

DWS Group GmbH & Co. KGaA  
DWS H1 2018 Investor & Analyst Conference Call

July 25<sup>th</sup> , 2018 | 10:30 a.m. CEST

Transcript

**Speaker:**

Oliver Flade  
Nicolas Moreau  
Claire Peel

Oliver Flade

Thank you very much operator and good morning to everybody from Frankfurt. This is Oliver from Investor Relations and I would like to welcome you to our second quarter 2018 earnings call.

Please be reminded again that the previous Deutsche Bank analyst call outlined the asset management segment results which have a different parameter basis to the DWS results we're presenting today.

I'm joined by Nicolas Moreau, our CEO and Claire Peel, our CFO. Nicolas will start today with some opening remarks and then Claire will take us through the presentation.

For the Q&A afterwards I would ask everybody to limit yourselves to the two most important questions so that we can give as many people a chance to participate in the Q&A session as possible.

I would also like to remind you that the presentation may contain forward looking statements which may not develop as we currently expect and I would therefore ask you to take note of a disclaimer and the precautionary warning on the forward looking statements at the end of our materials.

Now let me hand over to Nicolas.

Nicolas Moreau

Hello good morning everybody and welcome to this second quarterly results conference call for DWS. It has been another significant quarter during which we have continued to execute our strategy in order to achieve our medium term targets and to make continued progress during our transitional period.

We have completed the transfer of nearly all our legal entities, most notably the US and we will transfer the remaining head counts from DB Group to DWS in the second half of the year.

While our Q2 performance was disappointing in terms of flows, we are encouraged by the stability in other key financials as well as by operational progress that was made over the quarter.

In the areas that we've identified for growth such as passive, quant, multi assets and alternative, we saw net inflows of varying degrees.

Tied to this we have continued to invest in strategic areas of focus for our coverage teams illustrated by the higher focus last week to expand our institutional business in Europe.

We have seen excellent progress with our digital strategy as well as our ESG and sustainable investments services which has led to us being awarded headline mandates by Apple in China.

We have also advanced on our programme of operational efficiencies following the IPO.

In June we have announced the transfer of fund administration services to BNP Paribas Securities Services who also provide depository and custody services for DWS Retail Funds. We expect the move will not only deliver cost reduction but also to reduce the application landscape and simplify our fund accounting.

In general we've made progress in driving cost efficiencies and are on track to achieve expected savings this year.

Finally I was pleased with our progress on staff compensation. We are now near to completing all required approvals for the DWS Executive Board compensation related to KPIs and are close to finalising our IPO registered DWS equity linked award for staff which we intend to grant during Q3.

There have also been some positive developments toward implementation of our new DWS compensation framework. This will be in place for the coming year and compensation season and will more closely align DWS compensation to asset management market practices and sector specific regulations.

Overall then I'm satisfied with the tangible progress we've made since our listing four months ago. And it is important to emphasise that we are operating in a transition period as we finalise our work to establish DWS as a distinct organisation.

But we are quickly starting to see progress across many fronts towards our medium term targets and in creating a

sustainable global and leading asset management business.

I look forward to answering your questions but in the meantime let me now hand over to Claire Peel, our CFO who will take you through the presentation on our Q2 results.

Claire Peel

Thank you and welcome to everyone. Today I will present the recent activities and results for the second quarter 2018.

Let's begin by looking at some of our key financial developments. Starting with flows our passive business continues to attract strong inflows in Q2 18 with improved sales reported in both Europe and the Americas. There were also bright spots in our targeted growth areas with quant, multi asset and alternatives attracting inflows over the quarter.

However positive sales were offset by redemptions from active fixed income, cash and active equity resulting in total net outflows of 4.9 billion to the quarter.

Despite this AUM was up in Q2 18 as a result of improved market performance and favourable FX movements. Q2 18 management fee margin of 30.7 basis points is 0.3 basis points lower compared to last quarter but remains in line with our medium term targets.

Adjusted cost income ratio improved to 74.1% in Q2 18 primarily due to higher adjusted revenues. And adjusted profit before tax is 149 million in Q2 18, up 7% over the quarter.

Let me briefly explain the change in accounting before looking into our numbers.

We now report a consolidated view of DWS financial reporting, representing all legal entities in the DWS Group. This is now feasible following the anticipated transfer of our US entities in Q2.

We have provided here a pro forma consolidated figures to ensure quarter on quarter comparability.

