ALLIANZ SE
Form 6-K
August 13, 2007
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 6-K

Report of Foreign Private Issuer

Pursuant to Rules 13a-16 or 15d-16 of

the Securities Exchange Act of 1934

for the period ended June 30, 2007

Commission file Number: 1-15154

ALLIANZ SE

Königinstrasse 28

80802 Munich

Germany

(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.

Form 20-F x Form 40-F ¨

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes ¨ No x

THIS REPORT ON FORM 6-K (EXCEPT FOR ANY NON-GAAP FINANCIAL MEASURE AS SUCH TERM IS DEFINED IN REGULATION G UNDER THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED) SHALL BE DEEMED TO BE INCORPORATED BY REFERENCE IN THE REGISTRATION STATEMENTS ON FORM S-8 (FILE NO. 333-13462 AND NO. 333-139900) OF ALLIANZ SE AND TO BE A PART THEREOF FROM THE DATE ON WHICH THIS REPORT IS FURNISHED, TO THE EXTENT NOT SUPERSEDED BY DOCUMENTS OR REPORTS SUBSEQUENTLY FILED OR FURNISHED. FOR THE AVOIDANCE OF DOUBT, THE DISCLOSURE CONTAINING ANY NON-GAAP FINANCIAL MEASURE CONTAINED IN THE ATTACHED REPORT IS NOT INCORPORATED BY REFERENCE INTO THE ABOVE-MENTIONED REGISTRATION STATEMENTS FILED BY ALLIANZ SE.

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Development of the Allianz share price versus Dow Jones EURO STOXX 50 and Dow Jones EURO STOXX Insurance indexed on the Allianz share price in €

Source: Thomson Financial Datastream

Current information on the development of the Allianz share price is available on the internet at www.allianz.com/stock.

Basic Allianz share information

Share type	Registered share with restricted transfer
Denomination	No-par-value share
Stock exchanges	All German stock exchanges, London, Paris, Zurich, Milan, New York
Security Codes	WKN 840 400
	ISIN DE 000 840 400 5
Bloomberg	ALV GY
Reuters	ALVG.DE

Investor Relations

We endeavor to keep our shareholders up-to-date on all company developments. Our Investor Relations Team is pleased to answer any questions you may have.

Allianz SE

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Allianz Group Key Data

Balance sheet

	As of June 30, 2007	As of December 31, 2006	
	mn	mn	Change
Investments	293,491	298,134	(1.6)%
Loans and advances to banks and customers	452,961	408,278	10.9%
Total assets	1,111,145	1,053,226	5.5%
Liabilities to banks and customers	398,010	361,078	10.2%
Reserves for loss and loss adjustment expenses	64,824	65,464	(1.0)%
Reserves for insurance and investment contracts	290,276	287,697	0.9%
Shareholders equity	48,459	50,481	(4.0)%
Minority interests	3,288	6,409	(48.7)%

Allianz SE ratings as of July 31, 2007[1)]

	Standard & Poor s	Moody s	A.M. Best
Insurer financial strength	AA	Aa3	A+
Outlook	Stable	Stable	Stable
Counterparty credit	AA	Not rated	aa[2)]
Outlook	Stable		Stable
Senior unsecured debt	AA	Aa3	aa
Outlook		Stable	Stable
Subordinated debt	A+/A[3)]	A2/A3[3)]	a+/a[3)]
Outlook		Stable	Stable
Commercial paper (short term)	A-1+	P-1	Not rated
Outlook		Stable	

1) Includes ratings for securities issued by Allianz Finance B.V., Allianz Finance II B.V. and Allianz Finance Corporation.
2) Issuer credit rating.
3) Ratings vary on the basis of maturity period and terms.

Other selected financial data

		Three months ended June 30,			Six months ended June 30,		
		2007	2006	Change from previous year	2007	2006	Change from previous year
Income statement							
Total revenues[1]	€ mn	24,337	24,067	1.1%	53,660	53,708	(0.1)%
Operating profit[2]	€ mn	3,288	2,794	17.7%	6,158	5,471	12.6%
Income before income taxes and minority interests in earnings	€ mn	3,198	2,992	6.9%	7,754	6,023	28.7%
Net income	€ mn	2,140	2,279	(6.1)%	5,380	4,058	32.6%
Segments							
Property-Casualty							
Operating profit[2]	€ mn	1,894	1,845	2.7%	3,161	3,231	(2.2)%
Loss ratio	%	64.9	65.1	(0.2)% p	66.5	65.6	0.9% p
Expense ratio	%	28.0	26.8	1.2% p	28.3	27.7	0.6% p
Combined ratio	%	92.9	91.9	1.0% p	94.8	93.3	1.5% p
Life/Health							
Operating profit[2]	€ mn	758	527	43.8%	1,508	1,250	20.6%
Statutory expense ratio	%	9.6	9.5	0.1% p	8.4	8.8	(0.4)% p
Banking							
Operating profit[2]	€ mn	448	266	68.4%	1,148	813	41.2%
Cost-income ratio	%	72.3	84.0	(11.7)% p	69.4	78.5	(9.1)% p
Loan loss provisions	€ mn	(65)	(7)	828.6%	(60)	26	
Coverage ratio as of June 30,[3]	%	56.5%	58.5%	(2.0)% p	56.5%	58.5	(2.0)% p
Asset Management							
Operating profit[2]	€ mn	325	297	9.4%	637	601	6.0%
Cost-income ratio	%	59.2	59.1	0.1% p	59.6	59.3	0.3% p
Third-party assets under management as of June 30,	€ bn	789	764[4]	3.3%	789	764[4]	3.3%
Share information							
Basic earnings per share	€	4.85	5.62	(13.7)%	12.32	10.02	23.0%
Diluted earnings per share	€	4.75	5.51	(13.8)%	12.08	9.83	22.9%
Share price as of June 30,	€	173.59	154.76[4]	12.2%	173.59	154.76[4]	12.2%
Market capitalization as of June 30,	€ bn	77.9	66.9[4]	16.4%	77.9	66.9[4]	16.4%

[1] Total revenues comprise Property-Casualty segment s gross premiums written, Life/Health segment s statutory premiums, Banking segment s operating revenues and Asset Management segment s operating revenues.
[2] The Allianz Group uses operating profit to evaluate the performance of its business segments and the Group as a whole.
[3] Represents total loan loss allowances as a percentage of total non-performing loans and potential problem loans.
[4] As of December 31, 2006.

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Allianz Group Interim Report Second Quarter and First Half of 2007

Executive Summary and Outlook

18% increase in operating profit to €3.3 billion in 2Q 2007.

- Strong revenue growth in Banking and Asset Management.
- Growing operating profit contribution from all business segments.
- Low harvesting.
- Pre-tax income exceeds €3 billion and net income amounts to €2.1 billion.
- Net impact of AGF transaction, dividend payout and unrealized losses reduced shareholders equity to €48.5 billion.

Total revenues

in bn

Net income

in mn

Operating profit

in mn

Shareholders equity[2]

in mn

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[1] Internal total revenue growth excludes the effects of foreign currency translation as well as acquisitions and disposals. Please see page 35 for a reconciliation of nominal total revenue growth to internal total revenue growth for each of our segments and the Allianz Group as a whole.

[2] Does not include minority interests.

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Allianz Group s Consolidated Results of Operations

Total revenues

Total revenues Segments

in mn

Total revenues were up 1.1% and amounted to €24.3 billion in 2Q 2007 compared to a year ago. Based on internal growth our revenues increased by 1.7%. All segments recorded positive internal growth rates on a 2007 to 2006 second quarter comparison, while the increases in our Asset Management and Banking segments were particularly strong.

Property-Casualty Managed growth and stable prices led to gross premiums written of €10.0 billion in 2Q 2007 and €24.1 billion for the first six months of 2007. The acquisition of ROSNO and Progress Garant contributed to the increase in premiums. Positive growth rates were recorded on both a total and internal growth basis.

Life/Health At €11.8 billion in 2Q 2007, our statutory premiums were down 1.5% compared to a year ago, whereas internal growth turned positive with 0.3%. With the exception of Germany and the United States, we achieved strong growth in all our life markets. However, the slowdown in the United States bottomed out in the first quarter. For the first six months of 2007, statutory premiums reached €24.1 billion, down 2.7% year-on-year.

Banking Our Banking segment's operating revenues grew substantially to €1.9 billion in 2Q 2007 and €4.0 billion in 1H 2007, up 8.4% and 8.1% from the respective prior year periods, respectively . On an internal basis growth came to 9.3% for the second quarter.

Asset Management We achieved net inflows to third-party assets of €20 billion in the first half of 2007. Together with positive market effects of €21 billion, third-party assets grew by 5.3% since year-end 2006, excluding foreign exchange and consolidation effects. Commensurate with the higher asset base, operating revenues grew by 9.8% on a 2007 to 2006 second quarter comparison and 6.8% on a first half comparison.

Allianz Group Interim Report Second Quarter and First Half of 2007

Operating profit

Operating profit Segments

in mn

At €3.3 billion, operating profit in 2Q 2007 was 17.7% higher than in the comparison period, continuing a long-term history of substantial year-over-year improvement of quarterly operating profit. All business segments delivered higher operating profits than a year ago. For the first six months of 2007, operating profit amounted to €6.2 billion, 12.6% higher than in the same period last year.

Property-Casualty Operating profit grew by 2.7% to €1.9 billion in 2Q 2007 from an already high level a year ago. Despite the burden from winterstorm Kyrill in 1Q 2007, operating profit in the 2007 to 2006 first half comparison declined only €70 million to €3.2 billion.

Life/Health In 2Q 2007, operating profit grew dynamically by 43.8% to €758 million with most operations contributing to this growth. In the first half of 2007, operating profit was €1.5 billion, 20.6% above the same period last year. Solid improvements in our expense and investment margins drove these developments.

Banking We recorded strong operating profit growth of 68.4% and 41.2% compared to 2Q and the first half of 2006, respectively, resulting from higher revenues and lower expenses.

Asset Management Up 9.4% to €325 million in 2Q 2007 and 6.0% to €637 million in the first half of 2007, operating profit continued to benefit from our growing asset base and tight expense management. At 59.2% and 59.6%, our cost-income ratio remained at a very competitive level.

Non-operating items

The net result of non-operating items in 2Q 2007 was minus €90 million. Although not material in total, there were significant line item movements. As expected, harvesting returned to a normal level, while in the same period last year, we had the Schering sale, with a significant realized gain. Hence, the total impact from net realized gains and impairments of investments declined by €895 million to €401 million. Interest expense on AGF bridge financing amounted to approximately €74 million in 2Q 2007, resulting in substantially higher interest expense from external debt. Restructuring charges in 2Q 2006 stemmed primarily from the announcement at that time of our restructuring plan for the Allianz Group's insurance operations in Germany.

Contrary to the developments previously described in the comparison of the second quarters of 2007 versus 2006, in the six months comparison, the overall impact from net realized gains and impairments of investments increased by €372 million to €2.4 billion. This is attributable to the locking-in of unrealized gains in 1Q 2007, after the strong performance of our equity investments and thus we have already generated a significant part of our capital gains target for 2007. The cash from these sales was, in part, used for the acquisition of the outstanding shares in AGF that Allianz SE did not already own at that time.

Net income

Net income, at €2.1 billion in 2Q 2007, was down by 6.1%, primarily as a result of higher income tax expenses, with pre-tax income exceeding €3 billion. With significantly reduced tax-exempt income, the effective tax rate of 26.8% and income tax expenses of €858 million in 2Q 2007 were considerably higher than a year ago. Primarily due to the RAS minority buy-outs completed last year and the AGF minority buy-outs this year, the minority interests declined from €356 million to €200 million.

On a six months basis, net income grew by €1.3 billion to €5.4 billion, reflecting both our strong operating profit and the substantially increased non-operating result. Our six months effective tax rate rose from 20.9% in 2006 to 23.5% in 2007.

Earnings per share[1)]

**in **

[1)] See Note 37 to our consolidated financial statements for further details.

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Allianz Group Interim Report Second Quarter and First Half of 2007

The following table summarizes the total revenues, operating profit and net income for each of our segments for the three and six months ended June 30, 2007 and 2006, as well as IFRS consolidated net income of the Allianz Group.

	Property-Casualty		Life/Health		Banking		Asset Management		Corporate		Consolidation		Group	
	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006
	€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn
Three months ended June 30,														
Total revenues[1]	**9,982**	**9,682**	**11,758**	**11,931**	**1,850**	**1,706**	**797**	**726**			**(50)**	**22**	**24,337**	**24,067**
Operating profit (loss)	**1,894**	**1,845**	**758**	**527**	**448**	**266**	**325**	**297**	**(10)**	**(74)**	**(127)**	**(67)**	**3,288**	**2,794**
Non-operating items	180	440	15	(17)	39	12	(82)	(134)	(74)	184	(168)	(287)	(90)	198
Income (loss) before income taxes and minority interests in earnings	**2,074**	**2,285**	**773**	**510**	**487**	**278**	**243**	**163**	**(84)**	**110**	**(295)**	**(354)**	**3,198**	**2,992**
Income taxes	(578)	(466)	(234)	(90)	(56)	(89)	(101)	(62)	80	80	31	270	(858)	(357)
Minority interests in earnings	(116)	(237)	(60)	(92)	(20)	(27)	(8)	(11)	(4)	(7)	8	18	(200)	(356)
Net income (loss)	**1,380**	**1,582**	**479**	**328**	**411**	**162**	**134**	**90**	**(8)**	**183**	**(256)**	**(66)**	**2,140**	**2,279**
Six months ended June 30,														
Total revenues[1]	**24,093**	**23,831**	**24,084**	**24,753**	**3,951**	**3,654**	**1,577**	**1,477**			**(45)**	**(7)**	**53,660**	**53,708**
Operating profit (loss)	**3,161**	**3,231**	**1,508**	**1,250**	**1,148**	**813**	**637**	**601**	**(111)**	**(254)**	**(185)**	**(170)**	**6,158**	**5,471**
Non-operating items	844	868	118	141	156	404	(204)	(270)	437	(27)	245	(564)	1,596	552
Income (loss) before income taxes and minority interests in earnings	**4,005**	**4,099**	**1,626**	**1,391**	**1,304**	**1,217**	**433**	**331**	**326**	**(281)**	**60**	**(734)**	**7,754**	**6,023**
Income taxes	(1,115)	(990)	(435)	(309)	(224)	(334)	(181)	(127)	55	234	75	270	(1,825)	(1,256)
Minority interests in earnings	(330)	(427)	(159)	(220)	(44)	(55)	(19)	(24)	(8)	(9)	11	26	(549)	(709)
Net income (loss)	**2,560**	**2,682**	**1,032**	**862**	**1,036**	**828**	**233**	**180**	**373**	**(56)**	**146**	**(438)**	**5,380**	**4,058**

[1] Total revenues comprise Property-Casualty segment s gross premiums written, Life/Health segment s statutory premiums, Banking segment s operating revenues and Asset Management segment s operating revenues.

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Risk Management

Risk management is an integral part of our business processes and supports our value-based management. As our internal risk capital model provides management with information which allows for active asset-liability management and monitoring, risk is well controlled and there are no identified risks which could in the future pose a threat to the existence of the Allianz Group.

Out of our € 1,031 billion investments and receivables €35 billion are invested in asset-backed securities. Thereof €16.3 billion are kept in the trading book of our banking segment. Only €1.7 billion or 0.16% of our investments and receivables are related to risks out of the US subprime-market. Out of these €1.7 billion, € 1.6 billion are held in the trading book of our banking segment which is carried at fair-value. The exposure is split into the following ratings: 54.8% AAA, 31.0% AA, 12.7% A and 1.0% BBB. Only 0.5% are out of BB ratings.

The information contained in the risk report in our 2006 Annual Report is still valid.

Events After the Balance Sheet Date

See Note 41 to the consolidated financial statements.

Opportunities

As presented in our 2006 Annual Report, we remain confident that the business prospects for financial service providers remain positive against the background of continuous dynamic global economic development.

Outlook

Our outlook remains unchanged; we are on track to achieve our targets.

In the years 2007 to 2009, we expect average annual consolidated operating profit growth of 10% from the 2006 level, adjusted for the particularly favorable natural catastrophe trend in 2006. Within the same time period, we are striving to maintain a strong combined ratio of less than 94% on average in our Property-Casualty segment. In Life/Health we aim to achieve an average new business margin[1)] greater than 3%. We also target an average return on risk-adjusted capital in our Banking segment of above 15%. For our Asset Management segment, we are targeting average annual growth of third-party assets under management of 10%, excluding foreign currency conversion effects.

We expect net income of around €8 billion for the full year 2007.

As always, natural catastrophes and adverse developments in the capital markets, as well as the factors stated below in our cautionary note regarding forward-looking statements, may severely impact our results of operations.

Cautionary Note Regarding Forward-Looking Statements

The statements contained herein may include statements of future expectations and other forward-looking statements that are based on management s current views and assumptions and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. In addition to statements which are forward-looking by reason of context, the words may , will , should , expects , plans , intends , anticipates , believes , estimates , predicts , potential , or continue a expressions identify forward-looking statements.

Actual results, performance or events may differ materially from those in such statements due to, without limitation, (i) general economic conditions, including in particular economic conditions in the Allianz Group s core business and core markets, (ii) performance of financial markets, including emerging markets, (iii) the frequency and severity of insured loss events, (iv) mortality

and morbidity levels and trends, (v) persistency levels, (vi) the extent of credit defaults, (vii) interest rate levels, (viii) currency exchange rates including the Euro/U.S. Dollar exchange rate, (ix) changing levels of competition, (x) changes in laws and regulations, including monetary convergence and the European Monetary Union, (xi) changes in the policies of central banks and/or foreign governments, (xii) the impact of acquisitions, including related integration issues, (xiii) reorganization measures, and (xiv) general competitive factors, in each case on a local, regional, national and/or global basis. Many of these factors may be more likely to occur, or more pronounced, as a result of terrorist activities and their consequences.

The matters discussed herein may also be affected by risks and uncertainties described from time to time in Allianz SE s filings with the U.S. Securities and Exchange Commission. The company assumes no obligation to update any forward-looking statement.

[1)] New business margin according to the definition of European Embedded Value.

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Allianz Group Interim Report Second Quarter and First Half of 2007

Property-Casualty Insurance Operations

Strong profitability level slightly improved.

- Managed revenue growth and overall stable prices contributed to an excellent combined ratio.
- Higher yields and growing asset base drove current investment income.

Earnings Summary

Gross premiums written

Gross premiums written by region[1]

in %

[1] After elimination of transactions between Allianz Group companies in different geographic regions and different segments. Gross premiums written from our specialty lines have been allocated to the respective geographic regions.

Gross premiums written Growth rates[1]

in %

[1] Before elimination of transactions between Allianz Group companies in different geographic regions and different segments.
[2] Together with our property-casualty assumed reinsurance business, primarily attributable to Allianz SE, the decline within Germany was (6.7)% for 2Q 2007 over 2Q 2006 and (5.4)% for 1H 2007 over 1H 2006.

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2007 to 2006 second quarter comparison

At €9,982 million in 2Q 2007, gross premiums written were up 3.1% from a year ago. Based on internal growth, the increase amounted to 1.8%. We continued targeting risk adequate prices. Overall, we recorded a price effect on gross premiums written of minus 0.5% and a volume effect of plus 2.3%.

Operations with decreased or flat gross premiums written included Allianz Sach in Germany, our Italian entities and Allianz Global Corporate & Specialty.

At Allianz Sach and in Italy, tariff increases in certain lines of business were offset by unfavorable developments in other business lines, leading to stable gross premiums written at Allianz Sach of €1,696 million and slightly lower revenues in Italy of €1,340 million.

Allianz Global Corporate & Specialty recorded an aggregate decline of gross premiums written of 9.3% as we remained diligent in our risk selection. Furthermore, price decreases in the aviation business, in the property business in the United Kingdom, and in the German marine business impacted revenue growth.

At the same time, our growth markets, our credit insurance business and Spain recorded solid increases. In aggregate, New Europe our growth markets within Central and Eastern Europe together with Asia-Pacific and South America accounted for 13.3% of our Property-Casualty segment's gross premiums written in 2Q 2007, compared to 10.4% a year earlier.

Premium volume in New Europe benefited from organic growth and the first time consolidation of ROSNO and Progress Garant in Russia.

Premium growth at our credit insurer Euler Hermes was driven by increased business volume and higher retention rates. Total revenues went up €48 million to €446 million.

In Spain, gross premiums written increased by €38 million to €502 million. Here, we saw growth across all business lines.

2007 to 2006 first half comparison

In the 2007 to 2006 first half comparison, our gross premiums written increased by 1.1% to €24,093 million. In most of our markets, the developments were consistent with the 2007 to 2006 second quarter comparison. Only our operations at Fireman's Fund in the United States recorded a decline, mainly as a result of the unfavorable exchange rate development of the U.S. Dollar against the Euro. Adjusted for this effect internal growth was 0.6%.

Operating profit

Operating profit

in €mn

2007 to 2006 second quarter comparison

Operating profit remained strong at €1,894 million in 2Q 2007, up 2.7% from an already high profit level a year ago. This was primarily the result of increased investment income, reflecting higher dividend payments, higher yields on debt investments and positive net inflows to our asset base.

The top contributors to operating profit were Germany at €467 million, Italy at €264 million, the United States at €189 million, France at €163 million and our credit insurance business of Euler Hermes at €161 million.

We continued to benefit from our strong underwriting profitability and our initiatives to improve claims management. The accident year loss ratio was down 20 basis points to 69.4%. At 4.5%, the positive net development in prior years loss reserves was unchanged. The impact from natural catastrophes remained at a similar magnitude of 1.1% in 2Q 2007, compared to 1.2% a year ago, while we recorded a lower overall claims frequency[1)]

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1) Excluding claims related to winterstorm Kyrill that were reported in 2Q 2007 only.

and an almost stable net claims severity. Commensurate with the stable positive net development in prior years' loss reserves, our calendar year loss ratio also decreased by 20 basis points to 64.9%.

With our expense ratio up 1.2 percentage points to 28.0%, our combined ratio increased from 91.9% to 92.9%.

2007 to 2006 first half comparison

On a six months basis, operating profit amounted to €3,161 million, only down 2.2%, despite significantly higher net losses from natural catastrophes of €458 million, mainly related to winterstorm Kyrill in Europe in 1Q 2007. While strong, our combined ratio for the first six months of 2007 rose to 94.8%, after 93.3% in the same period last year, reflecting the increased impact from natural catastrophes. Consistent with the 2007 to 2006 second quarter comparison, current investment income grew mainly due to a strong dividend season.

