

DWS Group GmbH & Co. KGaA

DWS Q1 2018 Investor & Analyst Conference Call

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Transcript

Speaker Key:

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Nicolas Moreau
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Oliver Flade

Operator, thank you very much and good morning, everybody, from Frankfurt. This is Oliver from IR and I would like to welcome everybody to our first quarter 2018 earnings call. Please note that the previous Deutsche Bank analyst call outlined the asset management segments results which have a different perimeter basis to the DWS results we are presenting today.

I'm joined by Nicolas Moreau, our CEO, and Claire Peel, our CFO. And Nicolas will start today with some opening remarks and then Claire will take you through the analyst presentation. For the Q and A afterwards, I would ask, for the sake of efficiency and fairness, questioners please limit themselves to their two most important questions so that we can give as many people a chance to participate in the Q and A session as possible. Please be reminded of the disclaimer at the beginning of this presentation. And now, let me hand over to Nicolas.

Nicolas Moreau

Yes, good morning everybody. We are very pleased to host today our first DWS quarterly results conference call today. It has obviously been a very significant quarter for our company, as this is the one that has seen the completion of our IPO which was received very well, both by our clients, our staff and the consultants with whom we are working.

We have been able to introduce WS as our global brand, transitioning our business into a new era with this single brand. We also completed the separation process from Deutsche Bank, and in doing so, established a new intermediate holding company for our business in the US.

We therefore enter a new chapter of the life of DWS with very solid set of foundation. From the moment the IPO was complete, our goal was to move quickly and start fulfilling the potential of this excellent business. But as we said before, we still have a lot of work on our plate, a lot of things to do, and we are now really focusing, very focused on delivering on our targets.

In order to achieve that, we have appointed a Chief Transformation Officer who is responsible for tracking and delivery of our cost targets, as well as designing and adapting our newly integrated organisation in the most optimal way.

As you know, we used to be a department of a very large bank. We are now a 4,000 company, focused on asset management. We now need to adjust our processes and our way of working to our new world. And the Chief Transformation Officer is in charge

of delivering that and delivering the cost target that we have communicated to the market.

As you remember, our equity story was based on, twofold, cost control on the one side, and growth in revenues on the other side. And we are very focused on delivering on our gross revenues, as... on top of the transformation that I've just elaborated on, and as such, we've a lot of initiatives around systematic and quant investment, alternative credit, as well as active equities and realty assets in order to grow our business in the future.

We've seen a volatile quarter and... but on the bedrock of very strong growth on passive. On this, I look forward in answering your questions, but I will, in the meantime, hand over to Claire Peel, our CFO, who will take you through the presentation. Thank you.

Claire Peel

Thank you, and welcome, everyone, to our... to our call today. I will present to you today the recent activities and results for the first quarter of 2018. I would like to highlight four key points as we go through.

First, in the first quarter of 2018, we continued to see strong inflows in ETFs, but these have been offset in the quarter by outflows concentrated in low margin insurance, predominantly a single anticipated mandate loss, and a cash equivalent mandate outflow as a direct result of recent US tax reform. This activity resulted in net outflows in 1Q18 of €7.8 billion.

Second, 1Q18 management fee margin of 31.1 basis points is an improvement of 0.4 basis points compared to 4Q17, and above our medium-term target of 30 basis points. Third, the adjusted cost income ratio has remained at 76% compared to 4Q17, benefiting from reduced DB charges and compensation expenses, but was negatively impacted by lower revenues in the quarter. Fourth, the adjusted profit before tax for 1Q18 is €136 million.

Let me start with a snapshot of our 1Q18 financial performance on page three. Starting at the top left, first quarter 2018 AUM of 676 billion has declined 3% compared to 4Q17. AUM was negatively impacted by net outflows, FX and market effects, and I'll provide further context later on these items.

Moving to the top right, revenues of 561 million represent a decrease of 7% compared to 4Q17, due to high performance fees in 4Q17 and lower management fees this quarter, in part due to fewer business days. Management fee margin of 31.1 basis

points is a 0.4 basis point above 4Q17, and this is due to the reversal of a one-off revenue item in passive in 4Q17 as well as high volume but very low margin outflows in this quarter.

On the bottom left, adjusted costs of 425 million decreased by 8% compared to 4Q17, due to a 30% reduction in DB Group charges, representing the new service agreements, partially offset by increased expenses from MiFID II, company setup costs and front office investments that are part of our growth initiatives.