Note the Q1 consolidated figures for this year will vary slightly from the combined financials disclosed in April.

The main differences are due to legal entity transfers which became effective post Q1 18 and other immaterial perimeter and accounting adjustments including the representation of head counts.

The adjustment to SGE represents DWS employees that reside in DB entities but costs are charged to DWS. Some of these people move into DWS over time and other than changing how we segment our reported costs it has little impact on DWS operationally.

AUM adjustments over the quarter relate to the timing of legal entity transfers. There was a negative effect in Q1 but most of this returned in Q2.

Moving now to Q2 18 financial performance.

Starting at the top left, AUM improved to 687 billion in Q2 18, up 3% from the previous quarter with favourable FX and market performance offsetting negative impacts from net outflows.

Moving to the top right, revenues of 576 million represents an increase of 3% compared to Q1 reflecting higher performance fees and the integration of our quants business.

Management fee margin of 30.7 basis points is 0.3 basis points lower than that of Q1 18 with some dilution from equity and multi asset outflows.

On the bottom left, adjusted costs of 427 million were up 2% quarter on quarter primarily due to increased costs relating to comp and ben as well as additional company set up costs. Together these costs offset reductions in general and admin expenses.

Whilst income ratio improved to 74.1% down from 75% in the last quarter, and adjusted profit before tax is 149 million - an increase in 7% from Q1 driven by higher performance and transaction fees over the quarter.

Net income of 189 million for the H1 2018 period includes 90 million of tax with a period effective tax rate of 32%. We anticipate this as a guide for 2018 effective tax rates given the transitional effects this year.

To put these numbers into context, let's recap on the market environment during the period. We continue to operate in a challenging market environment in Q2.

The appreciation of the US Dollar worked in our favour, helping to boost quarterly AUM.

But investor sentiment became increasingly cautious particularly in June, reflecting a heightened year of political tensions and growing concerns over market uncertainty. This had a negative impact on European retail investors in particular.

Rising interest rates also continue to negatively affect fixed income absolute returns in Q2.

I will now cover the AUM development.

AUM grew to 687 billion at the end of Q2 18 – an increase of 3% from 665 billion in Q1 with improved FX and market performance offsetting negative impacts from outflows.

The shift to consolidated reporting also played a role. As mentioned earlier negative consolidation effect in Q1 reflects legal entities that were only transferred in Q2. The majority of this returned in the second quarter and are represented in the other category.

In contrast to the first quarter, AUM was boosted by favourable FX rates, primarily the strengthened US dollar resulting in 13 billion asset growth in Q2 18, more than compensating for the negative effect in Q1.

Stronger equity market performance also had a positive impact helping to increase AUM by six billion and marking a partial reversal from the negative market performance reported in Q1 18. And negative developments were driven by net outflows over the quarter which I will now focus on in further detail.

Overall we reported five billion of outflows in Q2 18 due to a number of factors. The loss of an institutional fixed income mandate, further fixed income outflows in our insurance business, ongoing cash volatility at quarter end periods and continued outflows from retail equity. All of these themes were also prominent in the first quarter reflecting the ongoing market challenges facing the asset management industry in general.

From a regional perspective, Germany continued to drive strong inflows with passive sales exceeding retail equity outflows.

However EMEA ex Germany was negatively impacted by cautious investor sentiment while the Americas was affected by fixed income redemptions, cash volatility and asset allocation actions following the Fed Fund rate changes.

From a client perspective we received a mandate top up of more than one billion Euros from a European institutional client split between SQI and passive.

And in the Americas our enhanced commodity is currently recommended by three of the four major wire houses.

Further bright spots in our Q2 flows include sales in our targeted growth areas in addition to passive. Net inflows to our real estate funds tripled to almost one billion in Q2 and we saw the first inflows to our China renewable energy fund.

Not reflected in our flows is our Chinese JV Harvest which generated 1.4 billion of net flows in Q2 up from 0.3 billion in Q1.

I'll now look at our flows more closely by asset class. Starting with passive, quarterly net inflows of approximately three billion were spread across our passive offerings, with sales reported from both retail and institutional clients across different regions.

European listed ETPs remain a key driver of sales making us the number two top selling provider in the region in Q2.

Flows in the Americas moved into positive territory marking a reversal from outflows in Q1, and institutional mandates contributed significantly to Q2 flows.