Non-operating items

2007 to 2006 second quarter comparison

The net gain from non-operating items decreased substantially by €260 million to €180 million. This development resulted mainly from lower realized gains from investments which amounted to €216 million, down €662 million from a year earlier largely as a result of the sale of our participation in Schering AG at that time. Conversely, no major single sales transaction was recorded in 2Q 2007. Similarly, restructuring charges were negligible in 2Q 2007, while in the prior year period expenses of €354 million were incurred, primarily in connection with the reorganization of our German insurance activities.

2007 to 2006 first half comparison

In contrast to the 2007 to 2006 second quarter comparison, on a six months basis, the net gain from non-operating items was down only slightly. In addition to the developments previously described, this resulted predominantly from higher net realized gains from investments in 1Q 2007 versus 1Q 2006.

Net income

2007 to 2006 second quarter comparison

Net income was down by €202 million to €1,380 million, predominantly reflecting the lower aggregate gain from non-operating items.

Income tax expenses, at €578 million in 2Q 2007, rose by €112 million. Mainly as a result of significantly higher tax-exempted realized gains in 2Q 2006 as compared to 2Q 2007, our effective tax rate increased from 20.4% to 27.9%

Minority interests in earnings declined from €237 million to €116 million mainly due to the minority buy-outs at RAS and AGF.

2007 to 2006 first half comparison

At €2,560 million for the first half of 2007, net income decreased by 4.5%. Both lower operating profit and lower non-operating income contributed to this development. Furthermore, income tax expenses increased by €125 million for the reasons already mentioned driving the effective tax rate up to 27.8% from 24.2%.

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The following table sets forth our Property-Casualty insurance segment s income statement, loss ratio, expense ratio and combined ratio for the three and six months ended June 30, 2007 and 2006.

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
	mn	mn	mn	mn
Gross premiums written[1)]	**9,982**	**9,682**	**24,093**	**23,831**
Ceded premiums written	(1,245)	(1,230)	(2,831)	(2,942)
Change in unearned premiums	919	906	(2,248)	(2,190)
Premiums earned (net)	**9,656**	**9,358**	**19,014**	**18,699**
Interest and similar income	1,380	1,257	2,386	2,179
Income from financial assets and liabilities designated at fair value through income (net)[2)]	39	6	71	42
Income from financial assets and liabilities held for trading (net), shared with policyholder[2)]	(40)		(55)	
Realized gains/losses (net) from investments, shared with policyholders[3)]	1	11	35	36
Fee and commission income	280	265	552	517
Other income	11	24	95	38
Operating revenues	**11,327**	**10,921**	**22,098**	**21,511**
Claims and insurance benefits incurred (net)	(6,266)	(6,090)	(12,649)	(12,272)
Changes in reserves for insurance and investment contracts (net)	(97)	(121)	(178)	(193)
Interest expense	(92)	(66)	(184)	(129)
Loan loss provisions	(9)	(2)	(9)	(3)
Impairments of investments (net), shared with policyholders[4)]	(5)	(13)	(7)	(17)
Investment expenses	(69)	(67)	(143)	(115)
Acquisition and administrative expenses (net)	(2,705)	(2,511)	(5,380)	(5,174)
Fee and commission expenses	(190)	(205)	(387)	(375)
Other expenses		(1)		(2)
Operating expenses	**(9,433)**	**(9,076)**	**(18,937)**	**(18,280)**
Operating profit	**1,894**	**1,845**	**3,161**	**3,231**
Income from financial assets and liabilities held for trading (net), not shared with policyholders[2)]	(1)	(1)	(30)	3
Realized gains/losses (net) from investments, not shared with policyholders[3)]	216	878	949	1,317
Impairments of investments (net), not shared with policyholders[4)]	(23)	(80)	(47)	(89)
Amortization of intangible assets	(4)	(3)	(6)	(7)
Restructuring charges	(8)	(354)	(22)	(356)
Non-operating items	**180**	**440**	**844**	**868**
Income before income taxes and minority interests in earnings	**2,074**	**2,285**	**4,005**	**4,099**
Income taxes	(578)	(466)	(1,115)	(990)
Minority interests in earnings	(116)	(237)	(330)	(427)
Net income	**1,380**	**1,582**	**2,560**	**2,682**
Loss ratio[5)] in %	64.9	65.1	66.5	65.6
Expense ratio[6)] in %	28.0	26.8	28.3	27.7
Combined ratio[7)] in %	**92.9**	**91.9**	**94.8**	**93.3**

[1] For the Property-Casualty segment, total revenues are measured based upon gross premiums written.
[2] The total of these items equals income from financial assets and liabilities carried at fair value through income (net) in the segment income statement included in Note 3 to the consolidated financial statements.
[3] The total of these items equals realized gains/losses (net) in the segment income statement included in Note 3 to the consolidated financial statements.
[4] The total of these items equals impairments of investments (net) in the segment income statement included in Note 3 to the consolidated financial statements.
[5] Represents claims and insurance benefits incurred (net) divided by premiums earned (net).
[6] Represents acquisition and administrative expenses (net) divided by premiums earned (net).
[7] Represents the total of acquisition and administrative expenses (net) and claims and insurance benefits incurred (net) divided by premiums earned (net).

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Property-Casualty Operations by Geographic Region

The following table sets forth our Property-Casualty gross premiums written, premiums earned (net), combined ratio, loss ratio, expense ratio and operating profit by geographic region for the three and six months ended June 30, 2007 and 2006. Consistent with our general practice, these figures are presented before consolidation adjustments, representing the elimination of transactions between Allianz Group companies in different geographic regions and different segments.

Three months ended June 30,	Gross premiums written		Premiums earned (net)		Combined ratio		Loss ratio		Expense ratio		Operating profit	
	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006
	€mn	€mn	€mn	€mn	%	%	%	%	%	%	€mn	€mn
Germany	**1,959**	**2,099**	**2,325**	**2,442**	**92.6**	**92.6**	**64.9**	**68.1**	**27.7**	**24.5**	**467**	**448**
France	**1,143**	**1,132**	**1,103**	**1,092**	**96.8**	**98.6**	**69.3**	**71.1**	**27.5**	**27.5**	**163**	**139**
Italy	**1,340**	**1,373**	**1,234**	**1,242**	**93.8**	**93.5**	**69.8**	**70.3**	**24.0**	**23.2**	**264**	**250**
United Kingdom	**613**	**648**	**498**	**462**	**98.5**	**94.6**	**65.3**	**65.6**	**33.2**	**29.0**	**64**	**71**
Switzerland	**305**	**284**	**402**	**432**	**92.3**	**94.9**	**66.3**	**72.8**	**26.0**	**22.1**	**71**	**54**
Spain	**502**	**464**	**452**	**417**	**90.9**	**90.0**	**71.3**	**70.6**	**19.6**	**19.4**	**65**	**64**
Netherlands	228	227	204	206	89.6	87.3	59.0	55.1	30.6	32.2	32	47
Austria	201	200	183	188	92.9	96.9	69.6	70.1	23.3	26.8	31	36
Ireland	165	176	154	153	94.7	65.9	70.0	42.5	24.7	23.4	29	68
Belgium	83	85	75	75	97.9	98.7	63.1	63.3	34.8	35.4	15	14
Portugal	67	68	62	64	89.9	86.5	62.7	60.9	27.2	25.6	11	13
Greece	19	19	12	12	97.1	78.0	65.4	49.1	31.7	28.9	1	3
Western and Southern Europe	**763**	**775**	**690**	**698**	**92.7**	**86.0**	**65.2**	**57.6**	**27.5**	**28.4**	**124**[1]	**186**[1]
Hungary	127	124	125	123	95.8	83.2	68.2	55.9	27.6	27.3	17	36
Slovakia	70	59	68	60	61.6	64.3	35.2	36.9	26.4	27.4	32	27
Czech Republic	54	57	46	44	75.5	82.1	52.4	63.0	23.1	19.1	13	9
Poland	95	71	61	49	93.0	83.8	57.6	49.8	35.4	34.0	7	9
Romania	83	67	39	24	86.5	103.8	72.1	97.9	14.4	5.9	5	1
Bulgaria	24	23	15	15	93.1	88.9	47.1	50.7	46.0	38.2	2	2
Croatia	21	18	14	13	105.9	95.0	69.9	62.5	36.0	32.5		1
Russia[2]	200	5	155		103.6	90.4	65.0	37.8	38.6	52.6	3	
New Europe[3]	**674**	**424**	**523**	**330**	**92.0**	**82.2**	**60.1**	**55.6**	**31.9**	**26.6**	**74**	**82**
Other Europe	**1,437**	**1,199**	**1,213**	**1,028**	**91.4**	**84.8**	**62.6**	**57.0**	**28.8**	**27.8**	**198**	**268**
United States	1,030	1,053	804	838	87.8	83.7	56.0	49.8	31.8	33.9	189	227
Mexico[4]	53	41	22	24	94.0	93.5	69.1	69.5	24.9	24.0	2	5
NAFTA	**1,083**	**1,094**	**826**	**862**	**88.0**	**83.9**	**56.4**	**50.3**	**31.6**	**33.6**	**191**	**232**
Australia	390	368	311	301	90.8	85.9	65.0	60.1	25.8	25.8	84	83
Other	81	79	39	35	86.0	93.5	51.0	54.1	35.0	39.4	8	5
Asia-Pacific	**471**	**447**	**350**	**336**	**90.2**	**86.7**	**63.4**	**59.5**	**26.8**	**27.2**	**92**	**88**
South America	**242**	**197**	**180**	**148**	**98.7**	**102.0**	**63.6**	**64.8**	**35.1**	**37.2**	**14**	**15**
Other	**22**	**16**	**15**	**7**	[5]	[5]	[5]	[5]	[5]	[5]	**1**	**3**
Specialty lines	**446**	**398**	**330**	**283**	**73.1**	**77.3**	**43.4**	**50.9**	**29.7**	**26.4**	**161**	**122**

Credit Insurance												
Allianz Global Corporate & Specialty	**623**	**687**	**462**	**368**	**94.4**	**103.1**	**74.3**	**72.0**	**20.1**	**31.1**	**116**	**66**
Travel Insurance and Assistance Services	**270**	**249**	**266**	**239**	**107.7**	**98.9**	**58.8**	**58.5**	**48.9**	**40.4**	**24**	**25**
Subtotal	**10,456**	**10,287**	**9,656**	**9,358**							**1,891**	**1,845**
Consolidation adjustments[6]	(474)	(605)									3	
Total	**9,982**	**9,682**	**9,656**	**9,358**	**92.9**	**91.9**	**64.9**	**65.1**	**28.0**	**26.8**	**1,894**	**1,845**

[1] Contains run-off of 5 mn in both 2007 and 2006 from a former operating entity located in Luxembourg.

[2] Effective February 21, 2007, Russian People s Insurance Society ROSNO was consolidated following the acquisition of approximately 49.2% of the shares in ROSNO by the Allianz Group, increasing our holding to approximately 97%. Effective May 21, 2007 we consolidated Progress Garant for the first time.

[3] Contains income and expense items from a management holding in both 2007 and 2006.

[4] Effective 1Q 2007, life business in Mexico is shown within the Life/Health segment.

[5] Presentation not meaningful.

[6] Represents elimination of transactions between Allianz Group companies in different geographic regions.

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Six months ended June 30,	Gross premiums written 2007	2006	Premiums earned (net) 2007	2006	Combined ratio 2007	2006	Loss ratio 2007	2006	Expense ratio 2007	2006	Operating profit 2007	2006
	€mn	€mn	€mn	€mn	%	%	%	%	%	%	€mn	€mn
Germany	**6,575**	**6,951**	**4,592**	**4,853**	**97.8**	**92.7**	**69.2**	**63.9**	**28.6**	**28.8**	**582**	**818**
France	**2,838**	**2,845**	**2,217**	**2,206**	**99.0**	**99.8**	**71.5**	**72.7**	**27.5**	**27.1**	**237**	**216**
Italy	**2,586**	**2,620**	**2,431**	**2,447**	**93.6**	**95.1**	**69.9**	**71.6**	**23.7**	**23.5**	**439**	**358**
United Kingdom	**1,152**	**1,227**	**989**	**919**	**97.4**	**96.7**	**64.1**	**66.7**	**33.3**	**30.0**	**127**	**127**
Switzerland	**1,272**	**1,241**	**806**	**868**	**94.9**	**95.6**	**68.3**	**71.5**	**26.6**	**24.1**	**122**	**118**
Spain	**1,193**	**1,121**	**885**	**812**	**90.5**	**90.7**	**71.3**	**71.6**	**19.2**	**19.1**	**135**	**123**
Netherlands	534	545	401	403	91.6	90.3	60.6	57.3	31.0	33.0	57	74
Austria	551	557	366	380	95.1	103.3	73.1	78.3	22.0	25.0	52	29
Ireland	369	374	305	306	93.9	78.8	69.3	55.1	24.6	23.7	128	95
Belgium	207	206	150	149	103.5	100.2	69.2	64.3	34.3	35.9	21	23
Portugal	147	152	124	130	89.7	86.9	61.8	63.2	27.9	23.7	20	24
Greece	40	38	24	23	91.6	86.4	61.1	57.2	30.5	29.2	4	4
Western and Southern Europe	**1,848**	**1,872**	**1,370**	**1,391**	**94.3**	**92.0**	**67.0**	**63.8**	**27.3**	**28.2**	**292**[1]	**259**[1]
Hungary	321	316	251	250	93.9	87.6	66.5	60.3	27.4	27.3	41	63
Slovakia	175	152	135	122	64.0	72.4	37.8	42.0	26.2	30.4	60	44
Czech Republic	132	139	91	87	77.6	86.0	54.9	65.1	22.7	20.9	25	14
Poland	181	143	117	97	94.6	90.0	60.5	57.5	34.1	32.5	12	12
Romania	173	138	75	60	94.8	95.3	76.3	82.1	18.5	13.2	4	4
Bulgaria	47	43	31	31	84.9	81.1	42.8	47.4	42.1	33.7	7	7
Croatia	44	40	29	27	101.7	95.8	69.2	64.1	32.5	31.7	1	2
Russia[2]	268	11	199	2	103.8	69.0	65.3	31.0	38.5	38.0	4	1
New Europe[3]	**1,341**	**981**	**928**	**676**	**91.2**	**85.8**	**60.3**	**58.6**	**30.9**	**27.2**	**143**	**144**
Other Europe	**3,189**	**2,853**	**2,298**	**2,067**	**92.3**	**89.9**	**64.1**	**62.1**	**28.2**	**27.8**	**435**	**403**
United States	1,912	2,054	1,605	1,723	89.3	87.0	56.5	54.9	32.8	32.1	355	426
Mexico[4]	92	92	42	49	89.6	101.3	64.0	76.9	25.6	24.4	7	8
NAFTA	**2,004**	**2,146**	**1,647**	**1,772**	**89.3**	**87.4**	**56.7**	**55.5**	**32.6**	**31.9**	**362**	**434**
Australia	741	703	615	601	96.5	94.1	71.3	68.8	25.2	25.3	134	121
Other	162	157	75	69	93.1	94.3	55.6	55.9	37.5	38.4	11	9
Asia-Pacific	**903**	**860**	**690**	**670**	**96.1**	**94.2**	**69.6**	**67.5**	**26.5**	**26.7**	**145**	**130**
South America	**479**	**423**	**347**	**300**	**99.4**	**102.5**	**64.4**	**65.7**	**35.0**	**36.8**	**28**	**27**
Other	**57**	**41**	**26**	**15**	[5]	[5]	[5]	[5]	[5]	[5]	**4**	**4**
Specialty lines												
Credit Insurance	**934**	**866**	**631**	**543**	**74.6**	**79.1**	**45.8**	**52.3**	**28.8**	**26.8**	**278**	**217**
Allianz Global Corporate &	**1,556**	**1,557**	**929**	**757**	**94.2**	**92.8**	**70.3**	**67.2**	**23.9**	**25.6**	**211**	**211**

Specialty Travel Insurance and Assistance Services	**566**	**515**	**526**	**470**	**104.2**	**100.2**	**56.9**	**60.1**	**47.3**	**40.1**	**55**	**47**
Subtotal	**25,304**	**25,266**	**19,014**	**18,699**							**3,160**	**3,233**
Consolidation adjustments[6]	(1,211)	(1,435)									1	(2)
Total	**24,093**	**23,831**	**19,014**	**18,699**	**94.8**	**93.3**	**66.5**	**65.6**	**28.3**	**27.7**	**3,161**	**3,231**

[1] Contains run-off of €10 mn in both 2007 and 2006 from a former operating entity located in Luxembourg.

[2] Effective February 21, 2007, Russian People s Insurance Society ROSNO was consolidated following the acquisition of approximately 49.2% of the shares in ROSNO by the Allianz Group, increasing our holding to approximately 97%. Effective May 21, 2007 we consolidated Progress Garant for the first time.

[3] Contains income and expense items from a management holding in both 2007 and 2006.

[4] Effective 1Q 2007, life business in Mexico is shown within the Life/Health segment.

[5] Presentation not meaningful.

[6] Represents elimination of transactions between Allianz Group companies in different geographic regions.

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Life/Health Insurance Operations

Operating profit up by 44%.

- Statutory premium growth held back by the United States and Germany, but overall internal growth turned positive.
- Solid improvement of expense and investment margins drove operating profit.
- Growing asset base and current investment income compensated lower harvesting rate.

Earnings Summary

Statutory premiums

Statutory premiums by region[1)]

in %

1) After elimination of transactions between Allianz Group companies in different geographic regions and different segments.

2007 to 2006 second quarter comparison

Our statutory premiums decreased by 1.5% to €11,758 million in 2Q 2007. On an internal basis, we grew slightly by 0.3%. Whereas in most of our life insurance markets we recorded positive developments, statutory premium volumes declined in the United States and in Germany by 18.5% and 9.7%, respectively. On an internal growth basis, the decrease within the United States came to 12.6%.

Statutory premiums Growth rates[1)]

in %

1) Before elimination of transactions between Allianz Group companies in different geographic regions and different segments.

The total revenue volume from New Europe and Asia-Pacific accounted for 12.0% of our Life/Health segment's statutory premiums in 2Q 2007, compared to 10.1% in the same period last year.

The highest absolute growth was achieved in Italy, where revenues grew by €210 million despite poor overall market performance, principally because sales through our bancassurance channel at RAS Group picked up and

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we successfully launched three index-linked single premium products.

Within France, the increase in premiums by €101 million was largely brought about by an increase in group life business. In contrast to previous quarters, the highest proportion of new business originated from proprietary sales channels.

Total revenues within Asia-Pacific were up €155 million, mainly as we recorded strong sales of single premium unit-linked products sold foremost through our bank channels. In China, we obtained sales licenses for additional provinces, that allowed us to grow via the expansion of our sales network. Furthermore, we benefited from our strategic partnership with Industrial and Commercial Bank of China Limited (ICBC).

Statutory premium volume from New Europe rose by €42 million to €214 million, mainly driven by our operations in Slovakia where we recorded strong sales of single premium products through the agent network.

These positive developments did not fully compensate for the declines in particular in the United States and Germany.

In the United States, the changed market regulations affecting the sale of indexed annuity products are still visible in the statutory premium development. On a 2007 to 2006 quarter comparison statutory premiums decreased by €408 million. Additionally, business was negatively affected by the weakening of the U.S. Dollar against the Euro. On a local currency basis, the decline amounted to USD 348 million. However, we recorded a significant slowdown in the deterioration and statutory premium volume picked up growth compared to 1Q 2007, as the launch of new products and the focusing on key distribution channels showed first signs of success.

In a weak market environment, premiums from our German life business declined due to higher market interest rates which made some of our short term savings products relatively less attractive. Furthermore, we saw a shift from single premium business towards business with recurring premiums.

2007 to 2006 first half comparison

Statutory premiums declined by 2.7% to €24,084 million. In most of our markets, we recorded developments consistent with those previously described. Based on internal growth, our statutory premiums were down 0.9%.

Operating profit

Operating profit

in mn

2007 to 2006 second quarter comparison

Operating profit grew dynamically by 43.8% to €758 million, resulting mostly from improved expense margins and investment result. Our expense margin benefited from among other factors increased fee and commission income on unit linked and variable annuity business, and our investment income grew mainly due to our higher asset base.

Interest and similar income was up as interest payments on debt securities and dividend payments on equity securities both grew. Conversely, due to significantly reduced equity harvesting in 2Q 2007, net realized gains dropped. In the prior year period, we recorded an exceptionally high level of realized capital gains, while this year, no major single transaction was executed. The considerably increased net loss from financial assets and liabilities carried at fair value through income stemmed largely from freestanding derivatives in connection with our German life business.

Changes in reserves for insurance and investment contracts (net) declined to €2,211 million from €2,950 million, predominantly due to lower net realized capital gains.

The markets which made the highest absolute contribution to operating profit in 2Q 2007 were France at €227 million, our German life operations at €141 million, Italy at €102 million and the United States at €88 million.

2007 to 2006 first half comparison

Operating profit was up €258 million to €1,508 million. The various line item developments in the 2007 to 2006 first half comparison were largely consistent with the second quarter comparison.

Non-operating items

2007 to 2006 second quarter comparison

Non-operating items improved to an aggregate gain of €15 million, coming from an aggregate loss of €17 million, as no restructuring charges were recorded in 2Q 2007.

2007 to 2006 first half comparison

Significantly lower net realized gains not to be shared with policyholders in the United States led to a decreased aggregate half-year non-operating result in 2007 of €118 million, compared to €141 million last year.

Net income

2007 to 2006 second quarter comparison

Net income increased by €151 million to €479 million, primarily driven by our increased operating profit.

Our effective tax rate rose from 17.6% to 30.3% as a significantly higher tax-exempt income was recorded in 2Q 2006.

Due to the minority buy-outs at RAS and AGF, minority interests in earnings decreased by €32 million to €60 million.

2007 to 2006 first half comparison

Net income for the first six months of 2007 amounted to €1,032 million, up by €170 million from the prior year level. Consistent with the 2007 to 2006 first quarter comparison, this development was primarily driven by our operating profit. Income tax expenses increased by €126 million to €435 million, driving up our effective tax rate by 4.6 percentage points to 26.8%. As in the second quarter comparison, a lower impact from tax-exempt income was the main reason behind this development.

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Group Management Report

The following table sets forth our Life/Health insurance segment s income statement and statutory expense ratio for the three and six months ended June 30, 2007 and 2006.