As a result, adjusted profit before tax is €136 million, down 7% compared to 4Q17 due to lower performance fees this quarter. The cost income ratio remains at 76%, in line with 4Q17 level, reflecting the timing of incremental expenditures in this transitional period. After tax, we report net income of 95 million of 1Q18.

As a backdrop, let's recap on the market environment during the period on page four. 2017 was a year of unusually low volatility, especially in stock markets. As you are all aware, 1Q18 was a challenging quarter for the equity markets, impacted by heightened volatility in February, and market decline in February and March across all major equity indices.

Markets have settled down since then, but we would not expect to return to the same smooth environment that we saw in 2017. Sustained depreciation of the US Dollar contributed to a lower AUM and revenue base, partially offset by lower cost base in Euro terms. And rising interest rates have also negatively affected fixed income absolute returns.

I will now cover the AUM development on page five. AUM decreased from 700 billion at year end 2017 to 676 billion at the end of 1Q18, a 3% decline. We suffered net outflows of 7.8 billion, primarily driven by two institutional clients with large redemptions in low margin business, a European insurance client in active fixed income and a US institutional mandate for passive.

These outflows have been partially offset by very strong ETF flows, with number one net flows in European ETFs in March. Unfavourable FX effects – primarily from the weakening of the US Dollar versus the Euro – brought an AUM reduction of six billion, and weak market performance is largely driven by equity indices globally, leading to a significant decrease in AUM by 11 billion. This is a reversal from the positive market performance

experience throughout the four quarters of 2017. Let me go into our flows by asset class in a little bit more detail.

Starting with passive, inflows of 1.3 billion are mainly contributed by European listed ETPs of 3.6 billion, partially offset by a mandate redemption of a US institutional client to fund a share buy-back programme as a result of US tax reform. This is a short duration cash equivalent mandate with a fee rate below five basis points.

In cash, quarter end liquidity management resulted in a total cash net outflow of 1.6 billion. In the last week of the quarter, DWS had 2.4 billion of cash withdrawn, most of which returned in the first week of April. This was an industry-wide phenomenon in the US money markets where investors pulled significant cash from domestic money market funds across ten managers on one day.

Active equity had 1.7 billion of outflows in the first quarter, most of which are from retail clients in DWS top dividend funds. The fund strategy to pick stocks with high dividends did not align with market growth in 2017, where many tech names that typically distribute little or no dividends, dominated index growth.

Weakened US Dollar... weakened US Dollar was a further headwind, and the fund's overweight position in more defensive, higher dividend companies will continue, to avoid divergence from the stated investment objective promise to our clients. The multi-asset... our flagship multi-asset fund concept, Kaldemorgen, similar to top dividend funds, have a more conservative strategy than their peers, so lagged in performance returns while the market appreciated in 2017.

In fixed income, outflows are driven by redemptions from Europe and US insurance clients in high volume, low margin mandates, partly offset by inflows from institutional corporate business. The most significant single outflow of 3.9 billion was the result of a competitive re-tender process following the client's change of strategy.

From a client perspective, we had some key winds in Q1. We won a mandate from a German insurance company for a global passive as well as US fixed income, demonstrating excellent collaboration across our regions and businesses. In the US, our high yield corporate bond ETF has cross the \$1 billion AUM mark after a quarter of strong inflows, and we also received wide-

spread support from consultants this quarter, with RREEF America REIT II taking \$650 million of commitments, yet to be represented in net flows and AUM.

To summarise on specific asset flows, I'll refer to page seven. First, on ETFs, I've touched before on retail ETF inflows, while we have maintained strong growth momentum and market shares globally, especially in European listed funds where our net flow share was 16%, above our AUM market share of 10.8%. There are three themes that drove almost ten billion of outflows in 1Q18 – an insurance mandate, a low margin passive mandate due to US tax reform, and the industry-wide US cash management events.

From a regional perspective, Germany drove strong net flows but EMEA ex-Germany was negatively impacted by the insurance outflows, and the Americas was negatively impacted by US tax reform and US cash volatility. While 1Q18 was a challenging quarter from a net flows perspective, our sales activity remains high with a strong pipeline and continuous ETF inflows, to date.