Quant or SQI strategies registered net inflows of 0.8 billion in Q2 18 compared to slight outflows in Q1, reflecting successful efforts to bolster growth in this area.

Quarterly sales are driven by improved retail flows as well as a mandate win from a European pension client.

Fixed income was a primary driver of our quarterly outflows. We saw an early redemption mandate with one of our institutional clients deciding to redeem ahead of

maturity due to favourable market conditions, and further losses were reported in our insurance business.

US tax reform continues to negatively impact flows albeit to a lesser extent than in Q1, however a flagship floating rate note fund attracted more than one billion net inflows in the year to date period.

Active equity has two billion of outflows amid continued redemptions from European retail clients reflecting growing investor concerns and market uncertainty. Our top dividend fund has been particularly impacted by market activity as well as by weaker performance.

In cash we ended the quarter with 1.2 billion of outflows due in part to the US Fed Fund Rate rising reversing inflows seen earlier in the quarter as well as a US tax payment date in June.

Average cash balances within Q2 were higher than the period end, reflecting cash returning in April but redeeming again in June.

In the context of AUM and flows, I'll now discuss our Q2 financials starting with revenues.

Revenues of 576 million this quarter up 3% compared to Q1. This is mainly due to higher performance fees.

Management fees continue to represent the majority of quarterly revenues growing by 5% compared to Q1 18 and I'll discuss the asset classes shortly.

Performance and transaction fees increased by 11 million quarter on quarter primarily due to strong performance fees in alternative funds, however performance fees were down year on year as Q2 17 revenues included biannual European infrastructure performance fee.

Other revenues were flat quarter on quarter with positive investment income offsetting the decrease in positive change in fair value of guaranteed products.

Let's review now the breakdown by asset class.

Overall our management fee margin of 30.7 basis points is 0.3 basis points lower than that of Q1 18 but in line with the medium term guidance.



Key developments are ongoing market challenges and outflows in high margin trends especially in Europe, resulting in declines in both equity and multi-asset management fees in the second quarter.

Quant management fees reflect the integration of the Sal. Oppenheim business in April although this had no impact on margin.

Fixed income management fees and margin were both flat quarter on quarter as outflows primarily came from low margin products. While cash revenues and margin were up in the quarter reflecting higher intra-quarter balances that that at Q1. The passive management fees were up in Q2 18 reflecting continued AUM and net new money growth and alternative management fees were unchanged from Q1 although margins were slightly down due to outflows from liquid real assets offsetting incremental real estate revenues.

Moving now onto costs first let me recap on head counts.

Reported FT represents head counts that reside in DWS entities only and therefore excludes DWS service centre head counts and pending DWS head count transfers from DB entities. Costs of the full population are reported but only DWS entity head count is reflected in comp and been.

DWS head count currently in Deutsche Bank entities is reported under G&A, and presented under charges for DWS functions in DB entities.

Coming back to costs, the total Q2 adjusted costs is 427 million up 2% on Q1.

On compensation and benefits costs, adjusted compensation and benefits costs of 180 million in Q2 18 were at 5% over the quarter, due to an increase in variable compensation including carried interest.

Looking at general and admin expenses, total costs of 245 million in the second quarter were down slightly, impacted by lower DB Group charges driven by continued insourcing of activity from DB Group to DWS which has a neutral cost effect in total plus some cost decline.

Non comp direct costs increased in Q2 18 primarily due to intensified marketing efforts and company set up costs offsetting improvements from efficiencies.

Let's take a look at the cost efficiency initiative in more detail.

Following our reorganisation we have front to back transparency on our cost base and greater control to review our operating model.

During the IPO we outlined a commitment to achieve 125 to 150 million in gross set cost savings over the medium term - the target we expect to achieve through the Chief Transformation Office and across the platform.

The team progresses a number of cost efficiency measures and we are currently on track to achieve between 20 and 30% of our gross savings targets by the end of 2018.

Some of our early successes include the announced transfer of our fund administration unit to BNP Paribas, a move which is expected to deliver cost reduction over time and reduce the application landscape.

Initial synergies from integrated our investment platforms, active assessment of our vendor consumption opportunities and a lower cost lease established for our New York office.

I will now move onto our capital position.

In the first half of 2018 we saw our common equity tier one capital increase to 2.6 billion up from 2.5 billion at the end of 2017. This increase was mainly driven by changes to consolidation adjustments and other impacts such as foreign exchange movements.

