process levels. The ELCA framework contains controls to monitor the system of governance effectiveness. In the ITGC framework we have implemented, for example, controls for access-right management and for project and change management.

ACCOUNTING AND CONSOLIDATION PROCESSES

The accounting and consolidation processes we use to produce consolidated financial statements are based on a central consolidation and reporting IT solution and local general ledger solutions. The latter are largely harmonized throughout the Group, using standardized processes, master data, posting logics, and interfaces for data delivery to the Holding. Access rights to accounting systems are managed according to strict authorization procedures.

Accounting rules for the classification, valuation, and disclosure of all items in the balance sheet, the income statement, and notes related to the annual and interim financial statements are defined primarily in our Group accounting manual. Internal controls are embedded in the accounting and consolidation processes to safeguard the accuracy, completeness, and consistency of the information provided in our financial statements.

INTERNAL CONTROL SYSTEM APPROACH

Our approach can be summarized as follows:

- We use a top-down, risk-based approach to determine the accounts and operating entities that should fall under the ***scope of our internal control system over financial reporting.*** The methodology is described in our ICOFR manual. During the scoping process, both materiality and susceptibility to a misstatement are considered simultaneously. The final results are documented in the list of operating entities under the scope of ICOFR as well as in the list of significant accounts. In addition to the quantitative ICOFR calculation, we also consider qualitative criteria – such as expected increase in business volume – which are provided by different Group Centers, Group Audit, and external Audit.

- Then, our local entities ***identify risks*** that could lead to material financial misstatements including all relevant root causes (i.e. human processing errors, fraud, system shortcomings, external factors, etc.). After identifying and analyzing the risks, their potential impacts and probabilities of occurrence are evaluated.

- ***Preventive and detective key controls*** over the financial reporting process have been put in place to reduce the likelihood and impact of financial misstatements. If a potential risk materializes, actions are taken to reduce the impact of the financial misstatement. Given the strong dependence of financial reporting processes on information technology systems, we also implement IT controls.

- Finally, we focus on ensuring that controls are appropriately designed and effectively executed to mitigate risk. We have set consistent documentation requirements across the Allianz Group for elements such as processes, related key controls, and execution. We conduct an annual ***assessment*** of our control system to maintain and continuously enhance its effectiveness. Group Audit and local internal audit functions ensure that the overall quality of our control system is subjected to regular control-testing, to assure reasonable design and operating effectiveness. Internal Audit does so through a comprehensive risk-based approach, which holistically assesses the key controls of the company's internal procedures and processes, including local and group-internal controls over financial reporting.

GOVERNANCE

Responsibility for ensuring the completeness, accuracy, and reliability of our consolidated financial statements rests with the Chairman of the Allianz SE Board of Management, as well as the board member responsible for Finance, Controlling, and Risk, supported by Group Center functions, the Group Disclosure Committee, and operating entities.

The Group Disclosure Committee ensures that these board members are made aware of all material information that could affect our disclosures, and assesses the completeness and accuracy of the information provided in the quarterly statements, half-year, and annual financial reports. In 2016, the Group Disclosure Committee met on a quarterly basis before the quarterly statements and financial reports were issued.

Subsidiaries within the scope of our control system are individually responsible for adhering to the Group's internal governance and control policy and for creating local Disclosure Committees that are similar to the Group-level committee. The entities' CEOs and CFOs provide periodic sign-offs to the management of Allianz SE, certifying the effectiveness of their local system of internal controls as well as the completeness, accuracy, and reliability of financial data reported to the Holding.