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
	mn	mn	mn	mn
Statutory premiums[1)]	**11,758**	**11,931**	**24,084**	**24,753**
Ceded premiums written	(186)	(213)	(379)	(409)
Change in unearned premiums	3	(76)	(24)	(151)
Statutory premiums (net)	11,575	11,642	23,681	24,193
Deposits from SFAS 97 insurance and investment contracts	(6,892)	(6,874)	(13,813)	(14,346)
Premiums earned (net)	4,683	4,768	9,868	9,847
Interest and similar income	3,783	3,698	6,938	6,745
Income from financial assets and liabilities carried at fair value through income (net), shared with policyholders[2)]	(668)	(216)	(979)	(185)
Realized gains/losses (net) from investments, shared with policyholders[3)]	646	947	1,734	2,050
Fee and commission income	164	162	335	291
Other income	9	7	63	13
Operating revenues	**8,617**	**9,366**	**17,959**	**18,761**
Claims and insurance benefits incurred (net)	(4,158)	(4,103)	(8,860)	(8,796)
Changes in reserves for insurance and investment contracts (net)	(2,211)	(2,950)	(4,835)	(5,598)
Interest expense	(111)	(73)	(202)	(137)
Loan loss provisions		1	(3)	1
Impairments of investments (net), shared with policyholders	(56)	(210)	(93)	(245)
Investment expenses	(163)	(211)	(359)	(368)
Acquisition and administrative expenses (net)	(1,115)	(1,105)	(1,989)	(2,130)
Fee and commission expenses	(43)	(70)	(105)	(120)
Operating restructuring charges[4)]	(2)	(118)	(5)	(118)
Operating expenses	**(7,859)**	**(8,839)**	**(16,451)**	**(17,511)**
Operating profit	**758**	**527**	**1,508**	**1,250**
Income from financial assets and liabilities carried at fair value through income (net), not shared with policyholders[2)]	(1)			
Realized gains/losses (net) from investments, not shared with policyholders[3)]	17	27	122	186
Amortization of intangible assets		(1)	(1)	(2)
Non-operating restructuring charges[4)]	(1)	(43)	(3)	(43)
Non-operating items	**15**	**(17)**	**118**	**141**
Income before income taxes and minority interests in earnings	**773**	**510**	**1,626**	**1,391**
Income taxes	(234)	(90)	(435)	(309)
Minority interests in earnings	(60)	(92)	(159)	(220)
Net income	**479**	**328**	**1,032**	**862**
Statutory expense ratio[5)] in %	**9.6**	**9.5**	**8.4**	**8.8**

1) For the Life/Health segment, total revenues are measured based upon statutory premiums. Statutory premiums are gross premiums written from sales of life 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.

[2] The total of these items equals income from financial assets and liabilities carried at fair value through income (net) in the segment income statement included in Note 3 to the consolidated financial statements.

[3] The total of these items equals realized gains/losses (net) in the segment income statement included in Note 3 to the consolidated financial statements.

[4] The total of these items equals restructuring charges in the segment income statement included in Note 3 to the consolidated financial statements.

[5] Represents acquisition and administrative expenses (net) divided by statutory premiums (net).

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Allianz Group Interim Report Second Quarter and First Half of 2007

Life/Health Operations by Geographic Region

The following table sets forth our Life/Health statutory premiums, premiums earned (net), statutory expense ratio and operating profit by geographic region for the three and six months ended June 30, 2007 and 2006. Consistent with our general practice, these figures are presented before consolidation adjustments, representing the elimination of transactions between Allianz Group companies in different geographic regions and different segments.

	Statutory premiums[1]		Premiums earned (net)		Statutory expense ratio		Operating profit	
Three months ended June 30,	2007	2006	2007	2006	2007	2006	2007	2006
	€mn	€mn	€mn	€mn	%	%	€mn	€mn
Germany Life	**2,776**	**3,075**	**2,222**	**2,317**	**8.1**	**9.5**	**141**	**113**
Germany Health[2]	**783**	**772**	**783**	**772**	**9.4**	**7.6**	**41**	**46**
Italy	**2,572**	**2,362**	**255**	**280**	**5.7**	**6.9**	**102**	**109**
France	**1,575**	**1,474**	**390**	**376**	**15.1**	**12.1**	**227**	**101**
Switzerland	**167**	**178**	**83**	**80**	**13.9**	**12.8**	**19**	**13**
Spain	**168**	**174**	**119**	**122**	**8.3**	**9.3**	**26**	**20**
Netherlands	101	104	34	35	13.4	11.9	12	12
Austria	95	83	71	64	8.8	15.5	6	9
Belgium	155	116	71	69	10.4	14.2	28	16
Portugal	28	25	17	16	26.1	16.2	7	5
Luxembourg	37	12	7	8	7.6	13.4	2	1
Greece	25	24	16	16	23.6	22.1	1	
Western and Southern Europe	**441**	**364**	**216**	**208**	**12.2**	**15.0**	**55[3]**	**43**
Hungary	26	22	20	18	27.6	27.4	4	4
Slovakia	64	45	40	34	12.3	19.2	9	6
Czech Republic	24	19	13	14	15.5	19.3	3	2
Poland	66	62	16	21	19.1	19.8	3	2
Romania	7	5	4	4	41.6	46.8		
Bulgaria	7	6	6	5	16.4	17.2	1	1
Croatia	17	11	10	8	6.1	23.6		1
Russia	3	2	3	2	126.1	(4.7)	(3)	
New Europe	**214**	**172**	**112**	**106**	**18.9**	**21.2**	**17**	**16**
Other Europe	**655**	**536**	**328**	**314**	**14.4**	**17.0**	**72**	**59**
United States	1,796	2,204	105	80	9.5	7.6	88	32
Mexico[4]	9		8		14.0		1	
NAFTA	**1,805**	**2,204**	**113**	**80**	**9.6**	**7.6**	**89**	**32**
South Korea	466	522	238	248	17.6	15.8	24	13
Taiwan	544	445	16	27	3.1	3.3	5	5
Malaysia	30	28	26	22	21.2	23.7	3	2
Indonesia	76	19	11	7	7.4	29.3	2	1
Other	82	29	4	4	10.1	18.4	(2)	(1)
Asia-Pacific	**1,198**	**1,043**	**295**	**308**	**10.0**	**11.0**	**32**	**20**
South America	**14**	**42**	**8**	**12**	**47.3**	**18.1**		**(1)**
Other[5]	**98**	**129**	**87**	**106**	[6]	[6]	**18**	**15**
Subtotal	**11,811**	**11,989**	**4,683**	**4,767**			**767**	**527**
Consolidation adjustments[7]	(53)	(58)					(9)	
Total	**11,758**	**11,931**	**4,683**	**4,767**	**9.6**	**9.5**	**758**	**527**

[1] Statutory premiums are gross premiums written from sales of life 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.
[2] Loss ratios were 68.1% and 63.7% for 2007 and 2006, respectively.
[3] Contains run-off of € (1) mn in 2007 from our former life insurance business in the United Kingdom which we sold in December 2004.
[4] Effective 1Q 2007, life business in Mexico is shown within the Life/Health segment.
[5] Contains, among others, the Life/Health business assumed by Allianz SE.
[6] Presentation not meaningful.
[7] Represents elimination of transactions between Allianz Group companies in different geographic regions.

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Six months ended June 30,	Statutory premiums[1] 2007	2006	Premiums earned (net) 2007	2006	Statutory expense ratio 2007	2006	Operating profit 2007	2006
	€mn	€mn	€mn	€mn	%	%	€mn	€mn
Germany Life	**5,815**	**6,204**	**4,788**	**4,898**	**4.6**	**9.1**	**332**	**246**
Germany Health[2]	**1,563**	**1,541**	**1,563**	**1,542**	**9.8**	**7.3**	**82**	**99**
Italy	**5,402**	**4,631**	**498**	**522**	**5.5**	**6.4**	**196**	**203**
France	**3,065**	**2,934**	**825**	**732**	**14.4**	**12.6**	**362**	**275**
Switzerland	**665**	**697**	**278**	**289**	**6.9**	**7.4**	**35**	**27**
Spain	**324**	**316**	**229**	**222**	**9.4**	**8.9**	**53**	**41**
Netherlands	214	228	69	73	12.9	12.2	23	22
Austria	198	184	139	132	9.4	12.5	25	22
Belgium	349	295	147	145	8.9	10.4	71	32
Portugal	50	45	36	33	28.4	15.1	17	12
Luxembourg	47	21	14	15	11.1	15.2	5	3
Greece	54	50	32	31	20.2	23.1	2	2
Western and Southern Europe	**912**	**823**	**437**	**429**	**11.8**	**12.7**	**142[3]**	**92[3]**
Hungary	56	45	40	37	23.8	27.1	8	8
Slovakia	126	88	80	67	13.6	19.5	16	14
Czech Republic	45	38	26	27	17.6	20.9	6	4
Poland	314	231	44	40	10.5	10.7	6	3
Romania	16	15	6	6	34.1	39.1	(1)	1
Bulgaria	15	11	13	10	15.3	15.9	2	1
Croatia	29	20	19	16	10.6	24.7	2	1
Russia	5	4	5	4	133.5	17.4	(3)	
New Europe	**606**	**452**	**233**	**207**	**14.7**	**16.4**	**36**	**32**
Other Europe	**1,518**	**1,275**	**670**	**636**	**12.9**	**14.0**	**178**	**124**
United States	3,465	4,976	205	168	9.4	6.5	159	153
Mexico[4]	16		16		15.0		2	
NAFTA	**3,481**	**4,976**	**221**	**168**	**9.5**	**6.5**	**161**	**153**
South Korea	931	1,094	490	503	15.8	13.3	78	38
Taiwan	894	744	30	41	2.8	2.5	9	9
Malaysia	58	50	49	41	18.2	21.2	5	4
Indonesia	106	34	22	16	11.4	31.9	4	1
Other	130	50	9	8	11.4	18.3	(6)	(1)
Asia-Pacific	**2,119**	**1,972**	**600**	**609**	**10.0**	**9.9**	**90**	**51**
South America	**47**	**88**	**17**	**25**	**27.5**	**14.3**	**(1)**	**(1)**
Other[5]	**200**	**242**	**179**	**204**	[6]	[6]	**34**	**32**
Subtotal	**24,199**	**24,876**	**9,868**	**9,847**			**1,522**	**1,250**
Consolidation adjustments[7]	(115)	(123)					(14)	
Total	**24,084**	**24,753**	**9,868**	**9,847**	**8.4**	**8.8**	**1,508**	**1,250**

[1] Statutory premiums are gross premiums written from sales of life 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.

[2] Loss ratios were 72.9% and 69.7% for 2007 and 2006, respectively.

[3] Contains run-off of €(1) mn in both 2007 and 2006 from our former life insurance business in the United Kingdom which we sold in December 2004.

[4] Effective 1Q 2007, life business in Mexico is shown within the Life/Health segment.
[5] Contains, among others, the Life/Health business assumed by Allianz SE.
[6] Presentation not meaningful.
[7] Represents elimination of transactions between Allianz Group companies in different geographic regions.

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Allianz Group Interim Report Second Quarter and First Half of 2007

Banking Operations

Continuous improvement of profitability.

- Strong operating profit growth.
- De-risking pays off.
- Significant improvement of our cost-income ratio.

Earnings Summary

The results of operations of our Banking segment are almost exclusively represented by Dresdner Bank, accounting for 96.0% of our total Banking segment s operating revenues in 1H 2007 (1H 2006: 96.1%). Accordingly, the discussion of our Banking segment s results of operations relates solely to the operations of Dresdner Bank.

We have restated the prior year presentation of revenues and operating profit stemming from trades in own shares[1)]. From 2007 onwards, these results are eliminated on Dresdner Bank level, whereas in 2006 they were adjusted on segment level only.

Operating revenues

2007 to 2006 second quarter comparison

Dresdner Bank s operating revenues at €1,770 million, up 8.7% compared to a year ago, continued the ongoing trend of exceeding prior year level.

Net interest income was €701 million, up 11.1%, mainly due to a significant increase in our structured transaction business and the favorable development of margins and volumes in our deposit business, which was partially offset by a slight margin-driven decline in the commercial loan business.

Net fee and commission income increased by €38 million to €718 million, benefiting from ongoing strong certificates business.

Trading income (net) increased by 11.7% to €335 million. The investment bank entered into various underlying positions which are economically hedged with own shares. The increase of the trading result represents the accounting treatment required under IFRS which results in this case in a one-sided effect stemming from the elimination of the economic hedge in own shares. Trading income (net) from our operating divisions declined. In expectation of the current development, we positioned ourselves on the conservative side and forewent upside potential, resulting in reduced trading volumes.

2007 to 2006 first half comparison

Operating revenues increased by 8.0% to €3,793 million. The main contributor was net interest income at €1,601 million which grew by 32.4%.

Operating profit

Operating profit

in mn

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[1] Shares of Allianz SE and its affiliates.

2007 to 2006 second quarter comparison

At €427 million, up 79.4% from a year ago, operating profit again grew substantially, notwithstanding higher loan loss provisions. The increase in revenues previously described and declining operating expenses contributed to this positive development. As a result, our cost-income ratio dropped by 12.7 percentage points to 72.4%.

Further efficiency gains and a continuous adherence to cost discipline continued to pay off. Operating expenses developed favorably, down 7.5% to €1,281 million. Non-personnel expenses accounted for €476 million, down 3.8% as a result of further cost reductions across almost all cost categories with the most significant reduction in fees for external services. Personnel expenses at €801 million dropped by 10.1%.

Loan loss provisions recorded net additions of €62 million. This increase was composed of gross additions of €140 million versus €106 million in 2Q 2006 and lower gross releases and recoveries of €78 million compared to €101 million a year ago.

2007 to 2006 first half comparison

We recorded a strong operating profit of €1,104 million, up 43.9% compared to a year earlier. Increased operating revenues and further decreasing operating expenses led to a significant decrease of our cost-income ratio to 69.4% down 9.6% percentage points.

The positive development of our operating profit was achieved despite net loan loss provisions turning to a net expense, as expected, and on a relatively low level in 1H 2007. Our coverage ratio amounted to 56.5% compared to 58.5% a year ago.

Non-operating items

2007 to 2006 second quarter comparison

Non-operating items increased by €18 million to €30 million, made up almost exclusively of realized gains which developed in a similar magnitude.

2007 to 2006 first half comparison

With a decline of 64.1% to €145 million, the impact from non-operating items was materially lower than in the prior year period. Realized gains in 1H 2006 included the sale of Dresdner Bank's remaining shareholdings in Munich Re to Allianz SE (formerly Allianz AG) and the disposal of our remaining participation in Eurohypo AG.

Net income

2007 to 2006 second quarter comparison

Net income at €395 million more than doubled compared to a year earlier. In addition to a higher income before taxes this was due to higher tax exempt income. Accordingly, our effective tax rate dropped to only 9.6% from 32.0% a year earlier**.**

2007 to 2006 first half comparison

Net income increased by 24.8% to €1,007 million due to significant tax-exempt income in 1H 2007. The high increase of operating profit was partially offset by the decline of non-operating items, leaving income before income taxes and minority interests in earnings €78 million higher, at €1,249 million.

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Allianz Group Interim Report Second Quarter and First Half of 2007

The following table sets forth the income statements and cost-income ratios for both our Banking segment as a whole and Dresdner Bank for the three and six months ended June 30, 2007 and 2006.

	Three months ended June 30,				Six months ended June 30,			
	2007		2006		2007		2006	
	Banking Segment	Dresdner Bank	Banking Segment	Dresdner Bank[1)]	Banking Segment	Dresdner Bank	Banking Segment	Dresdner Bank[1)]
	€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn
Net interest income[2)]	730	701	652	631	1,658	1,601	1,253	1,209
Net fee and commission income[3)]	766	718	728	680	1,598	1,507	1,560	1,473
Trading income (net)[4)]	338	335	308	300	689	680	795	784
Income from financial assets and liabilities designated at fair value through income (net)[4)]	16	16	18	18	6	5	21	21
Other income				(1)			25	25
Operating revenues[5)]	**1,850**	**1,770**	**1,706**	**1,628**	**3,951**	**3,793**	**3,654**	**3,512**
Administrative expenses	(1,334)	(1,277)	(1,436)	(1,386)	(2,744)	(2,632)	(2,864)	(2,767)
Investment expenses	(4)	(5)	(10)	(12)	(13)	(16)	(16)	(19)
Other expenses	1	1	13	13	14	14	13	13
Operating expenses	**(1,337)**	**(1,281)**	**(1,433)**	**(1,385)**	**(2,743)**	**(2,634)**	**(2,867)**	**(2,773)**
Loan loss provisions	(65)	(62)	(7)	(5)	(60)	(55)	26	28
Operating profit	**448**	**427**	**266**	**238**	**1,148**	**1,104**	**813**	**767**
Realized gains/losses (net)	51	43	32	30	190	180	446	444
Impairments of investments (net)	(9)	(9)	(12)	(12)	(22)	(22)	(32)	(32)
Amortization of intangible assets			(1)				(1)	
Restructuring charges	(3)	(4)	(7)	(6)	(12)	(13)	(9)	(8)
Non-operating items	**39**	**30**	**12**	**12**	**156**	**145**	**404**	**404**
Income before income taxes and minority interests in earnings	**487**	**457**	**278**	**250**	**1,304**	**1,249**	**1,217**	**1,171**
Income taxes	(56)	(44)	(89)	(80)	(224)	(202)	(334)	(318)
Minority interests in earnings	(20)	(18)	(27)	(21)	(44)	(40)	(55)	(46)
Net income	**411**	**395**	**162**	**149**	**1,036**	**1,007**	**828**	**807**
Cost-income ratio[6)] in %	**72.3**	**72.4**	**84.0**	**85.1**	**69.4**	**69.4**	**78.5**	**79.0**

[1)] We have restated the presentation of revenues and operating profit stemming from trades in shares of Allianz SE and its affiliates. From 2007 onwards, these results are eliminated on Dresdner Bank level, whereas in 2006 they were adjusted on segment level only.
[2)] Represents interest and similar income less interest expense.
[3)] Represents fee and commission income less fee and commission expense.
[4)] The total of these items equals income from financial assets and liabilities carried at fair value through income (net) in the segment income statement included in Note 3 to the consolidated financial statements.
[5)] For the Banking segment, total revenues are measured based upon operating revenues.
[6)] Represents operating expenses divided by operating revenues.

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Banking Operations by Division

The following table sets forth our banking operating revenues, operating profit and cost-income ratio by division. Consistent with our general practice, these figures are presented before consolidation adjustments, representing the elimination of transactions between Allianz Group companies in different segments.

	Operating revenues		Operating profit (loss)		Cost-Income ratio	
Three months ended June 30,	2007	2006	2007	2006	2007	2006
	mn	mn	mn	mn	%	%
Private & Corporate Clients[1]	884	875	188	193	75.7	75.3
Investment Banking[1]	760	868	153	178	75.1	79.4
Corporate Other[2]	126	(115)	86	(133)	[3]	[3]
Dresdner Bank[4]	**1,770**	**1,628**	**427**	**238**	**72.4**	**85.1**
Other Banks[5]	80	78	21	28	70.0	61.5
Total	**1,850**	**1,706**	**448**	**266**	**72.3**	**84.0**

	Operating revenues		Operating profit (loss)		Cost-Income ratio	
Six months ended June 30,	2007	2006	2007	2006	2007	2006
	mn	mn	mn	mn	%	%
Private & Corporate Clients[1]	1,880	1,870	510	506	71.4	71.1
Investment Banking[1]	1,649	1,731	372	399	75.8	78.9
Corporate Other[2]	264	(89)	222	(138)	[3]	[3]
Dresdner Bank[4]	**3,793**	**3,512**	**1,104**	**767**	**69.4**	**79.0**
Other Banks[5]	158	142	44	46	69.0	66.2
Total	**3,951**	**3,654**	**1,148**	**813**	**69.4**	**78.5**

[1] Our reporting by division reflects the organizational changes within Dresdner Bank effective starting with 1Q 2007, resulting in two operating divisions, Private & Corporate Clients (PCC) and Investment Banking (IB). PCC combines all banking activities formerly provided by the Personal Banking and Private & Business Banking (including Private Wealth Management) divisions as well as our activities with medium-sized business clients from our former Corporate Banking division. IB, with Global Banking and Capital Markets, unites the activities formerly provided by the Dresdner Kleinwort (formerly Dresdner Kleinwort Wasserstein) division and the remaining activities of the former Corporate Banking division. Prior year balances have been adjusted accordingly to reflect these reorganization measures and allow for comparability across periods.

[2] The Corporate Other division contains income and expense items that are not assigned to Dresdner Bank s operating divisions. These items include, in particular, impacts from the accounting treatment for derivative financial instruments which do not qualify for hedge accounting as well as provisioning requirements for country and general risks. For the three and six months, the impact from the accounting treatment for derivative financial instruments which do not qualify for hedge accounting on Corporate Other s operating revenues amounted to 4 mn and (16) mn respectively (2006: 9 mn and (14) mn respectively).

[3] Presentation not meaningful.

[4] We have restated the presentation of revenues and operating profit stemming from trades in shares of Allianz SE and its affiliates. From 2007 onwards, these results are eliminated on Dresdner Bank level, whereas in 2006 they were adjusted on segment level only.

[5] Consists of non-Dresdner Bank banking operations within our Banking segment.

Reconciliation of Operating Profit and Operating Revenues

			2006	
Three months ended	March 31,	June 30,	September 30,	December 31, mn

	€mn	€mn	€ mn	
Operating revenues				
Dresdner Bank previously stated	1,884	1,709	1,520	1,697
Reversal of impact Own shares (previously shown on segment level)		(81)	81	(6)
Dresdner Bank	**1,884**	**1,628**	**1,601**	**1,691**
Operating profit				
Dresdner Bank previously stated	529	319	310	202
Reversal of impact Own shares (previously shown on segment level)		(81)	81	(6)
Dresdner Bank	**529**	**238**	**391**	**196**

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Allianz Group Interim Report Second Quarter and First Half of 2007

Asset Management Operations

Continuing growth impacted by U.S. Dollar depreciation.

- Operating profit growth of 9.4%.
- Strong net inflows of €20 billion to third party assets.
- Cost income ratio at very competitive 59.2% despite investments in future growth.