Inter-year profits are not yet reflected in CT1 capital as this requires prior regulatory approval which we will seek and obtain in due course.

The impact of H1 18 profits on CT1 is however limited as these will be recognised net of dividend accruals in line with our previously communicated payout ratio targets of between 65 and 75%.

Our pillar one requirements remain stable in the first half of 18 with 8.4 billion of RWA compared to 8.5 billion for end of 2017.

Our CT1 ratio stood at 31% at month end of June remaining comfortably above requirements.

So to summarise, we continue to deliver against key milestones in a transitional year, including key entity transfers most notably the US, transferring control of remaining key functions from DB Group to DWS. I'm close to finalising the IPO related compensation awards.

We remain committed to our 3-5% net flow target in the medium term but looking ahead to the remainder of 2018, given the factors including the volatility of markets and investor sentiment and US tax reform dynamics, we believe the ability for DWS Group to compensate for the outflows in the first half of 2018 will not be possible.

It would therefore be unlikely that we achieve the annual net flow targets for this year.

Investment performance remains strong overall on a three and five year basis with our key flagship funds showing signs of improvement following under performance in Q1.

Our cost initiatives are well underway and we are on track to achieve targeted efficiencies this year. And we continue to invest into strategic priorities with key hires on boarded and a milestone ESG strategy launched in alternatives.

Together this will support our earnings for this year.

I will now pass back to Nicolas for closing comments.

Nicolas Moreau

Thank you Claire, thank you everyone for joining the call today. I would reiterate that we are making good progress towards our medium target goals to which we have committed.

With the late cycle market we are now in, we are taking great care to have the right products and solutions for our clients that fit to this new environment. And we are positioning our product suite accordingly. Whether with cash, short duration value or fixed income products.

While our net outflows are disappointing I am reassured by the great product capabilities and diversity that we have in DWS.

Our diversity of products really is one of the most compelling selling points of DWS. And it gives me great confidence of our future success.

Thank you and I will now pass to Oliver for the Q&A.

Oliver Flade

Thank you very much Nicolas and operator we are now ready for Q&A. And again if I could remind everybody in the queue to limit themselves to two questions at a time thank you.

Operator

Ladies and gentleman, at this time we will begin the question and answer session. Anyone who wishes to have a question may press star followed by one on their touch tone telephone. To withdraw your question you may press star followed by two. If you use the 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.

And the first question is from the line of Jaques-Henri Gaulard from Kepler Cheuvreux, please go ahead.

Jaques-Henri Gaulard

Yes good morning everyone. Really one question which is around the outflows. Usually the cyclical around US tax payments is something that recurs quite often so I was wondering if you had envisioned this into the 3-5% target for full year 18.

But beyond that in light of the discussion you have with your clients, is there a point to say that your parent company being again on the front page for the bulk of the second quarter for the wrong reasons, this has also had an impact on your flows this quarter? Thank you.

Claire Peel

Thank you for the question so regarding did we anticipate that amount of outflows that we have seen in the second quarter? I think we didn't anticipate the amount – we did anticipate some of the themes.

The US tax reform event is something that we hadn't anticipated in the prior year when looking forward and we have seen that as a feature of our outflows in both Q1 and Q2.

And likewise the volatility that we've seen in the markets over both periods has had more of an effect on our equity flows than anticipated.

And I would say in the US we see quite a lot of volatility at quarter end periods in our cash flows, but we are reassured by the fact that our average balances that we see intra quarter are higher than those quarter ends.

Nicolas Moreau      Regarding the impact of the noise around the bank on outflows, it's clear that we have some impact there. It's difficult to quantify and we haven't seen the issues we've seen in Q4 2016 linked to this noise. Because I believe that being an independent is creating protection to us. Now I cannot say it helps.

Jaques-Henri Gaulard      Okay thank you.

Operator      And the next question is from the line of Haley Tam with Citi, please go ahead.

Haley Tam      Morning everyone, two questions from me please. First of all on the move from the combined to the consolidated reporting basis, just to be clear that I understand this correctly, the combined basis that we had before would have been a business that we envisaged DWS will look like at the end of this year whereas the consolidated basis will reflect the legal entity reality.

                                 In which case I suppose my question is given that shift in the Q1 re-statement it seems that whilst your AUM went down; your profit actually was higher after moving to a consolidated basis. So does this mean your US business was actually loss making?