I will now discuss our Q1 financials, starting with revenues. Revenues of 561 million this quarter are down 7% compared to 4Q17, largely impacted by high active performance fees in 4Q17. More than 90% of revenues are driven by stable management fees. Note that management fees in the first quarter of each year are the lowest among the four quarters with respect to having fewer days in the quarter. The asset class specifics will be covered shortly.

Performance and transaction fees are down as active performance fees are typically weighted to Q4 of each year, which was the case in 4Q17. Alternatives performance and transaction fees are less seasonal. As a reminder, the flagship infrastructure fund only pays out eligible performance fees once every two years in alternatives.

This quarter, alternatives transaction fees have partially offset lower performance fees. The other revenue category have increased by 14 million due to a positive change in fair value of guaranteed products, as well as the contribution we received from Harvest.

Looking into the breakdown by asset class a bit more on the following page. Overall, our management fee margin of 31.1 basis points is 0.4 basis points above that of 4Q17. The management fee revenue is lower, largely due to the shorter quarter.

Highlighting the key changes across the asset classes. Given the volatile equity markets in the first quarter, equity management fees have declined by 4% compared to 4Q17, but margin has remained stable. Multi-asset management fees have declined due to outflows in our retail products coupled with unfavourable market impact, but margin has remained largely stable. Fixed income management fees decreased by 5%, from a lower AUM due to institutional outflows as well as FX and interest rate rises, but overall, margin is stable.

The passive, the one-off revenue item in 4Q17, as a result of the completion of our synthetic to physical conversion of ETF products, has reverted this quarter, supporting a 12% increase in management fees. The margin has also improved due to ETF inflows, coupled with low margin mandate outflows. Alternative decline in management fees is due to outflows in higher margin products, and inflows in lower margin in this period. Margin has remained largely stable.

We move now to look more at cost. At the end of 1Q2018, DWS reports 3,965 FTE. This is a net increase of 64 FTE compared to the year end, representing additional transfers in from DB Group, and also some growth hiring. On compensation and benefits costs, the adjusted compensation and benefit cost of 188 million in 1Q18 decreased by 4% compared to 4Q17, largely due to the true-up adjustment in variable compensation seen in 4Q17. A non-variable compensation increase is largely attributed to the cost seasonality in relation to benefits.

Looking at general and admin expenses. Total general and admin costs of 238 million in 1Q18 are down 10% compared to 4Q17. This is largely attributed to a 30% reduction in DB Group charges pertinent to the new service agreements now in place and in line with our expectations. This quarter, we have lower rebranding expenditure, but partially offset by a ten million increase in research costs as a result of MiFID II.

So let me conclude. The first quarter of 2018 was a challenging quarter in markets and net flows, reflecting the dynamics also faced by our peers. Nonetheless, we enjoyed very strong ETF flows. It's important to stress again that the largest outflows, we have seen in low margin businesses, and affected by US tax reform. Secondly, our flow pipeline is strong and the sales activity level at a high level, while overall performance numbers remain very good, at 74% outperformance over three years, despite the performance issues of some larger retail funds

Looking forward and further to what Nicolas has already outlined, we have made progress on our digital platform. In Q1, we had further enhanced WISE's functionality beyond the online, white-label, B2C and IFA offering, and WISE can now serve unit linked insurance clients. Our DWS investment app, Edison, was launched in Germany in March, and is available for download.

On cost efficiency initiatives, we have made good progress and started to execute on our organisational review strategy and the pricing of services. For our growth initiatives, our strategic hires in constant relations, insurance and ETFs should accelerate our flow growth in select areas.

In terms of flows, I have mentioned a reversal of US money market flows on the first day of Q2 trading, on 2nd April, and we anticipate further outflows in active fixed income, but expect these to be offset by other mandate successes, including an ESG passive mandate in Europe and strong April month-to-date ETF flows. Hence, we reiterate our medium term financial targets, and after the IPO event, we focus now on the execution of the strategy. I will now hand back to Oliver.

Oliver Flade

Yes, thank you very much, Claire. Operator, we are ready for Q and A now. And again, if I could remind everybody in the queue to limit themselves to two questions. Thank you very much.

Operator

Ladies and gentlemen, at this time, we will begin the question and answer session. Anyone who wishes to ask a question may press star followed by one on their touchtone telephone. To withdraw your question, you may press star followed by two. If you are using speaker equipment today, please lift your handset before making your selections.