Third-Party Assets Under Management of the Allianz Group

With third-party assets of €789 billion as of June 30, 2007 we recorded a 3.3% increase compared to December 31, 2006. In the first half of 2007, net inflows to third-party assets of €20 billion were achieved, primarily in the United States, France and Asia-Pacific. Of the total net inflows, our fixed income business made up for € 18 billion and our equity business for €2 billion. The strong fixed income net inflows were achieved despite a challenging market environment, in particular rising interest rates and flattening yield curves across regions.

Market-related appreciation was €21 billion. The majority of both the fixed income and equity assets we manage outperformed their respective benchmarks.

Net inflows and positive market effects were partly offset by negative currency translation effects of €14 billion, resulting primarily from a weaker U.S. Dollar versus the Euro. Overall, on a Euro-basis, our third-party assets increased by €25 billion[1] to €789 billion as of June 30, 2007, compared to €764 billion as of December 31, 2006.

We operate our third-party asset management business primarily through Allianz Global Investors (AGI). As of June 30, 2007, AGI managed approximately 94.7% (December 31, 2006: 94.6%) of the Allianz Group s third-party assets. The remaining third-party assets are managed by Dresdner Bank (approximately 2.6% and 2.7% as of June 30, 2007 and December 31, 2006, respectively) and other Allianz Group subsidiaries (approximately 2.7% as of both, June 30, 2007 and December 31, 2006).

[1] Including a negative deconsolidation effect of 2 bn.

The following graphs present the third-party assets managed by the Allianz Group by geographic region, investment category and investor class as of June 30, 2007 and December 31, 2006, respectively.

Third-party assets under management Fair values by geographic region[1]

in bn

[1] Based on the origination of the assets.
[2] Consists of third-party assets managed by Dresdner Bank (approximately 21 bn as of both, June 30, 2007 and December 31, 2006) and by other Allianz Group companies (approximately 20 bn as of both, June 30, 2007 and December 31, 2006).

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Third-party assets under management   Fair values by investment category

in bn

[1] Includes primarily investments in real estate.

Third-party assets under management   Fair values by investor class

in bn

Third-party assets under management   Composition of fair value development in the United States

in bn

Third-party assets under management   Composition of fair value development in Germany

in bn

Our major achievements in the first half of 2007 included:

- AGI Germany with assets under management of €284.8 billion and a market share of 17.8% is a clear market leader in Germany[1].
- AGI Germany for the third consecutive year achieved a TOP 3 position for service quality in the ranking of FONDS professionell magazine.
- Particular strong net inflows of approximately €2.2 billion at our equity fund manager NFJ Investment Group.
- PIMCO was awarded Best Third-Party Provider of Fixed Income Portfolio Management Services in Asia from Euromoney Private Banking Survey 2007.

[1] Source: Bundesverband Investment und Asset Management (BVI), an association representing the German investment fund industry.

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Allianz Group Interim Report Second Quarter and First Half of 2007

Earnings Summary

The results of operations of our Asset Management segment are almost exclusively represented by AGI, accounting for 97.6% and 96.6% of our total Asset Management segment s operating revenues and operating profit, respectively, in 2Q 2007 (2Q 2006: 98.8% and 99.3%, respectively). Accordingly, the discussion of our Asset Management segment s results of operations relates solely to the operations of AGI.

Operating revenues

2007 to 2006 second quarter comparison

At €778 million, operating revenues improved by 8.5%; a substantial increase given unfavorable currency effects such as the depreciation of the U.S. Dollar versus the Euro. At constant exchange rates, operating revenues

would have been up by 14.2%. Management fees increased alongside the growing asset base as previously described. Income from financial assets and liabilities carried at fair value through income (net) was up €17 million compared to a year ago; primarily stemming from higher mark-to-market valuation of seed money in the United States. Performance fees also developed favorably, predominantly as a result of our positive business development in Europe.

2007 to 2006 first half comparison

Operating revenues at €1,536 million were up 5.8% . The internal growth rate amounted to 12.0%. Asset-based management fees surpassed the result of last year's period, reflecting the growth of our third-party asset base at higher revenue margins. To a large extent driven by our business located in the United States, performance fees rose by 40.0% to €35 million. Reduced loading and exit fees reflect the development of mutual fund sales.

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
	mn	mn	mn	mn
Management fees	861	823	1,712	1,652
Loading and exit fees	78	86	159	177
Performance fees	20	9	35	25
Other income	94	97	196	176
Fee and commission income	**1,053**	**1,015**	**2,102**	**2,030**
Commissions	(226)	(223)	(446)	(449)
Other expenses	(84)	(91)	(185)	(176)
Fee and commission expenses	**(310)**	**(314)**	**(631)**	**(625)**
Net fee and commission income	**743**	**701**	**1,471**	**1,405**

Operating profit

Operating profit

in mn

2007 to 2006 second quarter comparison

Operating profit was €314 million; an increase of 6.4%. Adjusted for currency translation effects, operating profit would have exceeded the 2Q 2006 level by 12.6%. This increase was predominantly due to the favorable business development in the United States.

Administrative expenses, excluding acquisition-related expenses, rose by 10.0% to €464 million; €192 million of which were compensation related, an increase compared to €161 million a year earlier. Non-compensation related expenses were at €272 million versus €261 million in 2Q 2006. This development was in line with our ongoing business expansion and investments in future growth.

Our cost-income ratio slightly increased by 0.7% percentage points to 59.6%.

2007 to 2006 first half comparison

In 1H 2007 operating profit was up 3.9%, amounting to €618 million; despite the burden of unfavorable currency effects. Excluding these effects operating profit would have surpassed last year's result by 10.5%.

Due to continuous investment in future growth and further business expansion, administrative expenses, excluding acquisition-related expenses, were up €61 million to €918 million. Thereof, €384 million were compensation-related expenses and €534 million non compensation-related expenses.

Non-operating items

2007 to 2006 second quarter comparison

Acquisition-related expenses dropped by €49 million to €83 million. This decline was mainly driven by a lower number of outstanding PIMCO LLC Class B Units (or Class B Units). The Allianz Group had acquired 37,760 of the 150,000 PIMCO LLC Class B Units originally outstanding, as of June 30, 2007, compared to 11,721 as of June 30, 2006.

2007 to 2006 first half comparison

At €205 million, acquisition-related expenses were down by €65 million. A lower number of outstanding Class B Units as previously described contributed most to this development.

Net income

2007 to 2006 second quarter comparison

Net income of €126 million significantly exceeded the 2Q 2006 result by 40.0%. Excluding effects of exchange rate movements, the internal growth rate would have been 50.1%.

With income tax expenses at €100 million versus €62 million a year ago our effective tax rate was 43.1% (2Q 2006: 38.3%).

2007 to 2006 first half comparison

Net income grew significantly by 23.7% to €219 million, despite unfavorable currency effects. At constant exchange rates net income would have surpassed prior year's period by 32.0%

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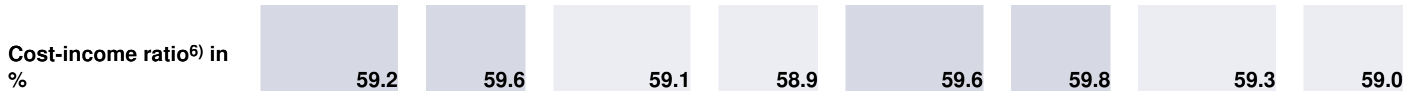
Allianz Group Interim Report Second Quarter and First Half of 2007

The following table sets forth the income statements and cost-income ratios for both our Asset Management segment as a whole and AGI for the three and six months ended June 30, 2007 and 2006.

	Three months ended June 30,				Six months ended June 30,			
	2007		2006		2007		2006	
	Asset Management Segment	Allianz Global Investors	Asset Management Segment	Allianz Global Investors	Asset Management Segment	Allianz Global Investors	Asset Management Segment	Allianz Global Investors
	€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn
Net fee and commission income[1)]	765	743	712	701	1,511	1,471	1,429	1,405
Net interest income[2)]	13	17	13	15	36	36	30	29
Income from financial assets and liabilities carried at fair value through income (net)	16	15	(2)	(2)	23	22	12	12
Other income	3	3	3	3	7	7	6	6
Operating revenues[3)]	**797**	**778**	**726**	**717**	**1,577**	**1,536**	**1,477**	**1,452**
Administrative expenses, excluding acquisition-related expenses[4)]	(472)	(464)	(429)	(422)	(940)	(918)	(876)	(857)
Operating expenses	**(472)**	**(464)**	**(429)**	**(422)**	**(940)**	**(918)**	**(876)**	**(857)**
Operating profit	**325**	**314**	**297**	**295**	**637**	**618**	**601**	**595**
Realized gains/losses (net)	1	1	(1)	(1)	3	3	1	
Impairments of investments (net)			(1)				(1)	
Acquisition-related expenses, thereof[4)]								
Deferred purchases of interests in PIMCO	(80)	(80)	(130)	(130)	(202)	(202)	(266)	(266)
Other acquisition-related expenses[5)]	(3)	(3)	(2)	(2)	(3)	(3)	(4)	(4)
Subtotal	**(83)**	**(83)**	**(132)**	**(132)**	**(205)**	**(205)**	**(270)**	**(270)**
Restructuring charges					(2)	(2)		
Non-operating items	**(82)**	**(82)**	**(134)**	**(133)**	**(204)**	**(204)**	**(270)**	**(270)**
Income before income taxes and minority interests in earnings	**243**	**232**	**163**	**162**	**433**	**414**	**331**	**325**
Income taxes	(101)	(100)	(62)	(62)	(181)	(179)	(127)	(126)
Minority interests in earnings	(8)	(6)	(11)	(10)	(19)	(16)	(24)	(22)
Net income	**134**	**126**	**90**	**90**	**233**	**219**	**180**	**177**



Cost-income ratio[6] in %	59.2	59.6	59.1	58.9	59.6	59.8	59.3	59.0

[1] Represents fee and commission income less fee and commission expense.
[2] Represents interest and similar income less interest expense and investment expenses.
[3] For the Asset Management segment, total revenues are measured based upon operating revenues.
[4] The total of these items equals acquisition and administration expenses (net) in the segment income statement in Note 3 to the consolidated financial statements.
[5] Consists of retention payments for the management and employees of PIMCO and Nicholas Applegate.
[6] Represents operating expenses divided by operating revenues.

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Corporate Activities

Earnings Summary

	Three months ended June 30,				Six months ended June 30,			
	Holding Function		Private Equity		Holding Function		Private Equity	
	2007	2006	2007	2006	2007	2006	2007	2006
	€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn
Operating profit	(46)	(97)	36	23	(178)	(285)	67	31
Non-operating items	(61)	169	(13)	15	451	(48)	(14)	21
Income before income taxes and minorities	(107)	72	23	38	273	(333)	53	52
Net income	(1)	151	(7)	32	362	(96)	10	40

Holding Function

Operating profit

2007 to 2006 second quarter comparison

The operating loss decreased by €51 million to €46 million benefiting from higher current investment income and lower investment expenses. These positive effects were partly offset by increased administrative expenses driven by higher performance-based remuneration.

2007 to 2006 first half comparison

The operating loss was €178 million, down €107 million from a year ago. An increase in interest and similar income stemming from a higher asset base with at the same time lower investment expenses, more than compensated for the development of administrative expenses. These went up, primarily driven by higher performance-based remuneration expenses.

Non-operating items

2007 to 2006 second quarter comparison

Total non-operating items declined by €230 million to an aggregate loss of €61 million. Lower realized gains and losses as well as higher interest expenses from external debt, which reflect predominantly the interest expenses of €74 million for the bridge financing in connection with the acquisition of the AGF shares that Allianz did not already own, turned the non-operating result negative. Acquisition-related expenses of €52 million for the redemption of stock-based compensation plans from AGF had an additional impact on the non-operating result.

2007 to 2006 first half comparison

Due to exceptionally high realized gains in the first quarter, non-operating items amounted to an aggregate gain of €451 million, up €499 million on the prior year period. Furthermore, the effects described above impacted the development in the first half of 2007.

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Private Equity

Operating profit

2007 to 2006 second quarter comparison

Operating profit increased by €13 million to €36 million. Higher invested capital and lending to shareholders had a positive impact on interest and similar income, which accounted for most of the rise.

2007 to 2006 first half comparison

Compared to the previous year, operating profit more than doubled to €67 million. Besides the higher interest and similar income lower administrative expenses contributed to this development.

Non-operating items

2007 to 2006 second quarter comparison

Aggregate non-operating items showed a negative result of €13 million compared to a positive result of €15 million a year ago. Gains from the disposal of an interest swap and capital gains from the disposal of an investment that were realized in the prior year period were not repeated. Additionally, depreciation of €8 million contributed to this development.

2007 to 2006 first half comparison

The improvement in the operating profit was offset by negative non-operating items of a similar magnitude. The causes did not change materially from that in 2Q.

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Group Management Report

Balance Sheet Review

Shareholders equity decreased due to dividend payments, higher interest rates and the net impact of the AGF transaction.

Shareholders Equity

Shareholders equity[1]

in mn

[1] Does not include minority interests of 3.3 bn as of June 30, 2007 and of 6.4 bn as of December 31, 2006. Please see Note 18 to the consolidated financial statements for further information.
[2] Includes foreign currency translation adjustments.

As of June 30, 2007, shareholders' equity was €48.5 billion, reflecting a decrease of 4.0% compared to year-end 2006. Our strong net income of €5.4 billion for the first half of 2007 could not fully compensate for various decreasing effects. The combined negative effect of €2.8 billion from transactions between equity holders resulted mainly from the minority buy-outs of AGF, Allianz Leben and in Taiwan. Thereof, the AGF transaction was the most significant with a net impact of minus €2.7 billion. Additionally, shareholders' equity was impacted by the dividend payment for fiscal year 2006 of €1.6 billion and increased unrealized losses of €0.6 billion resulting from the recent rise in interest rates.

Total Assets and Total Liabilities

Total assets and total liabilities increased by €57.9 billion and €63.1 billion, respectively. In the following sections we analyze important developments within the balance sheets of our Life/Health, Property-Casualty and Banking segments. Relative to the Allianz Group s total assets and total liabilities, we consider the total assets and total liabilities from our Asset Management segment as immaterial and have, accordingly, excluded these assets and liabilities from the following discussion. Our Asset Management segment s results of operations stem primarily from its business with third-party assets. Please see pages 24 and 25 for further information on the development of our third-party assets.

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Allianz Group Interim Report Second Quarter and First Half of 2007

Insurance Assets and Liabilities

Life/Health insurance operations

Life/Health asset base

fair values[1] in €bn

[1] Loans and advances to banks and customers, held-to-maturity investments, and real estate held for investment are stated at amortized cost. Investments in associates and joint ventures are stated at either amortized cost or equity, depending upon, among other factors, our ownership percentage.
[2] Financial assets for unit-linked contracts represent assets owned by, and managed on the behalf of, policyholders of the Allianz Group, with all appreciation and depreciation in these assets accruing to the benefit of policyholders. As a result, the value of financial assets for unit-linked contracts in our balance sheet corresponds with the value of financial liabilities for unit-linked contracts.
[3] Does not include affiliates at €2.9 bn and €2.8 bn as of June 30, 2007 and December 31, 2006, respectively.
[4] Includes, in each case as of June 30, 2007 and December 31, 2006, respectively, debt securities at €9.0 bn and €7.3 bn, equity securities at €3.3 bn and €2.9 bn, and derivative financial instruments at €(5.7) bn and €(4.4) bn.

As of June 30, 2007, reserves for insurance and investment contracts from the Life/Health segment amounted to €281.3 billion, up €2.5 billion from December 31, 2006. This development primarily stemmed from higher aggregate policy reserves for universal-life type insurance contracts. Compared to December 31, 2006, financial assets and liabilities for unit-linked contracts increased by 8.4% to €67.1 billion, reflecting our positive sales performance with regards to unit-linked insurance and investment contracts as well as market-related appreciation of our assets. In aggregate our Life/Health asset base improved to €348.7 billion, an increase of 2.2%.

Property-Casualty insurance operations

Property-Casualty asset base

fair values[1] in €bn

[1] Loans and advances to banks and customers, held-to-maturity investments, and real estate held for investment are stated at amortized cost. Investments in associates and joint ventures are stated at either amortized cost or equity, depending upon, among other factors, our ownership percentage.
[2] Does not include affiliates at €9.7 bn and €9.5 bn as of June 30, 2007 and December 31, 2006, respectively.
[3] Includes, in each case as of June 30, 2007 and December 31, 2006, respectively, debt securities at €4.1 bn and €3.2 bn, equity securities at €0.4 bn and € 0.4 bn, and derivative financial instruments at €0.1 bn and €0.1 bn.

The asset base of our Property-Casualty segment declined by €0.3 billion from year-end 2006 to €99.5 billion as of June 30, 2007. Reserves for loss and loss adjustment expenses, at €58.0 billion as of June 30, 2007, reflected a slight reduction of 1.2%, primarily due to the depreciation of the U.S Dollar compared to the Euro.

Banking Assets and Liabilities

Banking loans and advances to banks and customers

in bn

[1] Includes loan loss allowance at (1.0) bn as of both June 30, 2007 and December 31, 2006, respectively.

In our Banking segment, loans and advances to banks and customers were €355.6 million, up 13.4% as of June 30, 2007. This development was mainly driven by an increasing volume of the collateralized refinancing business of Dresdner Bank. Liabilities to banks and customers also recorded an increase, primarily in the form of repurchase agreements and collateral received from securities lending transactions.

Other Information

Reconciliation of Consolidated Operating Profit and Income before Income Taxes and Minority Interests in Earnings

The previous analysis is based on our consolidated financial statements and should be read in conjunction with those statements. The Allianz Group uses operating profit to evaluate the performance of its business segments and the Group as a whole. The Allianz Group considers the presentation of operating profit to be useful and meaningful to investors because it enhances the understanding of the Allianz Group s underlying operating performance and the comparability of its operating performance over time. Operating profit highlights the portion of income before income taxes and minority interests in earnings attributable to the on-going core operations of the Allianz Group. To better understand the on-going operations of the business, we exclude the effects of acquisition-related expenses and the amortization of intangible assets, as these relate to business

combinations; and we exclude interest expense from external debt and income from financial assets and liabilities held for trading (relating to exchangeables on external debt) as these relate to our capital structure.

We believe that trends in the underlying profitability of our business can be more clearly identified without the fluctuating effects of the realized capital gains and losses or impairments of investment securities, as these are largely dependent on market cycles or issuer-specific events over which we have little or no control, and can and do vary, sometimes materially, across periods. Further, the timing of sales that would result in such gains or losses is largely at our discretion. Due to the non-recurring nature of restructuring charges we also exclude them in order to avoid distortions in the operating results of the underlying business.

Operating profit should be viewed as complementary to, and not a substitute for, income before income taxes and minority interests in earnings or net income as determined in accordance with IFRS.

The following table reconciles operating profit on a consolidated basis to the Allianz Group s income before income taxes and minority interests in earnings.

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
	€mn	€mn	€mn	€mn
Operating profit	**3,288**	**2,794**	**6,158**	**5,471**
Realized gains/losses and impairments of investments (net)	401	1,296	2,446	2,074
Income from financial assets and liabilities held for trading (net)	(37)	(75)	(3)	(154)
Interest expense from external debt	(278)	(196)	(500)	(394)
Restructuring charges	(12)	(404)	(39)	(408)
Acquisition-related expenses	(135)	(132)	(257)	(270)

Amortization of intangible assets	(4)	(5)	(7)	(10)
Reclassification of policyholder participation in tax benefits arising in connection with tax-exempt income	(25)	(286)	(44)	(286)
Income before income taxes and minority interests in earnings	**3,198**	**2,992**	**7,754**	**6,023**

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Composition of Total Revenue Growth

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

which excludes the effects of foreign currency translation and changes in scope of consolidation. The following table sets forth the reconciliation of nominal total revenue growth to internal total revenue growth for each of our segments and the Allianz Group as a whole for the three and six months ended June 30, 2007, respectively.

Composition of total revenue[1] growth

	Three months ended June 30, 2007				Six months ended June 30, 2007			
Segment	Nominal growth	Changes in scope of consoli-dation	Foreign currency translation	Internal growth	Nominal growth	Changes in scope of consoli-dation	Foreign currency translation	Internal growth
	%	%	%	%	%	%	%	%
Property-Casualty	3.1	1.9	(0.6)	1.8	1.1	1.0	(0.8)	0.9
Life/Health	(1.5)	0.1	(1.9)	0.3	(2.7)		(1.8)	(0.9)
Banking	8.4		(0.9)	9.3	8.1		(0.6)	8.7
thereof: Dresdner Bank	8.7		(0.9)	9.6	8.0		(0.6)	8.6
Asset Management	9.8	(0.7)	(5.8)	16.3	6.8	(0.7)	(6.2)	13.7
thereof: Allianz Global Investors	8.5		(5.7)	14.2	5.7		(6.3)	12.0
Allianz Group	1.1	0.7	(1.3)	1.7	(0.1)	0.4	(1.4)	0.9

[1] Total revenues comprise Property-Casualty segment s gross premiums written, Life/Health segment s statutory premiums, Banking segment s operating revenues and Asset Management segment s operating revenues. Segment growth rates are presented before the elimination of transactions between Allianz Group companies in different segments.