                                 Any comment you can have there would be useful.

                                 And then the second question is actually just one for fund flows. With the flows into passive, I think you mentioned they were really driven by Exchange Traded Products. I saw the presentation talks about ETC so it's the Exchange Traded Commodity funds. I just wondered if you could talk us through the demand for those products. And whether the flows there usually increase in terms of the market volatility, for example? And whether they're offset by outflows from the more traditional ETFs? Thank you.

Claire Peel      Thank you I'll take the first question on the combined consolidated. So you're correct in your definition – that the combined population in the past represented all of the entities and activity that we anticipate to be part of the DWS Company going forward. And that's still very much the case as we look forward.

                                 The US transition into the DWS Group this year had no effect on the combined consolidated accounting

adjustments. It was actually some smaller entities and the timing of those that had an effect.

So the one of most note would be the Sal Oppenheim entity which transitioned in Q2, so the Q1 effect of that entity is not reflected, and that's reflecting in the 11 billion of AUM that we see adjusted in the first quarter.

So just to reconfirm, there was no impact from the US entities and a primary impact from the Sal Oppenheim entity that transitioned in the second quarter. And there were some lesser impacts from some small remaining entities to transfer in in the second half of the year and small perimeter adjustments.

On the question of fund flows in passive, we have seen a mix of inflows in the second quarter coming from both retail institutional mandates and ETFs, and also as we call ETPs or Exchange Traded Products.

Operator

Ms. Tam has this answered your question?

Haley Tam

Perhaps I can take it offline afterwards.

I suppose I was interested in the highlighting of Exchange Traded Commodities or whether that's just a misread on my part.

Nicolas Moreau

No but I think it's better to go to Oliver on this one because we don't have the right data to answer your question now.

Haley Tam

Okay thank you.

Operator

The next question is from the line of Stuart Graham with Autonomous Research. Please go ahead.

Stuart Graham

Morning, thank you for taking my questions. I have two. Obviously cutting your net new money guidance is a bit embarrassing but consensus didn't believe you anyway. I think consensus was plus 1.7% for the year so I'm not really sure what you're saying now on net new money for this year. I guess my question is are you comfortable with consensus at 1.7%? That's question one.

And then the second question is on the Q1 call you were at pains to say how good the pipeline was and how your early warning signals were looking good for net new money in Q2. Obviously that didn't prove to be the case so what went wrong with your pipeline indicators?

And what lessons have you learned from that if any? Thank you.

Claire Peel

Thank you so I'll pick up the question and Nicolas may add but on the question of the consensus levels, that was indeed around 1.5% mark compared to the target that we have of 3-5% over the medium term.

I think as we came out of the first quarter and we saw some exceptional events within that quarter driving the outflows with very specific outflows related to US tax reform and a single institutional client mandate outflow, it was considered really too early to reassess whether some of those features would continue later on through the year.

As we come into the second quarter, we have seen continued volatility and significant outflows in our fixed income and cash areas albeit low margins. And given those continued events that we saw have put us in a position of revising the guidance for the current year of 2018 but not deviating from where we are committed to for the medium term horizon.

On the pipeline we do have and do see a strong pipeline in our passive business. We have a strong pipeline within the alternatives business but we do absolutely see quite a lot of volatility in fixed income and cash.

Nicolas Moreau

Yes well I would say that the pipeline has not really changed from Q1 to Q2 but I think it has been longer for us to close the deals. We have also not anticipated properly the cash volatility.

If you look at the revenues on the cash line from quarter to quarter, it's clear and it shows that it has been growing in terms of revenue so the average cash during quarters has been higher than at the end of the quarters.

This volatility end of quarter is quite embarrassing because we see the cash going out just before the end of the quarter and coming out after, but that's something we have not anticipated in our guidance.

So some of the mandates that we have won took more time to close than was expected - that's one of the reasons. And we have also had some unexpected loss of accounts on the fixed income side that were not forecasted at the time.



So where are we for the end of the year and what type of guidance can we give now?

It's quite difficult to assess today given the volatility that we see currently, you know. And that's a market feature that in fact has no trend today in the market.

Whether in the retail or the institutional our clients are still undecided about where and how to invest their cash, so in that respect I think we'll leave it as it is in terms of guidance. I think we'll have some positive news but difficult to forecast given that net new assets is a mix of inflows and outflows. And for us given the cash business we have a huge amount in and a huge amount out.