Anyone who has a question may press star followed by one at this time. In the interests of time, please limit yourself to two questions only. One moment for the first question, please. And the first question is from the line of Jacques-Henri Gauland with Kepler Cheuvreux. Please go ahead.

Jacques-Henri Gauland

Yes, good morning, everybody. Two questions. The first one is on the performance on a one-year basis which has been objectively poor. I guess part of the investment case has always been to say this company performed very well and did manage to get inflows because it was performing very well. I hear what you're saying about your pipeline, but do you remain confident that that

remains a little bit of a blip, the performance, and that nonetheless, that shouldn't effectively detract from your outflows expectations for the rest of the year? That's the first question.

And the second question was more on what happened at parent company level with the purchase of some of the capital? And effectively, on your slides, you are now saying that the free flow is 20.5%. Can we safely assume that that level of free flow is going to remain the same? And maybe what motivated really the purchase of about 2% of your capital by your parent over the period. Thank you.

Claire Peel Thank you for the question. So your first question on performance, you're referring there to our flow performance or you're referring to our, yes, soft-flow performance [overtalking]?

Jacques-Henri Gauland It was the active retail where obviously the one-year performance benchmarking went from 88% to 78%, I think, and overall total for the year from 75 to 68. So that's what I'm referring to. But active retail would be probably the main... the main... the main one, yes.

Claire Peel Yes. So we have seen some short-term impact in our immediate investment performance, and that has a factor on some of the flow results that we have seen in the first quarter. We haven't yet seen any impact on our three-year investment performance – obviously, that's always possible, that that can take place. But it's a function, we see, of the investment strategy that we have for some of these retail products that differentiates it slightly. So it... we will see some fluctuations in investment performance, but we still consider ourselves to have good overall performance on the three-year basis.

Jacques-Henri Gauland Okay. So no reason for you effectively... I mean, you haven't seen anything that would effectively make you believe that that would have had an impact on your flows?

Claire Peel No. We have... we have a strong pipeline of flows for the remainder of 2018 and beyond. We have a net flow target of 3% to 5% for our medium-term horizon. We'll clearly be at the lower end of that range in 2018. We see a number of areas that will enable us to develop our flows as we... as we go through into following quarters, and that would include a reversal of some of the cash outflows that we've seen in the first quarter.

We have strong pipeline in ETFs and we have launched some new products there. We have a good pipeline within our alterna-

tives business where we have some dry powder that will be coming into our flows beyond Q1. We have good traction on our corporate fixed income side, and a number of areas that give us confidence in our flow pipeline for the remainder of the year.

There's always going to be ups and downs and we certainly have seen a headwind this quarter in our... some of our German retail flows, but we don't see that's something that would take us away from our commitments.

Jacques-Henri Gauland

Thank you, Claire.

Nicolas Moreau

Yes, regarding your second questions, this was the exercise of the Greenshoe option during the stabilisation period that led Deutsche Bank to buy back some shares. But now that the stabilisation period is over, the count, the free flow is stabilised and should not move.

Jacques-Henri Gauland

Thank you.

Operator

And the next question is from the line of Harley Tam with Citi. Please go ahead.

Harley Tam

Morning. Thank you. Just two questions then, please. First of all, could I ask about the strategic alliances? Could you provide any more detail on the Nippon Life alliance, what the value of the AUM has been that is going to be transferred to DWS, because I think it said there were going to be some in the IPO prospectus, and what sort of state of play we are there with the costs used for the distribution networks?

And then secondly, just a question on the P and L. My understanding was that there would be some negative impact from the distribution agreement with Deutsche Bank having changed. I just wondered if that's something that is already reflected in the management fee margin in Q1 or whether we should be looking for that in the future. Thank you.

Claire Peel

Thank you for your question.

Nicolas Moreau

Okay, I'll take the first one, perhaps, and Claire, you take the second one. On the strategic alliances, in fact, we've got two. We've got the one with Nippon Life and the one with Tikehau. On Nippon Life, we've begun to work with them, as well as with Tikehau, by the way, in order to find areas of collaboration.

So the first steering committee happened last week, in order to see where we could see some product development for the Japanese market or where the general accounts of Nippon Life

should invest with our strategies. So this is an active discussion and due diligence happened before the transaction, before the IPO, and are going on right now. So I cannot be very specific right now, but I would tell you that it is quite encouraging.