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70	28	Interest expense
70	29	Loan loss provisions
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71	31	Investment expenses
71	32	Acquisition and administrative expenses (net)
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Consolidated Balance Sheets

As of June 30, 2007 and as of December 31, 2006

	Note	As of June 30, 2007 €mn	As of December 31, 2006 €mn
ASSETS			
Cash and cash equivalents		32,927	33,031
Financial assets carried at fair value through income	4	166,774	156,869
Investments	5	293,491	298,134
Loans and advances to banks and customers	6	452,961	408,278
Financial assets for unit linked contracts		67,058	61,864
Reinsurance assets	7	18,012	19,360
Deferred acquisition costs	8	20,401	19,135
Deferred tax assets		4,639	4,727
Other assets	9	41,430	38,893
Intangible assets	10	13,452	12,935
Total assets		**1,111,145**	**1,053,226**

	Note	As of June 30, 2007 €mn	As of December 31, 2006 €mn
LIABILITIES AND EQUITY			
Financial liabilities carried at fair value through income	11	96,861	79,699
Liabilities to banks and customers	12	398,010	361,078
Unearned premiums		17,776	14,868
Reserves for loss and loss adjustment expenses	13	64,824	65,464
Reserves for insurance and investment contracts	14	290,276	287,697
Financial liabilities for unit linked contracts		67,058	61,864
Deferred tax liabilities		4,263	4,618
Other liabilities	15	49,096	49,764
Certificated liabilities	16	56,148	54,922
Participation certificates and subordinated liabilities	17	15,086	16,362
Total liabilities		**1,059,398**	**996,336**
Shareholders equity		48,459	50,481
Minority interests		3,288	6,409
Total equity	**18**	**51,747**	**56,890**
Total liabilities and equity		**1,111,145**	**1,053,226**

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Consolidated Income Statements

For the three months and six months ended June 30, 2007 and 2006

		Three months ended June 30,		Six months ended June 30,	
		2007	2006	2007	2006
	Note	€mn	€mn	€mn	€mn
Premiums written		**14,833**	**14,736**	**34,336**	**34,224**
Ceded premiums written		(1,415)	(1,439)	(3,176)	(3,336)
Change in unearned premiums		921	829	(2,278)	(2,342)
Premiums earned (net)	**19**	**14,339**	**14,126**	**28,882**	**28,546**
Interest and similar income	20	7,316	6,559	13,582	12,242
Income from financial assets and liabilities carried at fair value through income (net)	21	(343)	63	(228)	563
Realized gains/losses (net)	22	1,088	2,337	4,297	4,232
Fee and commission income	23	2,322	2,162	4,678	4,414
Other income	24	6	17	99	56
Income from fully consolidated private equity investments	25	470	169	941	328
Total income		**25,198**	**25,433**	**52,251**	**50,381**
Claims and insurance benefits incurred (gross)		(11,421)	(10,839)	(23,468)	(22,674)
Claims and Insurance benefits incurred (ceded)		997	646	1,959	1,606
Claims and insurance benefits incurred (net)	**26**	**(10,424)**	**(10,193)**	**(21,509)**	**(21,068)**
Changes in reserves for insurance and investment contracts (net)	27	(2,332)	(3,358)	(5,068)	(6,070)
Interest expense	28	(1,841)	(1,284)	(3,439)	(2,849)
Loan loss provisions	29	(74)	(8)	(72)	24
Impairments of investments (net)	30	(102)	(307)	(169)	(362)
Investment expenses	31	(202)	(299)	(463)	(482)
Acquisition and administrative expenses (net)	32	(5,950)	(5,718)	(11,588)	(11,527)
Fee and commission expenses	33	(601)	(607)	(1,235)	(1,185)
Amortization of intangible assets		(4)	(5)	(7)	(10)
Restructuring charges		(14)	(522)	(44)	(526)
Other expenses	34		12	13	11
Expenses from fully consolidated private equity investments	35	(456)	(152)	(916)	(314)
Total expenses		**(22,000)**	**(22,441)**	**(44,497)**	**(44,358)**
Income before income taxes and minority interests in earnings		**3,198**	**2,992**	**7,754**	**6,023**
Income taxes	36	(858)	(357)	(1,825)	(1,256)
Minority interests in earnings		(200)	(356)	(549)	(709)
Net income		**2,140**	**2,279**	**5,380**	**4,058**

		Three months ended June 30,		Six months ended June 30,	
		2007	2006	2007	2006
	Note	€	€	€	€
Basic earnings per share	37	4.85	5.62	12.32	10.02
Diluted earnings per share	37	4.75	5.51	12.08	9.83

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Consolidated Statements of Changes in Equity

For the six months ended June 30, 2007 and 2006

	Paid-in capital €mn	Revenue reserves €mn	Foreign currency translation adjustments €mn	Unrealized gains and losses (net) €mn	Shareholders equity €mn	Minority interests €mn	Total equity €mn
Balance as of December 31, 2005	**21,616**	**8,579**	**(1,032)**	**10,324**	**39,487**	**7,615**	**47,102**
Foreign currency translation adjustments			(894)	(7)	(901)	(215)	(1,116)
Available-for-sale investments							
Unrealized gains and losses (net) arising during the period				(939)	(939)	(412)	(1,351)
Transferred to net income on disposal				(1,484)	(1,484)	(117)	(1,601)
Cash flow hedges				(32)	(32)	(1)	(33)
Miscellaneous		(347)			(347)	14	(333)
Total income and expense recognized directly in shareholders equity		**(347)**	**(894)**	**(2,462)**	**(3,703)**	**(731)**	**(4,434)**
Net income		4,058			4,058	709	4,767
Total recognized income and expense for the period		**3,711**	**(894)**	**(2,462)**	**355**	**(22)**	**333**
Treasury shares		1,275			1,275		1,275
Transactions between equity holders		25	(4)	(4)	17	9	26
Dividends paid		(811)			(811)	(596)	(1,407)
Balance as of June 30, 2006	**21,616**	**12,779**	**(1,930)**	**7,858**	**40,323**	**7,006**	**47,329**
Balance as of December 31, 2006	**25,398**	**13,629**	**(2,210)**	**13,664**	**50,481**	**6,409**	**56,890**
Foreign currency translation adjustments			(262)	(7)	(269)	(42)	(311)
Available-for-sale investments							
Unrealized gains and losses (net) arising during the period				(559)	(559)	(52)	(611)
Transferred to net income on disposal				(2,202)	(2,202)	(97)	(2,299)
Cash flow hedges				(9)	(9)		(9)
Miscellaneous		(136)			(136)	9	(127)
Total income and expense recognized directly in shareholders equity		**(136)**	**(262)**	**(2,777)**	**(3,175)**	**(182)**	**(3,357)**
Net income		5,380			5,380	549	5,929
		5,244	**(262)**	**(2,777)**	**2,205**	**367**	**2,572**

Total recognized income and expense for the period							
Treasury shares		200			200		200
Transactions between equity holders	2,765	(6,051)	(62)	563	(2,785)	(3,242)	(6,027)
Dividends paid		(1,642)			(1,642)	(246)	(1,888)
Balance as of June 30, 2007	**28,163**	**11,380**	**(2,534)**	**11,450**	**48,459**	**3,288**	**51,747**

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Consolidated Statements of Cash Flows

For the six months ended June 30, 2007 and 2006

Six months ended June 30,	2007	2006
	€mn	€mn
Cash flow from operating activities:		
Net income	**5,380**	**4,058**
Adjustments to reconcile net income to net cash flow provided by (used in) operating activities:		
Minority interests in earnings	549	709
Share of earnings from investments in associates and joint ventures	(331)	(122)
Realized gains/losses (net) and impairments of investments (net) of:		
Available-for-sale and held-to-maturity investments, investments in associates and joint ventures, real estate held for investment, loans to banks and customers	(4,128)	(3,870)
Other investments, mainly financial assets held for trading and designated at fair value through income	449	(24)
Depreciation and amortization	419	324
Loan loss provision	72	(24)
Interest credited to policyholder accounts	1,268	2,070
Net change in:		
Financial assets and liabilities held for trading	10,266	15,678
Reverse repurchase agreements and collateral paid for securities borrowing transactions	(41,316)	(44,047)
Repurchase agreements and collateral received from securities lending transactions	34,231	28,483
Reinsurance assets	(50)	(117)
Deferred acquisition costs	(905)	(995)
Unearned premiums	2,610	2,626
Reserves for losses and loss adjustment expenses	(394)	(147)
Reserves for insurance and investment contracts	3,389	4,262
Deferred tax assets/liabilities	435	71
Other (net)	(1,392)	27
Net cash flow provided by operating activities	**10,552**	**8,962**
Cash flow from investing activities:		
Net change in:		
Financial assets designated at fair value through income	(2,869)	(1,397)
Available-for-sale investments	(944)	(7,710)
Held-to-maturity investments	4	30
Investments in associates and joint ventures	189	(72)
Non-current assets and disposal groups held for sale	3	1,397
Real estate held for investment	339	653
Loans and advances to banks and customers	(3,528)	(13,410)
Property and equipment	(120)	(514)
Acquisition of subsidiaries, net of cash acquired	(507)	
Other (net)	172	(21)
Net cash flow used in investing activities	**(7,261)**	**(21,044)**
Cash flow from financing activities:		
Net change in:		
Policyholders accounts	1,048	2,822
Liabilities to banks and customers	2,750	10,861
Certificated liabilities, participation certificates and subordinated liabilities	853	(1,875)
Transactions between equity holders	(6,027)	(70)
Dividends paid to shareholders	(1,888)	(1,407)
Net cash from sale or purchase of treasury shares	(290)	(279)
Other (net)	187	460

Net cash flow provided by (used in) financing activities	**(3,367)**	**10,512**
Effect of exchange rate changes on cash and cash equivalents	(28)	(61)
Change in cash and cash equivalents	**(104)**	**(1,631)**
Cash and cash equivalents at beginning of period	33,031	31,647
Cash and cash equivalents at end of period	**32,927**	**30,016**

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Notes to the Consolidated Financial Statements

1 Basis of presentation

The consolidated interim financial statements of the Allianz Group have been prepared using accounting policies consistent with International Financial Reporting Standards (IFRS) and in accordance with the requirements of IAS 34, Interim Financial Reporting, as published by the International Accounting Standard Board (IASB) and as endorsed by the European Union (EU).

The consolidated interim financial statements comply with all new or amended IFRSs, where application is compulsory for the first time for periods beginning on January 1, 2007. For existing and unchanged IFRSs the accounting policies for recognition, measurement, consolidation and presentation applied in the preparation of the consolidated interim financial statements are consistent with the accounting policies, that have been applied in the preparation of the consolidated financial statements for the year ended December 31, 2006.

IFRS does not provide specific guidance concerning all aspects of the recognition and measurement of insurance and reinsurance contracts. Therefore, as envisioned in IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, the provisions embodied under

accounting principles generally accepted in the United States of America (US GAAP) have been applied to those aspects where specific guidance is not provided by IFRS 4, Insurance Contracts.

IFRS 7, Financial Instruments: Disclosures, is applicable for annual periods beginning January 1, 2007. IFRS 7 requires extended disclosures about the significance of financial instruments and the nature and extent of risks arising from financial instruments. Simultaneously with the development of IFRS 7, the IASB amended IAS 1, Presentation of Financial Statements, to add disclosures about capital management and capital requirements. The new requirements of IFRS 7 and IAS 1 will be of significance for the consolidated financial statements for the year ended December 31, 2007.

The consolidated financial statements are presented in millions of Euro (€ mn).

2 Changes in the presentation of the consolidated financial statements

Reclassifications

Beginning with the third quarter of 2006, income from fully consolidated private equity investments and expenses from fully consolidated private equity investments have been included as separate line items in the consolidated income statements. Accordingly, the prior period income statement has been reclassified to conform to the current period presentation.

A summary of the impact of these changes on the consolidated income statements for the three and six months ended June 30, 2006 is as follows:

	Three months ended June 30,	Reclassifi-cations	Three months ended June 30,	Six months ended June 30, 2006	Reclassifi-cations	Six months ended June 30,

	2006 as previously reported		2006	as previously reported		2006
	€mn	€mn	€mn	€mn	€mn	€mn
Interest and similar income	6,576	(17)	6,559	12,267	(25)	12,242
Fee and commission income	2,314	(152)	2,162	4,717	(303)	4,414
Income from fully consolidated private equity investments		169	169		328	328
Interest expense	(1,299)	15	(1,284)	(2,899)	50	(2,849)
Acquisition costs and administrative expenses (net)	(5,791)	25	(5,766)	(11,634)	42	(11,592)
Fee and commission expenses	(719)	112	(607)	(1,407)	222	(1,185)
Expenses from fully consolidated private equity investments		(152)	(152)		(314)	(314)

Additionally, certain immaterial amounts of unearned premiums were previously netted against deferred acquisition costs in the consolidated balance sheets and

against the related amortization account in the consolidated income statements. All periods have now been presented on a gross basis.

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Allianz Group Interim Report Second Quarter and First Half of 2007

3 Segment reporting

Business Segment Information Consolidated Balance Sheets

As of June 30, 2007 and as of December 31, 2006

	Property-Casualty		Life/Health		Banking	
	As of June 30, 2007	As of December 31, 2006	As of June 30, 2007	As of December 31, 2006	As of June 30, 2007	As of December 31, 2006
	mn	mn	mn	mn	mn	mn
ASSETS						
Cash and cash equivalents	5,345	4,100	9,652	6,998	16,390	21,528
Financial assets carried at fair value through income	4,709	4,814	13,094	11,026	147,604	139,505
Investments	87,070	88,819	189,166	190,607	17,738	17,803
Loans and advances to banks and customers	17,462	16,825	88,794	85,769	355,609	313,709
Financial assets for unit linked contracts			67,058	61,864		
Reinsurance assets	11,409	11,437	6,641	7,966		
Deferred acquisition costs	4,001	3,704	16,347	15,381		
Deferred tax assets	1,676	1,651	583	503	1,750	1,679
Other assets	21,119	17,737	14,828	12,891	9,652	9,571
Intangible assets	2,253	1,653	2,396	2,399	2,285	2,285
Total assets	**155,044**	**150,740**	**408,559**	**395,404**	**551,028**	**506,080**

	Property-Casualty		Life/Health		Banking	
	As of June 30, 2007	As of December 31, 2006	As of June 30, 2007	As of December 31, 2006	As of June 30, 2007	As of December 31, 2006
	mn	mn	mn	mn	mn	mn
LIABILITIES AND EQUITY						
Financial liabilities carried at fair value through income	86	1,070	6,561	5,251	89,586	72,215
Liabilities to banks and customers	5,906	4,473	10,477	7,446	377,577	350,148
Unearned premiums	15,834	12,994	1,943	1,874		
Reserves for loss and loss adjustment expenses	57,966	58,664	6,857	6,804		
Reserves for insurance and investment contracts	9,042	8,956	281,250	278,701		
Financial liabilities for unit linked contracts			67,058	61,864		
Deferred tax liabilities	3,393	3,902	1,206	1,181	70	83
Other liabilities	19,439	18,699	17,211	16,314	11,395	12,140

Certificated liabilities	57	657	433	3	47,350	46,191
Participation certificates and subordinated liabilities	1,608	1,605	66	66	7,187	8,456
Total liabilities	**113,331**	**111,020**	**393,062**	**379,504**	**533,165**	**489,233**

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	Asset Management		Corporate		Consolidation		Group	
	As of June 30, 2007	As of December 31, 2006	As of June 30, 2007	As of December 31, 2006	As of June 30, 2007	As of December 31, 2006	As of June 30, 2007	As of December 31, 2006
	€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn
	612	767	1,800	536	(872)	(898)	32,927	33,031
	1,069	985	973	1,158	(675)	(619)	166,774	156,869
	680	774	104,607	96,652	(105,770)	(96,521)	293,491	298,134
	638	367	4,273	2,963	(13,815)	(11,355)	452,961	408,278
							67,058	61,864
					(38)	(43)	18,012	19,360
	53	50					20,401	19,135
	185	196	1,034	1,473	(589)	(775)	4,639	4,727
	3,471	3,471	4,930	7,020	(12,570)	(11,797)	41,430	38,893
	6,259	6,334	259	264			13,452	12,935
	12,967	**12,944**	**117,876**	**110,066**	**(134,329)**	**(122,008)**	**1,111,145**	**1,053,226**

	Asset Management		Corporate		Consolidation		Group	
	As of June 30, 2007	As of December 31, 2006	As of June 30, 2007	As of December 31, 2006	As of June 30, 2007	As of December 31, 2006	As of June 30, 2007	As of December 31, 2006
	€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn
			1,160	1,713	(532)	(550)	96,861	79,699
	778	605	13,313	7,293	(10,041)	(8,887)	398,010	361,078
					(1)		17,776	14,868
					1	(4)	64,824	65,464
			249	306	(265)	(266)	290,276	287,697
							67,058	61,864
	43	46	133	171	(582)	(765)	4,263	4,618
	3,608	3,689	14,024	14,149	(16,581)	(15,227)	49,096	49,764
			9,509	9,265	(1,201)	(1,194)	56,148	54,922
			7,094	7,099	(869)	(864)	15,086	16,362
	4,429	**4,340**	**45,482**	**39,996**	**(30,071)**	**(27,757)**	**1,059,398**	**996,336**
Total equity							**51,747**	**56,890**
Total liabilities and equity							**1,111,145**	**1,053,226**

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Allianz Group Interim Report Second Quarter and First Half of 2007

Business Segment Information Consolidated Income Statements

For the three months ended June 30, 2007 and 2006

Three months ended June 30,	Property-Casualty 2007	2006	Life/Health 2007	2006	Banking 2007	2006
	€mn	€mn	€mn	€mn	€mn	€mn
Premiums written	**9,982**	**9,682**	**4,856**	**5,053**		
Ceded premiums written	(1,245)	(1,230)	(175)	(208)		
Change in unearned premiums	919	906	2	(77)		
Premiums earned (net)	**9,656**	**9,358**	**4,683**	**4,768**		
Interest and similar income	1,380	1,257	3,783	3,698	2,214	1,630
Income from financial assets and liabilities carried at fair value through income (net)	(2)	5	(669)	(216)	354	326
Realized gains/losses (net)	217	889	663	974	51	32
Fee and commission income	280	265	164	162	923	868
Other income	11	24	9	7		
Income from fully consolidated private equity investments						
Total income	**11,542**	**11,798**	**8,633**	**9,393**	**3,542**	**2,856**
Claims and insurance benefits incurred (gross)	(7,093)	(6,554)	(4,336)	(4,293)		
Claims and insurance benefits incurred (ceded)	827	464	178	190		
Claims and insurance benefits incurred (net)	**(6,266)**	**(6,090)**	**(4,158)**	**(4,103)**		
Changes in reserves for insurance and investment contracts (net)	(97)	(121)	(2,211)	(2,950)		
Interest expense	(92)	(66)	(111)	(73)	(1,484)	(978)
Loan loss provisions	(9)	(2)		1	(65)	(7)
Impairments of investments (net)	(28)	(93)	(56)	(210)	(9)	(12)
Investment expenses	(69)	(67)	(163)	(211)	(4)	(10)
Acquisition and administrative expenses (net)	(2,705)	(2,511)	(1,115)	(1,105)	(1,334)	(1,436)
Fee and commission expenses	(190)	(205)	(43)	(70)	(157)	(140)
Amortization of intangible assets	(4)	(3)		(1)		(1)
Restructuring charges	(8)	(354)	(3)	(161)	(3)	(7)
Other expenses		(1)			1	13
Expenses from fully consolidated private equity investments						
Total expenses	**(9,468)**	**(9,513)**	**(7,860)**	**(8,883)**	**(3,055)**	**(2,578)**
Income before income taxes and minority interests in earnings	**2,074**	**2,285**	**773**	**510**	**487**	**278**
Income taxes	(578)	(466)	(234)	(90)	(56)	(89)
Minority interests in earnings	(116)	(237)	(60)	(92)	(20)	(27)
Net income	**1,380**	**1,582**	**479**	**328**	**411**	**162**

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Asset Management		Corporate		Consolidation		Group	
2007	2006	2007	2006	2007	2006	2007	2006
€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn
				(5)	**1**	**14,833**	**14,736**
				5	(1)	(1,415)	(1,439)
						921	829
						14,339	**14,126**
33	25	245	215	(339)	(266)	7,316	6,559
16	(2)	(44)	(56)	2	6	(343)	63
1	(1)	348	427	(192)	16	1,088	2,337
1,080	1,030	44	38	(169)	(201)	2,322	2,162
3	3	9	4	(26)	(21)	6	17
		470	169			470	169
1,133	**1,055**	**1,072**	**797**	**(724)**	**(466)**	**25,198**	**25,433**
				8	8	(11,421)	(10,839)
				(8)	(8)	997	646
						(10,424)	**(10,193)**
				(24)	(287)	(2,332)	(3,358)
(19)	(12)	(394)	(323)	259	168	(1,841)	(1,284)
						(74)	(8)
	(1)	(9)	9			(102)	(307)
(1)		(20)	(60)	55	49	(202)	(299)
(555)	(561)	(251)	(142)	10	37	(5,950)	(5,718)
(315)	(318)	(26)	(19)	130	145	(601)	(607)
						(4)	(5)
						(14)	(522)
				(1)			12
		(456)	(152)			(456)	(152)
(890)	**(892)**	**(1,156)**	**(687)**	**429**	**112**	**(22,000)**	**(22,441)**
243	**163**	**(84)**	**110**	**(295)**	**(354)**	**3,198**	**2,992**
(101)	(62)	80	80	31	270	(858)	(357)
(8)	(11)	(4)	(7)	8	18	(200)	(356)
134	**90**	(8)	**183**	**(256)**	**(66)**	**2,140**	**2,279**

Allianz Group Interim Report Second Quarter and First Half of 2007

Business Segment Information   Consolidated Income Statements

For the six months ended June 30, 2007 and 2006

	Property-Casualty		Life/Health		Banking	
Six months ended June 30,	2007	2006	2007	2006	2007	2006
	€mn	€mn	€mn	€mn	€mn	€mn
Premiums written	**24,093**	**23,831**	**10,251**	**10,397**		
Ceded premiums written	(2,831)	(2,942)	(353)	(398)		
Change in unearned premiums	(2,248)	(2,190)	(30)	(152)		
Premiums earned (net)	**19,014**	**18,699**	**9,868**	**9,847**		
Interest and similar income	2,386	2,179	6,938	6,745	4,423	3,510
Income from financial assets and liabilities carried at fair value through income (net)	(14)	45	(979)	(185)	695	816
Realized gains/losses (net)	984	1,353	1,856	2,236	190	446
Fee and commission income	552	517	335	291	1,901	1,860
Other income	95	38	63	13		25
Income from fully consolidated private equity investments						
Total income	**23,017**	**22,831**	**18,081**	**18,947**	**7,209**	**6,657**
Claims and insurance benefits incurred (gross)	(14,267)	(13,522)	(9,214)	(9,163)		
Claims and insurance benefits incurred (ceded)	1,618	1,250	354	367		
Claims and insurance benefits incurred (net)	**(12,649)**	**(12,272)**	**(8,860)**	**(8,796)**		
Changes in reserves for insurance and investment contracts (net)	(178)	(193)	(4,835)	(5,598)		
Interest expense	(184)	(129)	(202)	(137)	(2,765)	(2,257)
Loan loss provisions	(9)	(3)	(3)	1	(60)	26
Impairments of investments (net)	(54)	(106)	(93)	(245)	(22)	(32)
Investment expenses	(143)	(115)	(359)	(368)	(13)	(16)
Acquisition and administrative expenses (net)	(5,380)	(5,174)	(1,989)	(2,130)	(2,744)	(2,864)
Fee and commission expenses	(387)	(375)	(105)	(120)	(303)	(300)
Amortization of intangible assets	(6)	(7)	(1)	(2)		(1)
Restructuring charges	(22)	(356)	(8)	(161)	(12)	(9)
Other expenses		(2)			14	13
Expenses from fully consolidated private equity investments						
Total expenses	**(19,012)**	**(18,732)**	**(16,455)**	**(17,556)**	**(5,905)**	**(5,440)**
Income before income taxes and minority interests in earnings	**4,005**	**4,099**	**1,626**	**1,391**	**1,304**	**1,217**
Income taxes	(1,115)	(990)	(435)	(309)	(224)	(334)
Minority interests in earnings	(330)	(427)	(159)	(220)	(44)	(55)
Net income	**2,560**	**2,682**	**1,032**	**862**	**1,036**	**828**

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Notes to the Consolidated Financial Statements

Asset Management		Corporate		Consolidation		Group	
2007	2006	2007	2006	2007	2006	2007	2006
€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn
				(8)	**(4)**	**34,336**	**34,224**
				8	4	(3,176)	(3,336)
						(2,278)	(2,342)
						28,882	**28,546**
66	50	399	301	(630)	(543)	13,582	12,242
23	12	41	(152)	6	27	(228)	563
3	1	988	497	276	(301)	4,297	4,232
2,153	2,061	89	79	(352)	(394)	4,678	4,414
7	6	14	17	(80)	(43)	99	56
		941	328			941	328
2,252	**2,130**	**2,472**	**1,070**	**(780)**	**(1,254)**	**52,251**	**50,381**
				13	11	(23,468)	(22,674)
				(13)	(11)	1,959	1,606
						(21,509)	**(21,068)**
				(55)	(279)	(5,068)	(6,070)
(30)	(20)	(747)	(659)	489	353	(3,439)	(2,849)
						(72)	24
	(1)		22			(169)	(362)
		(54)	(77)	106	94	(463)	(482)
(1,145)	(1,146)	(368)	(281)	38	68	(11,588)	(11,527)
(642)	(632)	(61)	(42)	263	284	(1,235)	(1,185)
						(7)	(10)
(2)						(44)	(526)
				(1)		13	11
		(916)	(314)			(916)	(314)
(1,819)	**(1,799)**	**(2,146)**	**(1,351)**	**840**	**520**	**(44,497)**	**(44,358)**
433	**331**	**326**	**(281)**	**60**	**(734)**	**7,754**	**6,023**
(181)	(127)	55	234	75	270	(1,825)	(1,256)
(19)	(24)	(8)	(9)	11	26	(549)	(709)
233	**180**	**373**	**(56)**	**146**	**(438)**	**5,380**	**4,058**

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Allianz Group Interim Report Second Quarter and First Half of 2007

Segment Information   Total Revenues and Operating Profit

For the three months and six months ended June 30, 2007 and 2006

The following table summarizes the total revenues and operating profit for each of the segments for the three months and six months ended June 30, 2007 and 2006, as well as IFRS consolidated net income of the Allianz Group.

