Asset Allocation in a Low Interest Rate Environment: Where do we stand?

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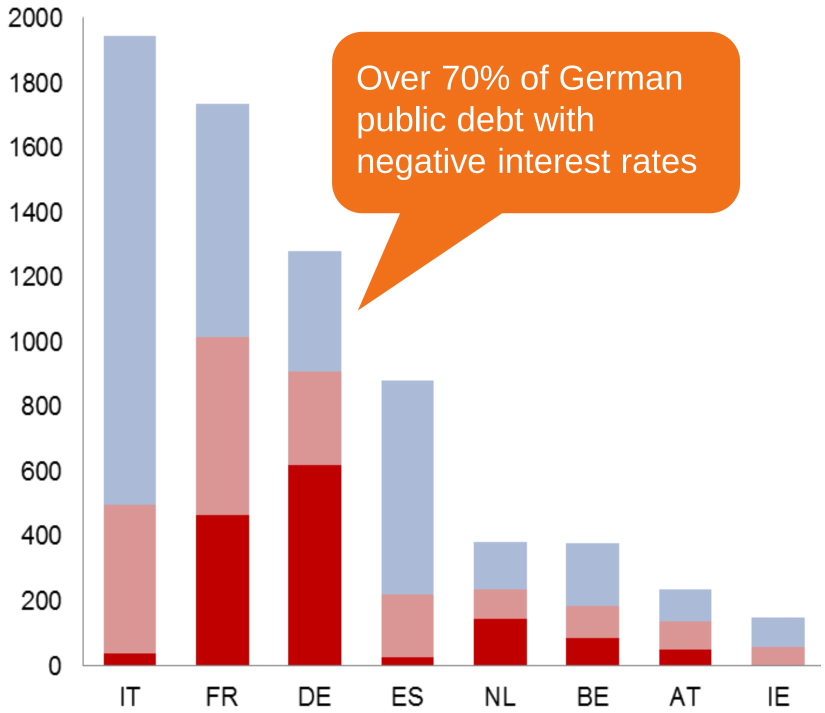
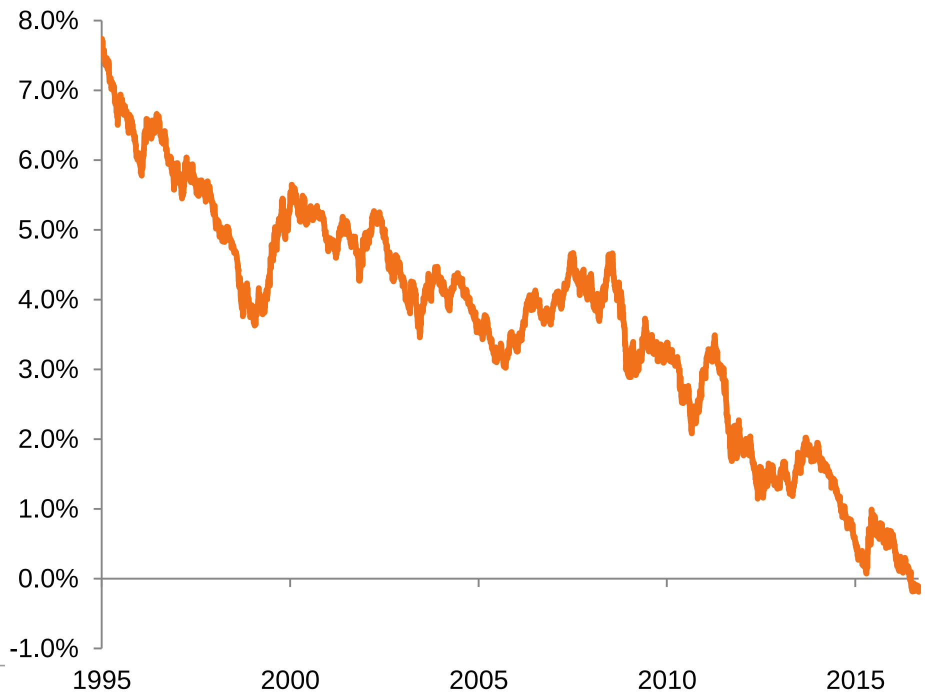
We are living in times of unprecedented low and negative interest rates

Market volume of outstanding public debt* with negative yields and yields below the ECB's deposit rate (EUR bn)



Interest rates (10-yr German Bunds)



■ Market value of outstanding govt. bonds with yields < -0.4 % ■ Market value of govt. bonds with negative yield ■ Total market value

In **Europe** slightly more than 50% of Eurozone sovereign debt is traded at negative yields, and this proportion rises to nearly 95% for debt with a maturity of two years or less

* excluding agencies, excluding T-Bills, including inflation-linked bonds
Sources: Bloomberg, Allianz GI Global Capital Markets & Thematic Research

Solvency II may complicate the situation

Risk-based capital requirements may lead to pro-cyclicality

- SII's risk-based approach incentivizes matching of assets and liabilities
- Falling interest rates increase duration gap and the demand for long-term bonds
- Further falling interest rates

Solvency II Standard Formula tends to distort asset allocation

- Lack of risk charges fosters increased investment in government bonds at the expense of corporate bonds
- A push towards financing the public deficit rather than the real economy may result