With Tikehau, we're also looking at potential collaboration in the field of sharing the inflows in real estate or co-developing products together, and this is also quite encouraging in the alternatives side. So both strategic alliances are promising. Not yet... I've got not yet anything to communicate on that.

The figures of transfer of assets, the commitment from Nippon Life in terms of assets, is still... is confidential, we have not communicated on it. But that, we are talking about sizable assets that would come in the near future. Claire, you want to...?

Claire Peel

Yes. And on your question about the DB distribution agreement, that did indeed come into effect at the start of 2018. That's a ten-year distribution agreement we have with the bank. In some areas, there was renegotiated fees on that, and that is reflected in our management fee margin in the first quarter.

Harley Tam

Thank you. So it doesn't seem to have had a very significant impact, so I can... I can assume that continues, going forwards.

Claire Peel

Yes, that's right. So it's not a significant impact by any means. It was only for select areas; it wasn't, you know, a change in pricing across the board, by any means. So it's not a significant effect. Obviously, it is a function of flows in the future, but not significant.

Harley Tam

Thank you.

Operator

Next question is from the line of Anil Sharma with Morgan Stanley. Please go ahead.

Anil Sharma

Morning guys. Just two questions please. In the active SQI bucket, the AUM looks like it's jumped almost 25%, Q on Q, so I'm just wondering if you could explain, kind of, what's happened there, because obviously the flows looked, sort of, broadly flat. That's the first question.

The second one, on your equities business, the actives equity, it looks like you're coming up to almost, sort of, two years of outflows there. I'm just wondering if you could help us think through what measures are being taken to try and turn around the, sort of, growth dynamic in that business, please. Thank you.

- Claire Peel Thank you for the question. I'll take the first one on SQL, which is our systematic and quant investments business. The revenues, the management fee revenues, have increased there in the first quarter compared to the fourth quarter, and there is a slight improvement in the management fee margin there.
- Obviously, there's a function there of the activity that's taken place also in the prior year, coming through to affect the current quarter, in addition to just the flows that we see within that given period, and these can be a little sensitive to those flows that we see historically, and that's just taken into account within the SQL margin. So nothing specific to report there.
- Anil Sharma Oh. Sorry, Claire, I meant... I actually meant the assets. The assets, I think you said, are 64 billion at the end of March. But then, at the end of December, they were 51.8. So it's just... it's obviously a very big jump, and it doesn't seem to be explained by flows, and obviously, the market hasn't been that good. So I just... I'm just trying to understand. Has there been a reclassification or has something happened there?
- Claire Peel Yes, there has been a very slight reclassification between SQL and a couple of other asset classes. I think we noted that on one page, which we'll point to. But yes, on the AUM, that's a reclass.
- Anil Sharma Okay, fine, thanks.
- Claire Peel And on active equity, you were asking about the outflows that we've seen historically.
- Anil Sharma Yes, and in the quarter.
- Nicolas Moreau Yes, I will... yes, I will take that, perhaps. I think on this, it's just mostly due to outflows on top dividends which is different. We've seen the performance suffering last year due to the Dollar. Compared to other funds of the same category, it's larger so it's more global. We have got a Dollar exposure which is larger. When we look at the performance of this fund in the quarter, it has regained, it's much better in its competitive universe.
- Now, one of our strategic initiatives is to re-dynamize or put more dynamic into our active equity arena because we believe that this is... even if the category is in outflow, globally, and you look that new funds and five-star funds and four-star funds are still in inflows in the market, so we believe that given our heritage, we should absolutely be one of the leaders in terms of... in terms of active equities, and so we have a particular initiative to relaunch

sectoral [? 00:30:25] funds and to get more sales attention and dynamic behind that, so we...

Anil Sharma Okay, thanks. And is it my understanding that the, sort of, top dividend fund, that's in this equities category? Is that correct?

Nicolas Moreau Yes, it is.

Anil Sharma Yes, okay. All right, thank you.

Claire Peel I would just add to that that if we look at the Americas' equity retail flows, historically, we know that those have been in outflow, and that's in a much lesser and smaller outflow position that we see in the first quarter of 2018. So the function that we see in this period is more related to the top dividend and to the... some of those German retail flows that we've seen in this short period. And we should bear in mind that looking at those flows as a percentage of the AUM overall is not something of deep concern, but it is an impact on the quarter.

Anil Sharma That's helpful. Thank you.

Operator Next question is from the line of Hubert Lam with Bank of America. Please go ahead.