	Property-Casualty		Life/Health		Banking		Asset Management		Corporate		Consolidation		Group	
	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006
	€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn
Three months ended June 30,														
Total revenues[1)]	**9,982**	**9,682**	**11,758**	**11,931**	**1,850**	**1,706**	**797**	**726**			**(50)**	**22**	**24,337**	**24,067**
Operating profit (loss)	**1,894**	**1,845**	**758**	**527**	**448**	**266**	**325**	**297**	**(10)**	**(74)**	**(127)**	**(67)**	**3,288**	**2,794**
Non-operating items	180	440	15	(17)	39	12	(82)	(134)	(74)	184	(168)	(287)	(90)	198
Income (loss) before income taxes and minority interests in earnings	**2,074**	**2,285**	**773**	**510**	**487**	**278**	**243**	**163**	**(84)**	**110**	**(295)**	**(354)**	**3,198**	**2,992**
Income taxes	(578)	(466)	(234)	(90)	(56)	(89)	(101)	(62)	80	80	31	270	(858)	(357)
Minority interests in earnings	(116)	(237)	(60)	(92)	(20)	(27)	(8)	(11)	(4)	(7)	8	18	(200)	(356)
Net income (loss)	**1,380**	**1,582**	**479**	**328**	**411**	**162**	**134**	**90**	**(8)**	**183**	**(256)**	**(66)**	**2,140**	**2,279**
Six months ended June 30,														
Total revenues[1)]	**24,093**	**23,831**	**24,084**	**24,753**	**3,951**	**3,654**	**1,577**	**1,477**			**(45)**	**(7)**	**53,660**	**53,708**
Operating profit (loss)	**3,161**	**3,231**	**1,508**	**1,250**	**1,148**	**813**	**637**	**601**	**(111)**	**(254)**	**(185)**	**(170)**	**6,158**	**5,471**
Non-operating items	844	868	118	141	156	404	(204)	(270)	437	(27)	245	(564)	1,596	552
Income (loss) before income taxes and minority interests in earnings	**4,005**	**4,099**	**1,626**	**1,391**	**1,304**	**1,217**	**433**	**331**	**326**	**(281)**	**60**	**(734)**	**7,754**	**6,023**
Income taxes	(1,115)	(990)	(435)	(309)	(224)	(334)	(181)	(127)	55	234	75	270	(1,825)	(1,256)
Minority interests in earnings	(330)	(427)	(159)	(220)	(44)	(55)	(19)	(24)	(8)	(9)	11	26	(549)	(709)
Net income (loss)	**2,560**	**2,682**	**1,032**	**862**	**1,036**	**828**	**233**	**180**	**373**	**(56)**	**146**	**(438)**	**5,380**	**4,058**

[1] Total revenues comprise Property-Casualty segment s gross premiums written, Life/Health segment s statutory premiums, Banking segment s operating revenues and Asset Management segment s operating revenues.

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Property-Casualty Segment

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
	€mn	€mn	€mn	€mn
Gross premiums written[1]	**9,982**	**9,682**	**24,093**	**23,831**
Ceded premiums written	(1,245)	(1,230)	(2,831)	(2,942)
Change in unearned premiums	919	906	(2,248)	(2,190)
Premiums earned (net)	**9,656**	**9,358**	**19,014**	**18,699**
Interest and similar income	1,380	1,257	2,386	2,179
Income from financial assets and liabilities designated at fair value through income (net)[2]	39	6	71	42
Income from financial assets and liabilities held for trading (net), shared with policyholder[2]	(40)		(55)	
Realized gains/losses (net) from investments, shared with policyholders[3]	1	11	35	36
Fee and commission income	280	265	552	517
Other income	11	24	95	38
Operating revenues	**11,327**	**10,921**	**22,098**	**21,511**
Claims and insurance benefits incurred (net)	(6,266)	(6,090)	(12,649)	(12,272)
Changes in reserves for insurance and investment contracts (net)	(97)	(121)	(178)	(193)
Interest expense	(92)	(66)	(184)	(129)
Loan loss provisions	(9)	(2)	(9)	(3)
Impairments of investments (net), shared with policyholders[4]	(5)	(13)	(7)	(17)
Investment expenses	(69)	(67)	(143)	(115)
Acquisition and administrative expenses (net)	(2,705)	(2,511)	(5,380)	(5,174)
Fee and commission expenses	(190)	(205)	(387)	(375)
Other expenses		(1)		(2)
Operating expenses	**(9,433)**	**(9,076)**	**(18,937)**	**(18,280)**
Operating profit	**1,894**	**1,845**	**3,161**	**3,231**
Income from financial assets and liabilities held for trading (net), not shared with policyholders[2]	(1)	(1)	(30)	3
Realized gains/losses (net) from investments, not shared with policyholders[3]	216	878	949	1,317
Impairments of investments (net), not shared with policyholders[4]	(23)	(80)	(47)	(89)
Amortization of intangible assets	(4)	(3)	(6)	(7)
Restructuring charges	(8)	(354)	(22)	(356)
Non-operating items	**180**	**440**	**844**	**868**
Income before income taxes and minority interests in earnings	**2,074**	**2,285**	**4,005**	**4,099**
Income taxes	(578)	(466)	(1,115)	(990)
Minority interests in earnings	(116)	(237)	(330)	(427)
Net income	**1,380**	**1,582**	**2,560**	**2,682**
Loss ratio[5] in %	64.9	65.1	66.5	65.6
Expense ratio[6] in %	28.0	26.8	28.3	27.7
Combined ratio[7] in %	**92.9**	**91.9**	**94.8**	**93.3**

[1] For the Property-Casualty segment, total revenues are measured based upon gross premiums written.

[2]

The total of these items equals income from financial assets and liabilities carried at fair value through income (net) in the segment income statement.

[3] The total of these items equals realized gains/losses (net) in the segment income statement.

[4] The total of these items equals impairments of investments (net) in the segment income statement.

[5] Represents claims and insurance benefits incurred (net) divided by premiums earned (net).

[6] Represents acquisition and administrative expenses (net) divided by premiums earned (net).

[7] Represents the total of acquisition and administrative expenses (net) and claims and insurance benefits incurred (net) divided by premiums earned (net).

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Life/Health Segment

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
	mn	mn	mn	mn
Statutory premiums[1]	**11,758**	**11,931**	**24,084**	**24,753**
Ceded premiums written	(186)	(213)	(379)	(409)
Change in unearned premiums	3	(76)	(24)	(151)
Statutory premiums (net)	11,575	11,642	23,681	24,193
Deposits from SFAS 97 insurance and investment contracts	(6,892)	(6,874)	(13,813)	(14,346)
Premiums earned (net)	**4,683**	**4,768**	**9,868**	**9,847**
Interest and similar income	3,783	3,698	6,938	6,745
Income from financial assets and liabilities carried at fair value through income (net), shared with policyholders[2]	(668)	(216)	(979)	(185)
Realized gains/losses (net) from investments, shared with policyholders[3]	646	947	1,734	2,050
Fee and commission income	164	162	335	291
Other income	9	7	63	13
Operating revenues	**8,617**	**9,366**	**17,959**	**18,761**
Claims and insurance benefits incurred (net)	(4,158)	(4,103)	(8,860)	(8,796)
Changes in reserves for insurance and investment contracts (net)	(2,211)	(2,950)	(4,835)	(5,598)
Interest expense	(111)	(73)	(202)	(137)
Loan loss provisions		1	(3)	1
Impairments of investments (net), shared with policyholders	(56)	(210)	(93)	(245)
Investment expenses	(163)	(211)	(359)	(368)
Acquisition and administrative expenses (net)	(1,115)	(1,105)	(1,989)	(2,130)
Fee and commission expenses	(43)	(70)	(105)	(120)
Operating restructuring charges[4]	(2)	(118)	(5)	(118)
Operating expenses	**(7,859)**	**(8,839)**	**(16,451)**	**(17,511)**
Operating profit	**758**	**527**	**1,508**	**1,250**
Income from financial assets and liabilities carried at fair value through income (net), not shared with policyholders[2]	(1)			
Realized gains/losses (net) from investments, not shared with policyholders[3]	17	27	122	186
Amortization of intangible assets		(1)	(1)	(2)
Non-operating restructuring charges[4]	(1)	(43)	(3)	(43)
Non-operating items	**15**	**(17)**	**118**	**141**
Income before income taxes and minority interests in earnings	**773**	**510**	**1,626**	**1,391**
Income taxes	(234)	(90)	(435)	(309)
Minority interests in earnings	(60)	(92)	(159)	(220)
Net income	**479**	**328**	**1,032**	**862**
Statutory expense ratio[5] in %	**9.6**	**9.5**	**8.4**	**8.8**

[1] For the Life/Health segment, total revenues are measured based upon statutory premiums. Statutory premiums are gross premiums written from sales of life 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.

[2]

The total of these items equals income from financial assets and liabilities carried at fair value through income (net) in the segment income statement.

[3] The total of these items equals realized gains/losses (net) in the segment income statement.

[4] The total of these items equals restructuring charges in the segment income statement.

[5] Represents acquisition and administrative expenses (net) divided by statutory premiums (net).

Banking Segment

	Three months ended June 30,				Six months ended June 30,			
	2007		2006		2007		2006	
	Banking Segment	Dresdner Bank	Banking Segment	Dresdner Bank[1]	Banking Segment	Dresdner Bank	Banking Segment	Dresdner Bank[1]
	€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn
Net interest income[2]	730	701	652	631	1,658	1,601	1,253	1,209
Net fee and commission income[3]	766	718	728	680	1,598	1,507	1,560	1,473
Trading income (net)[4]	338	335	308	300	689	680	795	784
Income from financial assets and liabilities designated at fair value through income (net)[4]	16	16	18	18	6	5	21	21
Other income				(1)			25	25
Operating revenues[5]	**1,850**	**1,770**	**1,706**	**1,628**	**3,951**	**3,793**	**3,654**	**3,512**
Administrative expenses	(1,334)	(1,277)	(1,436)	(1,386)	(2,744)	(2,632)	(2,864)	(2,767)
Investment expenses	(4)	(5)	(10)	(12)	(13)	(16)	(16)	(19)
Other expenses	1	1	13	13	14	14	13	13
Operating expenses	**(1,337)**	**(1,281)**	**(1,433)**	**(1,385)**	**(2,743)**	**(2,634)**	**(2,867)**	**(2,773)**
Loan loss provisions	(65)	(62)	(7)	(5)	(60)	(55)	26	28
Operating profit	**448**	**427**	**266**	**238**	**1,148**	**1,104**	**813**	**767**
Realized gains/losses (net)	51	43	32	30	190	180	446	444
Impairments of investments (net)	(9)	(9)	(12)	(12)	(22)	(22)	(32)	(32)
Amortization of intangible assets			(1)				(1)	
Restructuring charges	(3)	(4)	(7)	(6)	(12)	(13)	(9)	(8)
Non-operating items	**39**	**30**	**12**	**12**	**156**	**145**	**404**	**404**
Income before income taxes and minority interests in earnings	**487**	**457**	**278**	**250**	**1,304**	**1,249**	**1,217**	**1,171**
Income taxes	(56)	(44)	(89)	(80)	(224)	(202)	(334)	(318)
Minority interests in earnings	(20)	(18)	(27)	(21)	(44)	(40)	(55)	(46)
Net income	**411**	**395**	**162**	**149**	**1,036**	**1,007**	**828**	**807**
Cost-income ratio[6] in %	**72.3**	**72.4**	**84.0**	**85.1**	**69.4**	**69.4**	**78.5**	**79.0**

[1] We have restated the presentation of revenues and operating profit stemming from trades in shares of Allianz SE and its affiliates. From 2007 onwards, these results are eliminated on Dresdner Bank level, whereas in 2006 they were adjusted on segment level only.

[2] Represents interest and similar income less interest expense.

[3] Represents fee and commission income less fee and commission expense.

[4] The total of these items equals income from financial assets and liabilities carried at fair value through income (net) in the segment income statement.

[5] For the Banking segment, total revenues are measured based upon operating revenues.

[6] Represents operating expenses divided by operating revenues.

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Asset Management Segment

	Three months ended June 30,				Six months ended June 30,			
	2007		2006		2007		2006	
	Asset Management Segment	Allianz Global Investors	Asset Management Segment	Allianz Global Investors	Asset Management Segment	Allianz Global Investors	Asset Management Segment	Allianz Global Investors
	€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn
Net fee and commission income[1)]	765	743	712	701	1,511	1,471	1,429	1,405
Net interest income[2)]	13	17	13	15	36	36	30	29
Income from financial assets and liabilities carried at fair value through income (net)	16	15	(2)	(2)	23	22	12	12
Other income	3	3	3	3	7	7	6	6
Operating revenues[3)]	**797**	**778**	**726**	**717**	**1,577**	**1,536**	**1,477**	**1,452**
Administrative expenses, excluding acquisition-related expenses[4)]	(472)	(464)	(429)	(422)	(940)	(918)	(876)	(857)
Operating expenses	**(472)**	**(464)**	**(429)**	**(422)**	**(940)**	**(918)**	**(876)**	**(857)**
Operating profit	**325**	**314**	**297**	**295**	**637**	**618**	**601**	**595**
Realized gains/losses (net)	1	1	(1)	(1)	3	3	1	
Impairments of investments (net)			(1)				(1)	
Acquisition-related expenses, thereof[4)]								
Deferred purchases of interests in PIMCO	(80)	(80)	(130)	(130)	(202)	(202)	(266)	(266)
Other acquisition-related expenses[5)]	(3)	(3)	(2)	(2)	(3)	(3)	(4)	(4)
Subtotal	**(83)**	**(83)**	**(132)**	**(132)**	**(205)**	**(205)**	**(270)**	**(270)**
Restructuring charges					(2)	(2)		
Non-operating items	**(82)**	**(82)**	**(134)**	**(133)**	**(204)**	**(204)**	**(270)**	**(270)**

Income before income taxes and minority interests in earnings	**243**	**232**	**163**	**162**	**433**	**414**	**331**	**325**
Income taxes	(101)	(100)	(62)	(62)	(181)	(179)	(127)	(126)
Minority interests in earnings	(8)	(6)	(11)	(10)	(19)	(16)	(24)	(22)
Net income	**134**	**126**	**90**	**90**	**233**	**219**	**180**	**177**
Cost-income ratio[6] in %	**59.2**	**59.6**	**59.1**	**58.9**	**59.6**	**59.8**	**59.3**	**59.0**

[1] Represents fee and commission income less fee and commission expense.
[2] Represents interest and similar income less interest expense and investment expenses.
[3] For the Asset Management segment, total revenues are measured based upon operating revenues.
[4] The total of these items equals acquisition and administration expenses (net) in the segment income statement.
[5] Consists of retention payments for the management and employees of PIMCO and Nicholas Applegate.
[6] Represents operating expenses divided by operating revenues.

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Corporate Segment

	Three months ended June 30, 2007	2006	Six months ended June 30, 2007	2006
	€mn	€mn	€mn	€mn
Interest and similar income	245	215	399	301
Income from financial assets and liabilities designated at fair value through income (net)[1]	4		5	
Operating income from financial assets and liabilities held of trading (net)[1]	35		35	
Fee and commission income	44	38	89	79
Other income	9	4	14	17
Income from fully consolidated private equity investments	470	169	941	328
Operating revenues	**807**	**426**	**1,483**	**725**
Interest expense, excluding interest expense from external debt[2]	(116)	(127)	(247)	(265)
Investment expenses	(20)	(60)	(54)	(77)
Acquisition and administrative expenses (net), excluding acquisition-related expenses	(199)	(142)	(316)	(281)
Fee and commission expenses	(26)	(19)	(61)	(42)
Expenses from fully consolidated private equity investments	(456)	(152)	(916)	(314)
Operating expenses	**(817)**	**(500)**	**(1,594)**	**(979)**
Operating profit (loss)	**(10)**	**(74)**	**(111)**	**(254)**
Non-operating income from financial assets and liabilities held for trading (net)[1]	(83)	(56)	1	(152)
Realized gains/losses (net)	348	427	988	497
Interest expense from external debt[2]	(278)	(196)	(500)	(394)
Impairments of investments (net)	(9)	9		22
Acquisition-related expenses	(52)		(52)	
Non-operating items	**(74)**	**184**	**437**	**(27)**
Income (loss) before income taxes and minority interests in earnings	**(84)**	**110**	**326**	**(281)**
Income taxes	80	80	55	234
Minority interests in earnings	(4)	(7)	(8)	(9)
Net income (loss)	**(8)**	**183**	**373**	**(56)**

[1] The total of these items equals income from financial assets and liabilities carried at fair value through income (net) in the segment income statement.
[2] The total of these items equals interest expense in the segment income statement.

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Supplementary Information to the Consolidated Balance Sheets

4 Financial assets carried at fair value through income

	As of June 30, 2007 mn	As of December 31, 2006 mn
Financial assets held for trading		
Debt securities	74,065	81,881
Equity securities	42,144	31,266
Derivative financial instruments	28,198	24,835
Subtotal	**144,407**	**137,982**
Financial assets designated at fair value through income		
Debt securities	17,430	14,414
Equity securities	4,231	3,834
Loans to banks and customers	706	639
Subtotal	**22,367**	**18,887**
Total	**166,774**	**156,869**

5 Investments

	As of June 30, 2007 mn	As of December 31, 2006 mn
Available-for-sale investments	274,712	277,898
Held-to-maturity investments	4,680	4,748
Funds held by others under reinsurance contracts assumed	1,038	1,033
Investments in associates and joint ventures	5,176	4,900
Real estate held for investment	7,885	9,555
Total	**293,491**	**298,134**

Available-for-sale investments

	As of June 30, 2007				As of December 31, 2006			
	Amortized cost	Unrealized gains	Unrealized losses	Fair value	Amortized cost	Unrealized gains	Unrealized losses	Fair value
	€mn	€mn	€mn	€mn	€mn	€mn	€mn	€mn
Equity securities	43,034	27,051	(260)	69,825	43,139	26,795	(159)	69,775
Government debt securities	112,041	1,028	(3,031)	110,038	112,893	2,813	(1,077)	114,629
Corporate debt securities	93,950	672	(2,401)	92,221	90,493	1,542	(860)	91,175
Other debt securities	2,621	110	(103)	2,628	2,122	215	(18)	2,319
Total	**251,646**	**28,861**	**(5,795)**	**274,712**	**248,647**	**31,365**	**(2,114)**	**277,898**

6 Loans and advances to banks and customers

	As of June 30, 2007			As of December 31, 2006		
	Banks	Customers	Total	Banks	Customers	Total
	€mn	€mn	€mn	€mn	€mn	€mn
Short-term investments and certificates of deposit	8,066		8,066	6,775		6,775
Reverse repurchase agreements	89,858	67,362	157,220	86,957	52,456	139,413
Collateral paid for securities borrowing transactions	30,371	34,166	64,537	17,612	23,419	41,031
Loans	71,657	126,625	198,282	69,211	129,319	198,530
Other advances	12,154	13,779	25,933	15,225	8,358	23,583
Subtotal	**212,106**	**241,932**	**454,038**	**195,780**	**213,552**	**409,332**
Loan loss allowance	(107)	(970)	(1,077)	(108)	(946)	(1,054)
Total	**211,999**	**240,962**	**452,961**	**195,672**	**212,606**	**408,278**

Loans and advances to customers by type of customer

	As of June 30, 2007	As of December 31, 2006
	mn	mn
Corporate customers	172,166	146,750
Private customers	58,968	59,505
Public authorities	10,798	7,297
Subtotal	**241,932**	**213,552**
Loan loss allowance	(970)	(946)
Total	**240,962**	**212,606**

7 Reinsurance assets

	As of June 30, 2007	As of December 31, 2006
	mn	mn
Unearned premiums	1,749	1,317
Reserves for loss and loss adjustment expenses	9,354	9,719
Aggregate policy reserves	6,847	8,223
Other insurance reserves	62	101
Total	**18,012**	**19,360**

8 Deferred acquisition costs

	As of June 30, 2007	As of December 31, 2006
	mn	mn
Deferred acquisition costs		
Property-Casualty	3,992	3,692
Life/Health	14,487	13,619
Asset Management	53	50
Subtotal	**18,532**	**17,361**
Present value of future profits	**1,275**	**1,227**
Deferred sales inducements	**594**	**547**
Total	**20,401**	**19,135**

9 Other assets

	As of June 30, 2007	As of December 31, 2006
	mn	mn
Receivables		
Policyholders	4,351	4,292
Agents	4,188	3,698
Reinsurers	2,105	2,832
Other	6,099	6,283
Less allowance for doubtful accounts	(358)	(330)
Subtotal	**16,385**	**16,775**
Tax receivables		
Income tax	1,736	1,995
Other tax	779	690
Subtotal	**2,515**	**2,685**
Accrued dividends, interest and rent	**5,958**	**5,658**
Prepaid expenses		
Interest and rent	3,620	2,678
Other prepaid expenses	183	173
Subtotal	**3,803**	**2,851**
Derivative financial instruments used for hedging that meet the criteria for hedge accounting and firm commitments	**362**	**463**
Property and equipment		
Real estate held for use	3,796	4,758
Equipment	1,616	1,597
Software	1,092	1,078
Subtotal	**6,504**	**7,433**
Non-current assets and disposal groups held for sale	**2,717**	
Other assets[1)]	**3,186**	**3,028**
Total	**41,430**	**38,893**

[1)] As of June 30, 2007, includes prepaid benefit costs for defined benefit plans of 305 mn.