Stuart Graham

That's okay, just so that I'm clear can I just say what I think you just said? You're not commenting on consensus, it's too unpredictable.

And on your pipeline there is nothing broken in your pipeline system but just some unexpected things and it took slightly longer. But the system of your pipeline is still valid, you believe yes?

Nicolas Moreau

Yes I think on our pipeline the accounts that we had a high probability to win are still there. The only issue is that it took us more time to close than what was expected.

Stuart Graham

Got it, thank you for taking my questions. Thank you.

Operator

The next question is from the line of Arnaud Gibrat with Exane. Please go ahead.

Arnaud Gibrat

Yes good morning, I've got two questions for you. First on the pressures on Deutsche Bank and the implications that that's had on flows. I was wondering if you could comment a bit more about what sort of impact you have seen, and if the parent company remains under pressure do you see a risk of going back to 2016 levels of outflows? Or do you think the independence and the moving of custody services etc is sufficient to isolate DWS from that 2016 experience?

And my second question is on the tax rates. I think you reported a 38% tax rate and you're guiding for an effective tax rate of 32%. If I remember well your previous guidance used to be for a tax rate of 28% in the long term.

Is that 28% tax rate still valid? Thank you.



Claire Peel

Thank you for the questions. Let me start with the second question which is more discreet on the tax rate. So we look at the tax rate for 2018 for the half year period given the movements that we've seen between Q1 and Q2, and the half year tax rate is 32%.

We do see that being a guide for the current year given the transitional periods that we go through and it has been influenced by unfavourable tax adjustments within various jurisdictions including dividend repatriations and prior year tax adjustments and also the combined US State tax rate movements.

So that's related to the current year.

If we look forward over the medium term we still anticipate to have a targeted effective tax rate which is an average value of between 28 and 29% over that period.

Nicolas Moreau

On the DB side as I said before I think that it's not preventing us from winning business. The region where it is the most sensitive would be the US but I think at the worst day of the news flow this year we have been able to attract two large accounts with a wire house – one of 600 million and the other of 300 million.

And we have been able to explain to the fund selection team of this wire house that we were autonomous, that our US business was independent reporting to DWS directly.

I think the change of brand that we did is also an important factor in differentiating us from the bank.

And on top of it I think the partnership with Nippon Life and Tikehau is seen very positively by our clients. And we begin to make big progress in that respect.

Arnaud Giblat

Okay thank you.

Operator

The next question is from the line of Michael Werner with UBS. .

Michael Werner

Thank you for the opportunity to ask questions. Two of them from me – first on your fee margin target which I think in the medium term is to keep management fee margins above or equal to 30 basis points. We've seen about a 1.5 basis point decline year on year to 30.7 so I was just wondering, what makes you confident that over the next

couple of years you'll be able to keep the fee margin above 30 basis points?

And then secondly back to flows, apologies. You indicated that through April and May you saw relatively decent flows and I think towards the end of the quarter that trail dried up. So I was just wondering if you could give us any insight as to what the flow numbers were potentially month to month during the quarter, just to get a better idea of how things were progressing until June. Thank you.

Claire Peel

Thank you for the questions. If I start with the fee margin we have a fee margin in the second quarter of 30.7 basis points so that's within the guidance of the 30 basis points or greater in the medium term horizon. We have seen that decline over the period and there are a number of features there.

In terms of the asset classes that are having more of an effect in the current period, I would point to equity and multi asset retail flows which have certainly had an impact within the period. And also in the prior year we had higher gains from the general market environment which has declined as we've come into 2018. So all of those have had a function.

The outflows that we see in fixed income and cash are certainly at a lower margin end, so you see more stability in those levels.

So if you look across the asset classes for now it's very much the equity and multi asset that we see driving the trend.

In terms of your question on flows within the quarter, we wouldn't point to specific flow numbers that we see month by month but in terms of trends we have certainly seen the cash volatility at the quarter end and the quarter start, and that has had an impact on our net flow impact.

And we also see at the end of the quarter just more volatility in certain periods which is more market driven.

Michael Werner

Thank you.

Operator

Our next question comes from the line of Albert Ploegh with ING.

Albert Ploegh

Yes good morning. Thanks for taking my questions. I've two as well. First one is on the passive market especially in Germany on the ETF side. There was recently an article in the FT suggesting that players like Vanguard and Blackrock are trying to move into that market more aggressively.