Hubert Lam Good morning. I've got two questions. Firstly, on pipeline. You mentioned you are quite confident of your pipeline, given your ETF alternatives, fixed income, etc. I'm just wondering if you can, kind of, quantify what the pipeline is that you see.

 Second question is on cost. I've seen that your employees have gone up, year on year, but at the same time, your fixed costs around comp has actually gone slightly down. I'm just wondering, how would you think about employee to... or fixed cost, employee cost, going forward, just based on these dynamics. Thanks.

Claire Peel Thanks for the question. Maybe if I pick up, first of all, on the cost and FTE point. So in the first quarter of 18, we have total comp and ben of 188 million, with 3,965 FTE. I think that is broadly a good measure, going forward, in terms of what we'd anticipate around costs.

 When you look into the prior periods, there has been some volatility around the variable compensation which we now see normalised in the current period, and we've also seen quite a lot of shifting in the FTE as we've moved and transferred people from DB Group infrastructure areas into the DWS perimeter, and there's a real mix across the FTE population, and hence, in the

5% net new money range this year, but just at the lower end of it? And, sort of, as part of that, could you just remind us what the alternatives dry powder that could turn into inflows currently stands at? Thanks very much.

Claire Peel

Thank you for the questions. I will cover the first one around the FTE movements. So if we look at the movement between the end of 2017 and the end of Q1, we see an increase in 64 head-count.

Approximately 40 of that is coming from the transfer in of DB Group infrastructure areas and specifically from areas such as audit and communications, amongst other areas as well. We have 15 hires that we've put against very specifically strategic initiatives that we are tracking and identifying, so those have been onboarded within the quarter.

And then we had some smaller other movements around the outskirts of that, which would include some efficiencies that have occurred across the platform, the usual movements of leavers and joiners, and also some positions that we have to add incrementally, to complete the construction of the company requirements.

Tom Mills

Thank you.

Claire Peel

On your second question around alternatives dry powder, we had 7.5 of dry powder at the end of 2017. We've seen that move slightly in the first quarter, where some of that has been deployed and we've seen an increase in flows in our alternatives business, albeit the flows are net flat overall, and we have also closed a new fund which has added additional dry powder, to be deployed in future quarters.

I think you were also asking when would we expect to see that coming through into flows. It takes a number of months, years for that to be deployed, so that all 7.5 billion would take a matter of two to three years. But of course, some of that comes through into the pipeline into 2018.

And I think you also asked again about the 3% to 5% net flow rates. We have to acknowledge, of course, that there is volatility that we have seen in the first quarter. We are yet to see any further volatility that we can experience from the US tax reform event in the first quarter.

But we certainly don't have any indication at this point in time of the magnitude of outflows that we saw in the first quarter around

US tax reform or around insurance outflows. So therefore, based on our pipeline expectations, given that volatility constraint, we remain confident with our flow target.

Tom Mills

Thank you, Claire.

Operator

Next question is from the line of Albert Ploegh with ING Bank. Please go ahead.

Albert Ploegh

Yes, good morning. Thanks for taking my questions. I've got two as well. The first one is on the cost base on the DB Group charges which is now 55 million, so around 23% of the total admin expenses. Is this now basically the full, yes, run rate that we can take into account for the coming quarters, or do you still expect, at some stage later in the year, to review the actual services needed? And it would be helpful to have some comments there.

And the second question, and I come back to an earlier question on the renegotiated contract on the management fees with Deutsche Bank itself, already noticing indeed the comment, that that did not have a material impact, but I was still actually surprised that on the equity... the active equity, you had 36 basis point, there was no impact at all. Is there anything somehow in the mix or in the average AUM over the quarter that explains it's actually stable? Because I expected that one especially to have come down a little bit. Thank you.

Claire Peel

Thank you for the questions. I'll take the first one on your cost point. And in our general and admin costs, we include in there the charge that we received from DB Group for the service agreement that's now in place, and that was 55 million in the first quarter. Just to recap, that's a change as we come into 2018, as that charge is based on the service agreement terms as opposed to an allocation that we have received into the division of a bank in prior quarters. And so there's a shift change there. That 55 million represents the services outlined in the agreement and is a good run rate of what we would expect as we go through the rest of the year.

You asked if we would revalue and revise our services. Of course, that's an ongoing exercise. As we go through this transition year of 2018, and we internalise the activities that we have within the DWS perimeter, we will continue to review and assess the services that we need from DB Group and other third parties. But certainly, at this point in time, you should consider that a good run rate, going forwards.