Non-current assets and disposal groups held for sale as of June 30, 2007 consists primarily of real estate held for investment and real estate held for use in Germany. Much of the real estate held for use is expected to be disposed of through sale-leaseback transactions.

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10 Intangible assets

	As of June 30, 2007	As of December 31, 2006
	mn	mn
Goodwill	12,511	12,007
Brand names	737	717
Other	204	211
Total	**13,452**	**12,935**

Changes in goodwill for the six months ended June 30, 2007, were as follows:

	mn
Cost as of 1/1/2007	12,231
Accumulated impairments as of 1/1/2007	(224)
Carrying amount as of 1/1/2007	**12,007**
Additions	586
Foreign currency translation adjustments	(82)
Carrying amount as of 6/30/2007	**12,511**
Accumulated impairments as of 6/30/2007	224
Cost as of 6/30/2007	12,735

Additions include goodwill from

- increasing the interest in Russian People s Insurance Society, ROSNO , Moscow, from 47.4% to 97.2%,
- the acquisition of 100.0% participation in Insurance Company Progress Garant , Moscow,
- the acquisition of 100.0% participation in United Mercantile Agencies, Inc., Kentucky.

11 Financial liabilities carried at fair value through income

	As of June 30, 2007	As of December 31, 2006
		mn

€mn		
Financial liabilities held for trading		
Obligations to deliver securities	48,928	39,951
Derivative financial instruments	32,954	27,823
Other trading liabilities	13,936	10,988
Subtotal	**95,818**	**78,762**
Financial liabilities designated at fair value through income	**1,043**	**937**
Total	**96,861**	**79,699**

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12 Liabilities to banks and customers

	As of June 30, 2007			As of December 31, 2006		
	Banks	Customers	Total	Banks	Customers	Total
	€mn	€mn	€mn	€mn	€mn	€mn
Payable on demand	18,122	62,312	80,434	18,216	68,677	86,893
Savings deposits		5,310	5,310		5,421	5,421
Term deposits and certificates of deposit	55,552	65,311	120,863	68,429	50,380	118,809
Repurchase agreements	84,656	56,203	140,859	68,189	49,403	117,592
Collateral received from securities lending transactions	24,807	14,775	39,582	19,914	8,703	28,617
Other	8,017	2,945	10,962	876	2,870	3,746
Total	**191,154**	**206,856**	**398,010**	**175,624**	**185,454**	**361,078**

13 Reserves for loss and loss adjustment expenses

	As of June 30, 2007	As of December 31, 2006
	€mn	€mn
Property-Casualty	57,966	58,664
Life/Health	6,857	6,804
Consolidation	1	(4)
Total	**64,824**	**65,464**

Changes in the reserves for loss and loss adjustment expenses for the Property-Casualty segment for the six months ended June 30, 2007 and 2006, are as follows:

	2007			2006		
	Gross	Ceded	Net	Gross	Ceded	Net
	€mn	€mn	€mn	€mn	€mn	€mn
Reserves for loss and loss adjustment expenses as of 1/1/	**58,664**	**(9,333)**	**49,331**	**60,259**	**(10,604)**	**49,655**
Loss and loss adjustment expenses incurred						
Current year	15,114	(1,822)	13,292	14,362	(1,487)	12,875
Prior years	(847)	204	(643)	(840)	237	(603)

Subtotal	**14,267**	**(1,618)**	**12,649**	**13,522**	**(1,250)**	**12,272**
Loss and loss adjustment expenses paid						
Current year	(5,086)	402	(4,684)	(4,464)	170	(4,294)
Prior years	(9,384)	1,199	(8,185)	(9,066)	1,338	(7,728)
Subtotal	**(14,470)**	**1,601**	**(12,869)**	**(13,530)**	**1,508**	**(12,022)**
Foreign currency translation adjustments and other	**(617)**	**358**	**(259)**	**(1,299)**	**398**	**(901)**
Changes in the consolidated subsidiaries of the Allianz Group	**122**	**(14)**	**108**			
Reserves for loss and loss adjustment expenses as of 6/30/	**57,966**	**(9,006)**	**48,960**	**58,952**	**(9,948)**	**49,004**

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14 Reserves for insurance and investment contracts

	As of June 30, 2007	As of December 31, 2006
	mn	mn
Aggregate policy reserves	259,892	256,333
Reserves for premium refunds	29,623	30,689
Other insurance reserves	761	675
Total	**290,276**	**287,697**

15 Other liabilities

	As of June 30, 2007	As of December 31, 2006
	mn	mn
Payables		
Policyholders	4,743	5,322
Reinsurance	2,283	1,868
Agents	1,550	1,494
Subtotal	**8,576**	**8,684**
Payables for social security	**356**	**219**
Tax payables		
Income tax	2,011	2,076
Other	1,064	968
Subtotal	**3,075**	**3,044**
Accrued interest and rent	**883**	**793**
Unearned income		
Interest and rent	3,476	2,645
Other	173	279
Subtotal	**3,649**	**2,924**
Provisions		
Pensions and similar obligations	4,156	4,120
Employee related	2,654	3,120
Share-based compensation	1,866	1,898
Restructuring plans	684	887
Loan commitments	243	261
Other provisions	1,849	1,943
Subtotal	**11,452**	**12,229**
Deposits retained for reinsurance ceded	**4,450**	**5,716**
Derivative financial instruments used for hedging purposes that meet the criteria for hedge accounting and firm commitments	**1,168**	**907**
Financial liabilities for puttable equity instruments	**4,226**	**3,750**
Disposal groups held for sale	**314**	
Other liabilities	**10,947**	**11,498**
Total	**49,096**	**49,764**

16 Certificated liabilities

	As of June 30, 2007	As of December 31, 2006
	mn	mn
Allianz SE1)		
Senior bonds	6,496	6,195
Exchangeable bonds	450	1,262
Money market securities	1,613	870
Subtotal	**8,559**	**8,327**
Banking subsidiaries		
Senior bonds	20,665	23,337
Money market securities	26,491	22,655

1,970	$ -	$ -	$ 1,970	
Obligations of U.S. Government agencies	-	11,751	-	11,751
Obligations of state and political subdivisions	-	56,857	-	56,857
Corporate debt securities	-	1,001	-	1,001
Trust Preferred Securities	-	5,051	-	5,051
Agency mortgage-backed securities	-	81,027	-	81,027
Private-label mortgage-backed securities	-	1,969	-	1,969
Asset-backed securities	-	48	-	48
Total assets	$ 1,970	$ 157,704	$ -	$ 159,674
Liability Description				
Interest rate swaps	$ -	$ 561	$ -	$ 561
Total liabilities	$ -	$ 561	$ -	$ 561

The Corporation used the following methods and significant assumptions to estimate the fair values for financial assets measured at fair value on a recurring basis.

Investment securities: Level 1 securities represent equity securities that are valued using quoted market prices from nationally recognized markets. Level 2 securities represent debt securities that are valued using a mathematical model based upon the specific characteristics of a security in relationship to quoted prices for similar securities.

Interest rate swaps: The interest rate swaps are valued using a discounted cash flow model that uses verifiable market environment inputs to calculate the fair value. This method is not dependent on the input of any significant judgments or assumptions by Management.

Nonrecurring Fair Value Measurements

For financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2014 and December 31, 2013 are as follows:

(Dollars in Thousands)

	Fair Value at September 30, 2014			
Asset Description	Level 1	Level 2	Level 3	Total
Impaired loans (1)	$ -	$ -	$ 3,083	$ 3,083
Other real estate owned (1)	-	-	538	538
Mortgage servicing rights	-	-	172	172
Total assets	$ -	$ -	$ 3,793	$ 3,793

(Dollars in Thousands)	Fair Value at December 31, 2013			
Asset Description	Level 1	Level 2	Level 3	Total
Impaired loans (1)	$ -	$ -	$ 8,588	$ 8,588
Other real estate owned (1)	-	-	498	498
Mortgage servicing rights	-	-	184	184
Total assets	$ -	$ -	$ 9,270	$ 9,270

(1) Includes assets directly charged-down to fair value during the year-to-date period.

The Corporation used the following methods and significant assumptions to estimate the fair values for financial assets measured at fair value on a nonrecurring basis.

Impaired loans: Impaired loans are reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 3 inputs based on customized discounting criteria.

Other real estate: The fair value of other real estate, upon initial recognition, is estimated using Level 2 inputs within the fair value hierarchy based on observable market data and Level 3 inputs based on customized discounting criteria. In connection with the measurement and initial recognition of the foregoing assets, the Corporation recognizes charge-offs through the allowance for loan losses. Subsequent charge-offs are recognized as an expense.

Mortgage servicing rights: The fair value of mortgage servicing rights, upon initial recognition, is estimated using a valuation model that calculates the present value of estimated future net servicing income. The model incorporates Level 3 assumptions such as cost to service, discount rate, prepayment speeds, default rates and losses.

The Corporation did not record any liabilities at fair value for which measurement of the fair value was made on a nonrecurring basis at September 30, 2014. For financial assets and liabilities measured at fair value on a recurring basis, there were no transfers of financial assets or liabilities between Level 1 and Level 2 during the period ending September 30, 2014.

The following table presents additional quantitative information about Level 3 assets measured at fair value on a nonrecurring basis:

(Dollars in Thousands)	Quantitative Information about Level 3 Fair Value Measurements at September 30, 2014			
Asset Description	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted Average)
Impaired loans (1)	$ 3,083	Appraisal	Appraisal Adjustments (2)	0% - 100% (22.93%)
			Cost to sell	0% - 10% (5.52%)
Other real estate owned (1)	538	Appraisal	Appraisal Adjustments (2)	
			Cost to sell	8% (8%)
Mortgage servicing rights	172	Discounted Cash Flow (3)		
	at December 31, 2013			
Impaired loans (1)	$ 8,588	Appraisal	Appraisal Adjustments (2)	0% - 60% (5%)
			Cost to sell	5% - 13.5% (7%)
Other real estate owned (1)	498	Appraisal	Appraisal Adjustments (2)	
			Cost to sell	8% (8%)
Mortgage servicing rights	184	Discounted Cash Flow (3)		

(1) Includes assets directly charged-down to fair value during the year-to-date period.
(2) Qualitative adjustments are discounts specific to each asset and are made as needed.
(3) Valuation and inputs are determined by a third-party pricing service without adjustment.

Note 10. Financial Derivatives

The Board of Directors has given Management authorization to enter into additional derivative activity including interest rate swaps, caps and floors, forward-rate agreements, options and futures contracts in order to hedge interest rate risk. The Bank is exposed to credit risk equal to the positive fair value of a derivative instrument, if any, as a positive fair value indicates that the counterparty to the agreement is financially liable to the Bank. To limit this risk, counterparties must have an investment grade long-term debt rating and individual counterparty credit exposure is limited by Board approved parameters. Management anticipates continuing to use derivatives, as permitted by its Board-approved policy, to manage interest rate risk.

Information regarding the interest rate swaps as of September 30, 2014 follows:

(Dollars in thousands)				Amount Expected to be Expensed into
Notional	Maturity	Interest Rate		Earnings within the
Amount	Date	Fixed	Variable	next 12 Months
$ 10,000	5/30/2015	3.87%	0.02%	$ 257

Fair Value of Derivative Instruments in the Consolidated Balance Sheets were as follows as of September 30, 2014 and December 31, 2013:

Fair Value of Derivative Instruments (Dollars in thousands)		Balance Sheet	
			Fair
Date	Type	Location	Value
September 30, 2014	Interest rate contracts	Other liabilities	$ 286
December 31, 2013	Interest rate contracts	Other liabilities	$ 561

The Effect of Derivative Instruments on the Statement of Income for the Three and Nine Months Ended September 30, 2014 and 2013 follows:

Derivatives in ASC Topic 815 Cash Flow Hedging Relationships

(Dollars in thousands)

Date / Type	Amount of Gain or (Loss) Recognized in OCI net of tax on Derivative (Effective Portion)	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain or (Loss) Recognized in Income on Derivatives (Ineffective Portion and Amount Excluded from Effectiveness Testing)
Interest rate contracts					
Three months ended:					
September 30, 2014	$ 64	Interest Expense	$ (96)	Other income (expense)	$ -
September 30, 2013	$ 51	Interest Expense	$ (97)	Other income (expense)	$ -
Nine months ended:					
September 30, 2014	$ 181	Interest Expense	$ (285)	Other income (expense)	$ -
September 30, 2013	$ 299	Interest Expense	$ (429)	Other income (expense)	$ -

Interest Rate Swap Agreements ("Swap Agreements")

The Bank has entered into interest rate swap agreements as part of its asset/liability management program. The swap agreements are free-standing derivatives and are recorded at fair value in the Corporation's consolidated statements of condition. The Bank is party to master netting arrangements with its financial institution counterparties; however, the Bank does not offset assets and liabilities under these arrangements for financial statement presentation purposes. The master netting arrangements provide for a single net settlement of all swap agreements, as well as collateral, in the event of default on, or termination of, any one contract. Collateral, in the form of marketable securities, is posted by the counterparty with net liability positions in accordance with contract thresholds.

Securities Sold Under Agreements to Repurchase ("Repurchase Agreements")

The Bank enters into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities. Under these arrangements, the Bank may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Bank to repurchase the agreements. As a result, these repurchase agreements are accounted for as collateralized financing arrangements (i.e., secured borrowings) and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability in the Corporation's consolidated statements of condition, while the securities underlying the repurchase agreements remain in the respective investment securities asset accounts. In other words, there is no offsetting or netting of the investment securities assets with the repurchase agreement liabilities. In addition, as the Bank does not enter into reverse repurchase agreements, there is no such offsetting to be done with repurchase agreements.

The following table presents the liabilities subject to an enforceable master netting arrangement or repurchase agreements as of September 30, 2014 and December 31, 2013. As of these dates, all of the Bank's swap agreement with an institutional counterparty was in a liability position. Therefore, there were no assets to be recognized in the consolidated statements of condition. The Bank has no swap agreements with our commercial banking customers.

(Dollars in thousands)	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statements of Condition	Net Amounts of Liabilities Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition: Financial Instruments	Cash Collateral Pledged	Net Amount
Interest Rate Swap Agreements						
September 30, 2014	$ 286	$ -	$ 286	$ 286	$ -	$ -
December 31, 2013	$ 561	$ -	$ 561	$ 561	$ -	$ -

1Note 11. Reclassification

Certain prior period amounts may have been reclassified to conform to the current year presentation. Such reclassifications did not affect the Corporation's financial position or results of operations.

Note 12. Subsequent Events

On October 27, 2014, the Bank announced the consolidation of several community banking offices. On January 21, 2015, the Bank will consolidate the Warfordsburg and Penns Village offices with the McConnellsburg Office in

Fulton County and the St. Thomas office with the West Side Office in Franklin County.

On October 30, 2014, S&T Bancorp Inc. agreed to acquire Integrity Bancshares Inc. (Integrity). The Bank owns shares of Integrity and expects to recognize a pre-tax gain of approximately $628,000, based on the terms of the agreement, upon completion of this transaction in the first quarter of 2015.

These subsequent events did not have an effect on the Corporation's third quarter financial statements.

Management's Discussion and Analysis of Results of Operations and Financial Condition

For the Three and Nine Months Ended September 30, 2014 and 2013

Forward Looking Statements

Certain statements appearing herein which are not historical in nature are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements refer to a future period or periods, reflecting management's current views as to likely future developments, and use words such as "may," "will," "expect," "believe," "estimate," "anticipate," or similar terms. Because forward-looking statements involve certain risk uncertainties and other factors over which the Corporation has no direct control, actual results could differ materially from those contemplated in such statements. These factors include (but are not limited to) the following: general economic conditions, changes in interest rates, changes in the Corporation's cost of funds, changes in government monetary policy, changes in government regulation and taxation of financial institutions, changes in the rate of inflation, changes in technology, the intensification of competition within the Corporation's market area, and other similar factors.

Critical Accounting Policies

Management has identified critical accounting policies for the Corporation to include Allowance for Loan Losses, Mortgage Servicing Rights, Financial Derivatives, Temporary Investment Impairment and Stock-based Compensation. There were no changes to the critical accounting policies disclosed in the 2013 Annual Report on Form 10-K in regards to application or related judgments and estimates used. Please refer to Item 7 of the Corporation's 2013 Annual Report on Form 10-K for a more detailed disclosure of the critical accounting policies.

Results of Operations

Year-to-Date Summary

At September 30, 2014, total assets were $1.023 billion, an increase of $38.2 million from December 31, 2013. Net loans increased to $721.7 million and total deposits increased to $898.9 million. The Corporation reported net income for the first nine months of 2014 of $6.6 million. This is a 28.8% increase versus net income of $5.1 million for the same period in 2013. Total revenue (interest income and noninterest income) decreased $33 thousand year-over-year. Interest income decreased $754 thousand, while interest expense decreased by $1.0 million, resulting in a $282 thousand increase in net interest income. The provision for loan losses was $464 thousand for the period, $1.5 million less than in 2013. Noninterest income increased $721 thousand, while noninterest expense increased $460 thousand. Income tax expense increased from $1.1 million in 2013 to $1.7 million in 2014. The effective tax rate increased from 17.6% in 2013 to 20.2% in 2014 due to tax exempt income comprising a less significant amount of income before federal income taxes. Diluted earnings per share increased to $1.56 in 2014 from $1.23 in 2013.

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Key performance ratios as of, or for the nine months ended September 30, 2014 and 2013 are listed below:

	September 30,	
	2014	2013
Performance measurements		
Return on average assets*	0.86%	0.66%
Return on average equity*	8.90%	7.37%
Return on average tangible assets (1)*	0.89%	0.69%
Return on average tangible equity (1)*	10.15%	8.58%
Efficiency ratio (1)	69.86%	70.70%
Net interest margin*	3.56%	3.40%
Current dividend yield*	3.24%	4.26%
Dividend payout ratio	32.52%	41.31%
Shareholders' Value (per common share)		
Diluted earnings per share	$ 1.56	$ 1.23
Basic earnings per share	1.57	1.23
Regular cash dividends paid	0.51	0.51
Book value	24.30	22.51
Tangible book value (1)	22.06	20.14
Market value	21.00	15.95
Market value/book value ratio	86.42%	70.86%
Price/earnings multiple*	10.10	9.73
Safety and Soundness		
Risk-based capital ratio (Total)	15.04%	13.92%
Leverage ratio (Tier 1)	9.51%	8.90%
Common equity ratio	9.98%	9.31%
Tangible common equity ratio (1)	9.15%	8.41%
Nonperforming loans/gross loans	2.59%	4.00%
Nonperforming assets/total assets	2.21%	3.35%
Allowance for loan losses as a % of loans	1.22%	1.58%
Net charge-offs/average loans*	0.22%	0.17%
Trust assets under management (fair value)	$ 594,046	$ 560,940

* Annualized
(1) See GAAP versus Non-GAAP disclosures that follow

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GAAP versus Non-GAAP Disclosure – The Corporation supplements its traditional GAAP measurements with Non-GAAP measurements. The Non-GAAP measurements include Return on Average Tangible Assets, Return on Average Tangible Equity, Tangible Book Value and Tangible Common Equity ratio. As a result of merger transactions, intangible assets (primarily goodwill, core deposit intangibles and customer list) were created. The Non-GAAP disclosures are intended to eliminate the effects of the intangible assets and allow for better comparisons to periods when such assets did not exist. However, not all companies use the same calculation methods for the same non-GAAP measurements and therefore may not be comparable. The following table shows the adjustments made between the GAAP and NON-GAAP measurements:

GAAP Measurement	Calculation
Return on Average Assets	Net Income / Average Assets
Return on Average Equity	Net Income / Average Equity
Book Value	Total Shareholders' Equity / Shares Outstanding
Common Equity Ratio	Total Shareholders' Equity / Total Assets
Non- GAAP Measurement	Calculation
Return on Average Tangible Assets	Net Income plus Intangible Amortization (net of tax) / Average Assets less Average Intangible Assets
Return on Average Tangible Equity	Net Income plus Intangible Amortization (net of tax) / Average Equity less Average Intangible Assets
Tangible Book Value	Total Shareholders' Equity less Intangible Assets / Shares outstanding
Tangible Common Equity Ratio	Total Shareholders' Equity less Intangible Assets / Total Assets less Intangible Assets
Efficiency Ratio	Noninterest expense / tax equivalent net interest income plus noninterest income less net securities gains or losses

Comparison of the three months ended September 30, 2014 to the three months ended September 30, 2013:

Net Interest Income

The most important source of the Corporation's earnings is net interest income, which is defined as the difference between income on interest-earning assets and the expense of interest-bearing liabilities supporting those assets. Principal categories of interest-earning assets are loans and securities, while deposits, securities sold under agreements to repurchase (Repos), short-term borrowings and long-term debt are the principal categories of interest-bearing liabilities. Demand deposits enhance net interest income because they are noninterest-bearing deposits. For the purpose of this discussion, balance sheet items refer to the average balance for the year and net interest income is adjusted to a fully taxable-equivalent basis. This tax-equivalent adjustment facilitates performance comparisons between taxable and tax-free assets by increasing the tax-free income by an amount equivalent to the Federal income taxes that would have been paid if this income were taxable at the Corporation's 34% Federal statutory rate.