Limited reflection of insurance business model may lead to artificial volatility

- Solvency II does not adequately reflect that insurers typically hold assets to maturity (no risk of fire sales due to long-term stable liabilities)
- Insurers are forced to act pro-cyclical and may display herding behavior

Insurers are forced to lock in low/negative yields and may be less able to act as economic stabilizers

Strategic reaction of insurers on the low interest rate environment

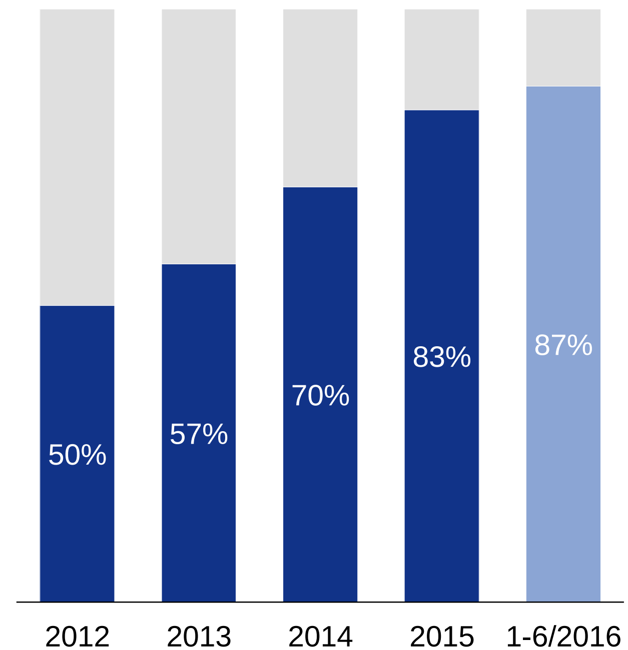
Asset side	Liability side
▪ Narrowing the duration mismatch by – Increasing asset duration – Derivatives ▪ Investing in alternative assets – Real Estate (debt and equity) – Infrastructure (debt and equity) – Renewables – Private Equity	▪ Redesigning long-term saving products – Lowering guarantees (level and duration) – Increasing flexibility (e.g. resettable guarantees) ▪ Moving to less capital-intensive products (e.g. unit-linked) ▪ Selling protection (biometric risks)

Actions should be supported by adequate improvements of the regulatory framework

Allianz's answer: a complete redesign of the product portfolio…

Strong demand for the new concepts

Retail business: Portion of new guarantee concepts, including biometric risks (in % of valuation sum)

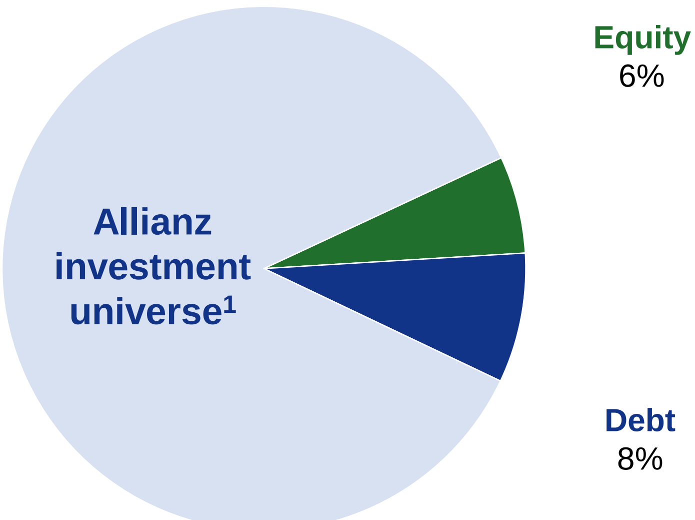


…and increasing alternative investments

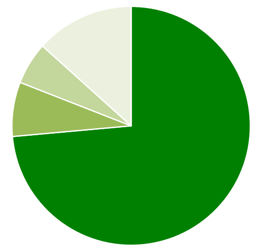
Portfolio of alternative assets 2015: EUR 92 bn

Medium-term target: EUR 110 bn

Total:
EUR 666 bn[1]

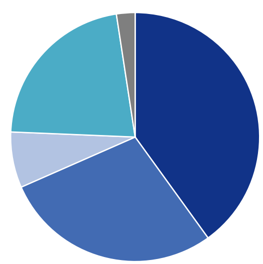


EUR 40 bn



Equity	Average expected yield
Real Estate	4-6%
Infrastructure	5-8%
Renewable Energy	5-6%
Private Equity	10-12%

EUR 52 bn



Debt	Average expected yield
Retail Mortgage Loans	1,5-2%
Commercial Mortgage Loans	1,5-2%
Infrastructure Loans	3%
Private Placements	2-4%
Other	6-8%

1 Economic view: Due to the use of market values instead of book values for Real Estate, Mortgage Loans, and consideration of further assets (Fair Value Option, Trading, Own Use Real Estate and Alternative Assets) the economic value is higher than the book value of the investment universe

Summary

- The economic environment is likely to remain difficult for policyholders and insurers
- Allianz reacts pro-actively with new product offerings and innovative investment concepts
- Adequate regulation is important for insurers to manage the low-yield environment
- Politics should boost economic growth by supporting new stable investment opportunities (e.g. infrastructure)