Albert Ploegh Okay.

Claire Peel On your second question around the DB distribution agreement, the ten-year agreement, correct, that is a small impact in the first quarter. It is reflected in the management fee margin. It is a function of the asset class mix that's distributed via DB Group, so can always shift a little bit, but it's not something we would expect to have a significant impact by any means at all.

The equity side, that's... or the... in terms of equity products distributed through the DB network, the rates are already factored into the 76 basis points that we see on average. What we should recognise within equities is that the management fees have declined, quarter on quarter.

And that is a function, of course, of the declining equity markets that we have seen in Q1. And there will be an ongoing effect that we see from that as we look at the fee margin in future quarters, albeit we have an outlook for improving markets in the future quarters of 2018.

Albert Ploegh Okay, thank you.

Operator Next question is from the line if David Hart with Kepler Cheuvreux. Please go ahead.

David Hart Yes, good morning. Thanks for taking my questions here. Just coming back on the cost element here, and in particular, the slide that you provided earlier on in the year on the cost tailwinds and headwinds there. In terms of the cost headwinds, where are we in terms of the expected timing of the cost, additional costs to come through? Because you've highlighted MiFID II and the additional VAT and the synergy costs, but should we assume that we have a bit more upfront cost in H1 vis-à-vis H2? That would be the first question.

And second of all, if I rightly understood in regard to the active fixed income, you're expecting further outflows in subsequent quarters. Is this in relation to what you've seen and experienced in Q1 or something else?

Claire Peel Thank you for your questions. I'll cover the first one again on costs. And you're referring to some guidance that we gave earlier in the process around cost tailwinds and headwinds. On the headwinds, we guided that we would see incremental costs related to MiFID II research coming into play. We guided to 40 million incremental costs. And we have seen that reflected in our

Q1 results, obviously a quarter of that, so that is embedded in the run rate and no change from there.

We also guided to a further 40 million of additional dys-synergy costs. Some of that is in the cost base where it reflects the head-count perimeter where we have had to bring in activities and functions which we didn't previously have and that is in the run rate.

But there's other areas not yet, which we would see incremental as we go through the year, and that would include, for example, the back charges that we would take on a DB... the DB service agreement, and also some of the charges regarding the company setup that will come through later on. So that is to come.

But offsetting that, I should highlight that we also had cost tailwinds related to our cost efficiency initiatives and also to the DB service agreement. The DB service agreement has reduced in line with our expectations, and we will see some efficiencies come through in the second half of the year which will offset the increments that we will see in the first half.

The second question around active fixed income, we have seen specifically the outflows on the insurance and other sides in the first quarter. We don't expect that size of quantum of outflow going forward in the fixed income business.

David Hart

Okay, thank you.

Operator

If you would like to ask a question, please press star followed by one. Next question is from the line of Harley Tam with Citi. Please go ahead.

Harley Tam

Hi there. Sorry, just a quick follow-up from me, just to be greedy. Could you help me understand or help me recognise the passive net flow figures? So I've got a €1.3 billion net inflow in Q1, and you've talked about 3.6 billion of inflows into your ETF products being offset by a €3.4 billion US institutional client redemption. So I just wondered whether the other 1.5 billion... how I should think about that other inflow into passive. Thank you.

Claire Peel

Hi, thanks for the question. Yes, you're right to point that out. So we have seen also inflows on the institutional mandate side within passive. So we have this large low margin outflow that we specifically highlight. We've had the ETF inflows also of 3.6 billion. But then, in addition, we have seen institutional mandating flows into the passive business. So an area we're quite confident that we'll continue to see strong growth, going forwards.

Harley Tam Thank you.

Claire Peel Oh, perhaps also just to add on passive, just for completeness, that we see a continuation of the average fee margin there, given we incurred expenditure in Q4 of 2017 as we had to switch some of our ETFs from synthetic to physical. That cost has now been incurred and we don't take that forward, and that again supports our margin in passive.

Operator Thank you. There are no further questions at this time. I hand back to Oliver Flade for closing comments.

Oliver Flade Great, Operator. Thank you very much. And thank you, everyone, for dialling in today. Obviously, for any follow-up questions, you're free to contact the IR team. Otherwise, we wish you the rest of a good day. Bye-bye.