Do you see anything yet developing there? And what is your near term guidance on the passive margin which has been still quite stable at 24/25, but compared to some of your space of course still very high. So some comments on that would be helpful.

And the second question is more a clarification or a confirmation.

On one of the slides it was mentioned that 150 FTEs will be transferred back to DWS to have this confirmed. I mean this will have no impact let's say on the disclosed cost base? So it's more a move out of G&A back to compensation? So generally no further impact on the cost base overall itself? Thank you.

Claire Peel

Thank you for the questions, just to close off on the second one on the movement of DWS FTE, you're quite correct there. That as that FTE transfers out of DB entities into the DWS entities, there's no impact on costs. It's purely a shift from G&A to comp and been as you described.

On ETFs we continue to see very strong inflows in all regions and across retail and institutional. And in Europe we maintained our numbers to ranking in terms of flows, so we continue to see very strong performance there.

The average fee margin of 25 basis points has been relatively stable. We would anticipate to see some dilution over time of course but that has been taken into account within our guidance.

Albert Ploegh

Thank you.

Nicolas Moreau

If I can come in Blackrock have been in Germany for a very long time. I think the article in the FT was commenting about Lyxor buying the Commerzbank business in Germany. This is not a new competitor for us – that would be a continuation of what exists.

The question mark is about Vanguard. Now it's quite difficult when coming to a market with no asset base. The ETF market is not only price; it's also liquidity, volumes. I

believe that our fund range like the fund range of Blackrock is very liquid so execution is easy. And at the end our total return is excellent after costs and in the end that's what people are looking at.

So I don't see... I think it's a competitive market anyhow but I think we have an excellent fund range, so I'm confident that we'll be able to continue to grow at the same type of margin.

Thank you to the caller.

Operator

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

Anil Sharma

Hello yes just two questions please. The first one I'm just curious on the cost income medium term targets. Just given the downgrading of the flow expectations and therefore the lower start point you're going to have on AUM, and given some of the remarks you've made about the Q3 compensation this year, I'm just curious as to whether you're going to still stick with the 55% target? Or if you think that needs to change?

And then secondly on your flow picture, again just if I look at the slide 17 where you give the breakdown by region and by channel, the Asia Pacific region seems to have stepped up the outflows. They seem to be quite heavy for the first time in a while.

I'm just wondering, does that number already include some of the allocation from Nippon or is that yet to come?

And if you can give just a bit more colour as to what is going on out in Asia that would be helpful. Thank you.

Claire Peel

Thank you for your questions. Let me start with your cost/income ratio question. So we have a guidance of 65% or below over the medium term and we still maintain that target and objective.

Indeed we transition into that as we go through the current year and beyond, so we currently are this quarter at 74%. So certainly we have more to do on cost efficiencies which are on track and also in growth and revenues over time.

So as much as we will see volatility over the period as indicated by the flow environment that we have seen, we

are still confident that we will get to that target over the medium term horizon.

Anil Sharma

Just to be clear, ignoring the fact that the revenue this year might be worse than what you anticipated you still think you can manage the cost base to get to a 65% target?

Claire Peel

Yes that's right. It's a medium term target, so over that time horizon we have the opportunity to manage the levers required to maintain that objective.

Anil Sharma

Cool thank you.

Claire Peel

And on your question around regional flows in Asia Pacific actually that was a very specific fixed income mandate outflow that we saw within the period that actually was one of the contributing factors to the total flow that we saw within the quarter, so very much an isolated matter.

With regard to Nippon Life, we have very active dialogue with Nippon Life and many strategic opportunities in the pipeline and have some early inflows incorporated already.

Anil Sharma

Okay but there's no announcement on what AUM transfer might be or anything like that is there?

Nicolas Moreau

No we are working on various situations. We have had a very beginning and small contribution so that doesn't add any impact on our outflows.

But we would expect to see some of the projects we are working on together to come to fruition before year end.

Anil Sharma

Perfect thank you.

Operator

The next question is from the line of Matthew Clark with Main First. Please go ahead.

Matthew Clark

Good morning, so two questions from me. Firstly on active retail equity fund performance; the 12 months proportion beating benchmark fell a long way this quarter from 72% to 47%. Is there anything you can tell us to help us understand why that is, why your fund suite is particularly unsuited to market conditions that we've seen? And whether that's something we should be worried about going forward with respect to flows?

And then second question is just on your pillar two capital requirements. It seems very high – is there anything you

can tell us to help us understand why it's so high and whether it's going to stay at that level? Thanks very much.

Claire Peel

Thank you for your questions. Firstly just to comment on the one year investment performance, we did see an increase in the institutional measure and a decline in the retail measure with a net percentage point decline in the overall for the one year, but the three year and five year remained stable.

And as you point to, there was a declining performance in the one year within two funds within our active retail equity population and also within fixed income. But there was an offset in institutional and stable on the three year.

On your question on pillar two capital requirements, they are certainly the binding constraints for DWS and are higher than those of pillar one. We have seen some downward trends in our pillar two that we don't disclose until year end but we have seen some downward decline in that related to structural FX.

And otherwise there's the full suite of exposures that are incorporated into our pillar two. So we don't expect to see substantial movement in that but we will continue to optimise our pillar two requirements over time.

Nicolas Moreau

If I can complete your question about active funds, I think the two funds we are talking about are equity funds that are two very large funds. They are quite more in a value style, in an environment which has been very [inaudible 00:50:13] and we believe that with the change in the market environment that we are seeing today that that should be better.

So the two funds are DWS Deutschland which is one of the best funds in the market as you know and the other one is DWS Vermoegensbildungsfonds.

And these two funds are quite large and so they have a big impact on the average performance that we give. We believe that the funds are very strong funds and the portfolio management team is one of the best in the German market. So I don't think this is a long term issue.

I don't think there's any problem of franchise if that's your question. I think we remain very dedicated to active retail in

Germany and we believe that these funds will go back to performance soon.

Matthew Clark

Thank you.

Operator

The next question is from the line of Tom Mills of Credit Suisse, please go ahead.

Tom Mills

Good morning, I just wondered if you could quantify how many gross cost savers have been booked in the first half just so we can understand what's coming in the second. And then based on your guidance.

And then are you able to provide at this stage any broad guidance around what the impact from IPO awards might be in the third quarter? Thank you.

Claire Peel

Hi thanks for your questions. If I take the first around cost savings, just to recap that we committed to medium term cost save guidance between 125 and 150 million of savings, and we anticipate to achieve between 20 and 30% of that on a gross basis within this year.

You can see within our restructuring expense that we have incurred more restructuring costs within the second quarter, and that reflects some savings that we realised within quarter, but also anticipated in the second half of the year regarding restructuring.

In addition to that we have further savings that we've realised in our G&A population. So no specific numbers to quote but you can see within the mix of stable comp and been on the non variable side, it's effectively reflecting the absorption of savings to reflect the growth in investment that we have made.

The second question, the impact of the IPO award – we would indeed see an effect to that come into the second half of the year as we start to account for those awards that will get granted through the third quarter.

Tom Mills

Okay thanks.

Operator

And the next question is from the line of Hubert Lam with Bank of America.

Hubert Lam

Hi good morning. Two questions, firstly just a follow up on that question of the IPO awards second half. I'm just wondering what we should expect there for the comp and



to maybe the comp to revenue ratio for the second half of the year?

Would it be materially higher than what it was in the first half? That's the first question.

The second question is on flows – you referred to pretty chunky outflows coming from the US tax reform in both Q1 and Q2. I'm just wondering if that drag is now over and we should expect probably more normalised flows in the second half, or do you expect that impact to continue in the second half? Thank you.

Nicolas Moreau

I'll take the IPO one. I think it would be absorbed through the viable compensation line so you should not expect an increase in the viable compensation line compared to last year.

Claire Peel

And on the flow question in the first half of this year as we have really disclosed today, we've seen a lot of volatility some of which was not anticipated which makes it very hard to look forward and predict whether we will see more of that activity related to US tax reform or the volatility of markets.

So a bit difficult to predict exactly the outcome that we anticipate for the second half of the year.

Hubert Lam

Okay so you're not ruling out that could have further effect in the second half then?

Claire Peel

We certainly wouldn't expect anything to the magnitude that we've seen in the first half of the year; that's not within our expectations.

Hubert Lam

Okay thank you.

Operator

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

Oliver Flade

Yes thank you very much everyone for dialling in today. Obviously for any follow up questions please feel free to contact the IR team; otherwise we wish you a good day. Bye bye.