Tax equivalent net interest income for the third quarter of 2014 increased $156 thousand quarter over quarter. Average interest-earning assets increased $4.9 million from 2013, but the yield on these assets decreased by 2 basis points. The average balance of investment securities increased $16.9 million while average loans increased $7.4 million quarter over quarter. Average commercial loans increased $4.5 million and average mortgage loans increased $3.0 million. The average balance of consumer loans, including home equity loans, decreased slightly, by $181 thousand.

Interest expense was $799 thousand for the third quarter, a decrease of $146 thousand from the 2013 total of $945 thousand. Average interest-bearing liabilities decreased $21.9 million to $779.1 million for 2014 from an average balance of $801.0 million in 2013. The average cost of these liabilities decreased from .47% in 2013 to .41% in 2014. Average interest-bearing deposits decreased $162 thousand and the cost of these deposits decreased from .42% to .35%. Securities sold under agreements to repurchase (Repos) decreased $21.3 million on average over the prior year quarter while the average rate remained constant at .15% in both years. The average balance of long-term debt decreased $405 thousand, due to prepayments and amortizations.

The changes in the balance sheet and interest rates resulted in an increase in tax equivalent net interest income of $156 thousand to $8.5 million in 2014 compared to $8.4 million in 2013. The increase in net interest income was due to a $245 thousand increase from higher volume offset by an $89 thousand decrease due to changes in rates.

The following table presents average balances, tax-equivalent (T/E) interest income, and yields earned or rates paid on the assets or liabilities. All nontaxable interest income has been adjusted to a tax-equivalent basis using a tax rate of 34%.

	For the Three Months Ended September 30,					
	2014			2013		
(Dollars in thousands)	Average balance	Income or expense	Average yield/rate	Average balance	Income or expense	Average yield/rate
Interest-earning assets:						
Interest-bearing obligations of other banks and federal funds sold	$ 40,881	$ 49	0.48%	$ 60,244	$ 49	0.32%
Investment securities:						
Taxable	129,489	689	2.11%	118,863	495	1.65%
Nontaxable	49,160	579	4.71%	42,909	557	5.19%
Loans:						
Commercial, industrial and agricultural	582,296	6,266	4.21%	577,760	6,399	4.31%
Residential mortgage	82,850	856	4.10%	79,827	840	4.17%
Home equity loans and lines	60,243	773	5.09%	58,617	839	5.68%
Consumer	7,658	128	6.63%	9,465	151	6.33%
Loans	733,047	8,023	4.30%	725,669	8,229	4.45%
Total interest-earning assets	952,577	9,340	3.89%	947,685	9,330	3.91%
Other assets	71,324			71,030		
Total assets	$ 1,023,901			$ 1,018,715		
Interest-bearing liabilities:						
Deposits:						
Interest-bearing checking	$ 212,061	62	0.12%	$ 187,111	48	0.10%
Money Management	382,623	418	0.43%	382,620	422	0.44%
Savings	63,559	12	0.08%	61,584	12	0.07%
Time	104,533	187	0.71%	131,623	329	0.99%
Total interest-bearing deposits	762,776	679	0.35%	762,938	811	0.42%
Securities sold under agreements to repurchase	4,370	2	0.15%	25,702	10	0.15%
Long- term debt	12,000	118	3.95%	12,405	124	3.99%
Total interest-bearing liabilities	779,146	799	0.41%	801,045	945	0.47%
Noninterest-bearing deposits	135,574			118,077		
Other liabilities	8,542			7,365		
Shareholders' equity	100,639			92,228		
Total liabilities and shareholders' equity	$ 1,023,901			$ 1,018,715		
T/E net interest income/Net interest margin		8,541	3.56%		8,385	3.51%
Tax equivalent adjustment		(510)			(389)	
Net interest income		$ 8,031			$ 7,996	

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Provision for Loan Losses

For the third quarter of 2014, the Bank recorded net charge-offs of $584 thousand compared to $412 thousand in 2013. Provision expense for the third quarter was $0 and as a result, the allowance for loan losses (ALL) decreased $584 thousand during the quarter. For more information refer to the Loan Quality and Allowance for Loan Losses discussion in the Financial Condition section.

Noninterest Income

For the third quarter of 2014, noninterest income increased $264 thousand from the same period in 2013. Investment and trust service fees decreased due to lower nonrecurring estate fees. Loan service charges increased due to higher commercial letter of credit fees. Mortgage banking fees decreased, as 2014 had lower reversals of previously recorded impairment charges compared to the prior year. Deposit service charges increased due to higher account analysis fees and higher retail and commercial overdraft fees. Other service charges and fees increased primarily due to increases in ATM fees, while debit card income also increased. The net losses in other real estate owned decreased from prior year due to less write downs in 2014. Other than temporary impairment charges were recorded on one bond in 2014 compared to OTTI losses on two bonds in 2013.

The following table presents a comparison of noninterest income for the three months ended September 30, 2014 and 2013:

	For the Three Months Ended September 30		Change	
(Dollars in thousands)	2014	2013	Amount	%
Noninterest Income				
Investment and trust services fees	$ 1,120	$ 1,140	$ (20)	(1.8)
Loan service charges	265	232	33	14.2
Mortgage banking activities	15	18	(3)	(16.7)
Deposit service charges and fees	563	472	91	19.3
Other service charges and fees	317	232	85	36.6
Debit card income	339	315	24	7.6
Increase in cash surrender value of life insurance	139	150	(11)	(7.3)
Other real estate owned	-	(119)	119	100.0
Other	30	89	(59)	(66.3)
OTTI losses recognized in income	(20)	(25)	5	(20.0)
Total noninterest income	$ 2,768	$ 2,504	$ 264	10.5

Noninterest Expense

Noninterest expense for the third quarter of 2014 increased $366 thousand compared to the same period in 2013. The increase in salaries and benefits was primarily due to annual salary adjustments ($148 thousand) and incentive program expense ($128 thousand), but these increases were partially offset by a $73 thousand decrease in pension

expense and a $31 decrease in health insurance expense. Advertising expenses decreased over prior year, due to the timing of various marketing campaigns. Legal and professional fees increased due to the implementation of new corporate initiatives. Bank shares tax expense decreased year over year due to a change by the state of Pennsylvania in the method of calculating the shares tax. Other expenses increased due to prepayment penalties on several FHLB term loans, as well as development costs for a potential community office site.

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The following table presents a comparison of noninterest expense for the three months ended September 30, 2014 and 2013:

(Dollars in thousands)	For the Three Months Ended September 30		Change	
Noninterest Expense	2014	2013	Amount	%
Salaries and benefits	$ 4,191	$ 3,977	$ 214	5.4
Net occupancy expense	555	566	(11)	(1.9)
Furniture and equipment expense	241	239	2	0.8
Advertising	312	386	(74)	(19.2)
Legal and professional fees	361	233	128	54.9
Data processing	471	472	(1)	(0.2)
Pennsylvania bank shares tax	173	204	(31)	(15.2)
Intangible amortization	104	106	(2)	(1.9)
FDIC insurance	236	245	(9)	(3.7)
ATM/debit card processing	188	174	14	8.0
Other	916	780	136	17.4
Total noninterest expense	$ 7,748	$ 7,382	$ 366	5.0

Provision for Income Taxes

For the third quarter of 2014 the Corporation recorded a Federal income tax expense of $641 thousand compared to $583 thousand for the same quarter in 2013. While pretax income was higher in 2014 due primarily to less provision expense, 2014 also had a higher ratio of tax exempt income to pre-tax income. As a result, the effective tax rate remained virtually unchanged at 21.0% for the third quarter of 2014 compared to 21.1% for 2013. All taxable income for the Corporation is taxed at a rate of 34%.

Comparison of the nine months ended September 30, 2014 to the nine months ended September 30, 2013:

Net Interest Income

Tax equivalent net interest income for the first nine months of 2014 increased $570 thousand year over year. Average interest-earning assets decreased $21.5 million from 2013, but the yield on these assets increased by 3 basis points. The average balance of investment securities increased $22.5 million while average loans decreased $7.7 million (1.0%) year over year. Average mortgage loans increased $6.0 million, but the increase was offset by a decrease in the average balance of commercial loans and consumer loans. Average commercial loans decreased $11.3 million, as commercial loans continue to run-off. Average consumer loans, including home equity loans, decreased $2.4 million, as consumers continue to borrow less.

Interest expense was $2.4 million for the first nine months of 2014, a decrease of $1.1 million from the 2013 total of $3.5 million. Average interest-bearing liabilities decreased $39.3 million to $783.8 million for 2014 from an average balance of $823.1 million in 2013. The average cost of these liabilities decreased from .57% in 2013 to .42% in

2014. Average interest-bearing deposits decreased $13.5 million and the cost of these deposits decreased from .53% to .36%. Securities sold under agreements to repurchase (Repos) decreased $25.6 million on average over the prior year quarter while the average rate remained constant at .15% in both years. The average balance of long-term debt decreased $183 thousand, due to prepayments and amortizations.

The changes in the balance sheet and interest rates resulted in an increase in tax equivalent net interest income of $570 thousand to $25.2 million in 2014 compared to $24.6 million in 2013. This increase was due to a $367 thousand increase from higher volume and a $203 thousand increase due to changes in rates.

The Bank's net interest margin increased from 3.40% in 2013 to 3.56% in 2014. The increase in the net interest margin is the result of an increase in the rate on interest-earning assets of 3 basis points, compared to a decrease in the yield on interest-bearing liabilities of 15 basis points.

The following table presents average balances, tax-equivalent (T/E) interest income, and yields earned or rates paid on the assets or liabilities. All nontaxable interest income has been adjusted to a tax-equivalent basis using a tax rate of 34%.

	For the Nine Months Ended September 30, 2014			2013		
(Dollars in thousands)	Average balance	Income or expense	Average yield/rate	Average balance	Income or expense	Average yield/rate
Interest-earning assets:						
Interest-bearing obligations of other banks and federal funds sold	$ 45,303	$ 133	0.39%	$ 81,561	$ 180	0.29%
Investment securities:						
Taxable	125,110	2,047	2.19%	105,842	1,253	1.58%
Nontaxable	45,577	1,680	4.92%	42,362	1,671	5.26%
Loans:						
Commercial, industrial and agricultural	579,503	18,445	4.20%	590,762	19,390	4.31%
Residential mortgage	82,845	2,569	4.15%	76,849	2,511	4.37%
Home equity loans and lines	59,460	2,332	5.24%	59,771	2,607	5.83%
Consumer	7,935	428	7.21%	10,048	488	6.49%
Loans	729,743	23,774	4.31%	737,430	24,996	4.48%
Total interest-earning assets	945,733	27,634	3.91%	967,195	28,100	3.88%
Other assets	71,386			72,473		
Total assets	$ 1,017,119			$ 1,039,668		
Interest-bearing liabilities:						
Deposits:						
Interest-bearing checking	$ 202,394	170	0.11%	$ 168,381	110	0.09%
Money Management	388,386	1,267	0.44%	391,649	1,470	0.50%
Savings	62,741	36	0.08%	60,183	42	0.09%
Time	108,232	603	0.74%	155,022	1,454	1.25%
Total interest-bearing deposits	761,753	2,076	0.36%	775,235	3,076	0.53%
Securities sold under agreements to repurchase	9,792	11	0.15%	35,414	40	0.15%
Long- term debt	12,228	360	3.93%	12,411	367	3.95%
Total interest-bearing liabilities	783,773	2,447	0.42%	823,060	3,483	0.57%
Noninterest-bearing deposits	127,109			116,483		
Other liabilities	7,900			7,750		
Shareholders' equity	98,337			92,375		
Total liabilities and shareholders' equity	$ 1,017,119			$ 1,039,668		
T/E net interest income/Net interest margin		25,187	3.56%		24,617	3.40%
Tax equivalent adjustment		(1,469)			(1,181)	
Net interest income		$ 23,718			$ 23,436	

Provision for Loan Losses

For 2014, the Bank recorded net charge-offs of $1.2 million compared to $958 thousand in 2013. The charge-offs were not completely offset by the provision expense of $464 thousand for the year and as a result, the allowance for loan losses (ALL) decreased $767 thousand over year-end 2013. For more information refer to the Loan Quality and Allowance for Loan Losses discussion in the Financial Condition section.

Noninterest Income

For the first nine months of 2014, noninterest income increased $721 thousand from the same period in 2013. Investment and trust service fees increased due to higher recurring asset management fees. Loan service charges remained flat, while mortgage banking fees increased slightly, as 2014 had lower amortization costs compared to 2013. Deposit service charges increased due to higher account analysis fees and higher retail and commercial overdraft fees. Other service charges and fees increased primarily due to increases in ATM fees, while debit card income also increased. Net losses on other real estate owned decreased from prior year due to smaller write-downs in 2014 compared to 2013. Other than temporary impairment charges were recorded on one bond in 2014 compared to OTTI losses on two bonds in 2013. Security gains were higher in 2014 compared to prior year as the Corporation liquidated the majority of its equity portfolio.

The following table presents a comparison of noninterest income for the nine months ended September 30, 2014 and 2013:

	For the Nine Months Ended September 30		Change	
(Dollars in thousands)	2014	2013	Amount	%
Noninterest Income				
Investment and trust services fees	$ 3,311	$ 3,288	$ 23	0.7
Loan service charges	682	674	8	1.2
Mortgage banking activities	47	36	11	30.6
Deposit service charges and fees	1,553	1,359	194	14.3
Other service charges and fees	901	687	214	31.1
Debit card income	982	917	65	7.1
Increase in cash surrender value of life insurance	426	455	(29)	(6.4)
Other real estate owned	(184)	(260)	76	(29.2)
Other	92	179	(87)	(48.6)
OTTI losses recognized in income	(20)	(75)	55	(73.3)
Securities gain (losses), net	221	30	191	636.7
Total noninterest income	$ 8,011	$ 7,290	$ 721	9.9

Noninterest Expense

Noninterest expense for the first nine months of 2014 increased $460 thousand compared to the same period in 2013. The increase in salaries and benefits was primarily due to annual salary adjustments ($376 thousand) and incentive program expense ($262 thousand), but these increases were partially offset by a $191 thousand decrease in health insurance and a $211 thousand decrease in pension expense. Health insurance expense declined due to lower claims expense during the year from the Bank's participation in a self-insured health insurance plan. Net occupancy expense increased due to higher costs for snow removal and utilities in 2014 compared to 2013. Advertising expenses decreased over prior year, due to the timing of various marketing campaigns. Legal and professional fees increased due to the implementation of new corporate initiatives that began in the third quarter of 2014. Bank shares tax expense decreased year over year due to a change in the calculation. FDIC expense decreased as the Corporation's balance sheet was smaller in 2014 compared to 2013. Other expenses increased due to prepayment penalties on several FHLB term loans, as well as development costs for a potential community office site.

The following table presents a comparison of noninterest expense for the nine months ended September 30, 2014 and 2013:

(Dollars in thousands)	For the Nine Months Ended September 30		Change	
Noninterest Expense	2014	2013	Amount	%
Salaries and benefits	$ 12,548	$ 12,208	$ 340	2.8
Net occupancy expense	1,817	1,702	115	6.8
Furniture and equipment expense	732	730	2	0.3
Advertising	898	1,039	(141)	(13.6)
Legal and professional fees	979	871	108	12.4
Data processing	1,355	1,317	38	2.9
Pennsylvania bank shares tax	520	612	(92)	(15.0)
Intangible amortization	311	319	(8)	(2.5)
FDIC insurance	690	760	(70)	(9.2)
ATM/debit card processing	545	520	25	4.8
Other	2,656	2,513	143	5.7
Total noninterest expense	$ 23,051	$ 22,591	$ 460	2.0

Provision for Income Taxes

For the first nine months of 2014 the Corporation recorded a Federal income tax expense of $1.7 million compared to $1.1 million for the same period in 2013. While pretax income was higher in 2014 due primarily to less provision expense, 2013 benefited from a higher ratio of tax exempt income to pre-tax income. As a result, the effective tax rate increased year over year to 20.2% for the first nine months of 2014 compared to 17.6% for 2013. All taxable income for the Corporation is taxed at a rate of 34%.

Financial Condition

Summary:

At September 30, 2014, assets totaled $1.023 billion, an increase of $38.2 million from the 2013 year-end balance of $984.6 million. Investment securities increased $16.4 million, while net loans increased $8.0 million. Deposits were up $53.1 million for the first nine months of 2014 due to increases in every deposit category except time deposits. Shareholders' equity increased $6.7 million during the first nine months as retained earnings increased approximately $4.4 million, other comprehensive loss improved $1.7 million and the Corporation's Dividend Reinvestment Plan (DRIP) added an additional $543 thousand in new capital.

Cash and Cash Equivalents:

Cash and cash equivalents totaled $56.2 million at September 30, 2014, an increase of $15.5 million from the prior year-end balance of $40.7 million. The increase is due to inflows of deposits as well as slow loan growth

opportunities. Interest-bearing deposits are held primarily at the Federal Reserve.

Investment Securities:

The investment portfolio has grown approximately 9% on a cost basis, since year-end 2013. However, the composition of the portfolio is essentially unchanged. Municipal securities and U.S. Agency mortgage-backed securities continue to comprise the greatest portion of the portfolio at approximately 38% and 49% of the portfolio fair value, respectively. The Bank invested $37.0 million during the first nine months of 2014 with the purchases spread between U.S. Agency securities, U.S. Agency mortgage-backed securities and municipal securities.

The investment portfolio had a net unrealized gain of $1.5 million at September 30, compared to an unrealized loss of $741 thousand at year-end 2013. The trust preferred securities sector continues to hold the largest net unrealized loss.

The portfolio averaged $170.7 million with a yield of 2.91% for the first nine months of 2014. This compares to an average of $148.2 million and a yield of 2.63% for the same period in 2013. The improvement in the yield is primarily the result of a slow-down in prepayments on mortgage-backed securities.

During 2014, the equity portfolio was reduced significantly as the Corporation took advantage of price increases and sold selected holdings with gains. The Bank currently holds only 2 equity securities, both in Pennsylvania community banks. The municipal bond portfolio is well diversified geographically (issuers from within 28 states) and is comprised

primarily of general obligation bonds (70%). Most municipal bonds have credit enhancements in the form of private bond insurance or other credit support. The largest geographic municipal bond exposure is to nineteen issuers in the state of Texas with a fair value of $9.7 million and eleven issuers in the state of Pennsylvania with a fair value of $7.1 million. The municipal bond portfolio contains $64.7 million of bonds rated A, or higher and $1.4 million that are not rated by Moody's rating agency. No municipal bonds are rated below investment grade.

The holdings of trust preferred investments and private-label mortgage-backed securities are unchanged since year-end and are detailed in separate tables.

The amortized cost and estimated fair value of investment securities available for sale as of September 30, 2014 and December 31, 2013 is as follows:

(Dollars in thousands)		Gross	Gross	
	Amortized	unrealized	unrealized	Fair
September 30, 2014	cost	gains	losses	value
Equity securities	$ 274	$ 336	$ -	$ 610
U.S. Government agency securities	16,064	112	(85)	16,091
Municipal securities	64,850	1,790	(466)	66,174
Trust preferred securities	5,935	-	(588)	5,347
Agency mortgage-backed securities	85,665	836	(459)	86,042
Private-label mortgage-backed securities	1,750	53	-	1,803
Asset-backed securities	46	-	(2)	44
	$ 174,584	$ 3,127	$ (1,600)	$ 176,111

(Dollars in thousands)		Gross	Gross	
	Amortized	unrealized	unrealized	Fair
December 31, 2013	cost	gains	losses	value
Equity securities	$ 1,472	$ 499	$ (1)	$ 1,970
U.S. Government agency securities	11,771	94	(114)	11,751
Municipal securities	56,861	1,400	(1,404)	56,857
Corporate debt securities	1,002	-	(1)	1,001
Trust preferred securities	5,922	-	(871)	5,051
Agency mortgage-backed securities	81,352	726	(1,051)	81,027
Private-label mortgage-backed securities	1,984	16	(31)	1,969
Asset-backed securities	51	-	(3)	48
	$ 160,415	$ 2,735	$ (3,476)	$ 159,674

The following table provides additional detail about the Bank's trust preferred securities as of September 30, 2014:

Deal Name	Maturity	Single Issuer or Pooled	Class	Amortized Cost	Fair Value	Gross Unrealized Gain (Loss)	Lowest Credit Rating Assigned
(Dollars in thousands)							
BankAmerica Cap III	1/15/2027	Single	Preferred Stock	$ 962	$ 843	$ (119)	BB
Wachovia Cap Trust II	1/15/2027	Single	Preferred Stock	276	263	(13)	BBB
Huntington Cap Trust	2/1/2027	Single	Preferred Stock	938	846	(92)	BB+
Corestates Captl Tr II	2/15/2027	Single	Preferred Stock	934	879	(55)	BBB+
Huntington Cap Trust II	6/15/2028	Single	Preferred Stock	889	823	(66)	BB+
Chase Cap VI JPM	8/1/2028	Single	Preferred Stock	962	879	(83)	BBB-
Fleet Cap Tr V	12/18/2028	Single	Preferred Stock	974	814	(160)	BB
				$ 5,935	$ 5,347	$ (588)	

The following table provides additional detail about private label mortgage-backed securities as of September 30, 2014:

Description	Origination Date	Amortized Cost	Fair Value	Gross Unrealized Gain (Loss)	Collateral Type	Lowest Credit Rating Assigned	Credit Support %	Cumulative OTTI Charges
(Dollars in thousands)								
RALI 2004-QS4 A7	3/1/2004	$ 105	$ 108	$ 3	ALT A	BBB+	12.31	$ -
MALT 2004-6 7A1	6/1/2004	417	426	9	ALT A	CCC	14.00	-
RALI 2005-QS2 A1	2/1/2005	289	302	13	ALT A	CC	5.85	10
RALI 2006-QS4 A2	4/1/2006	562	573	11	ALT A	D	-	293
GSR 2006-5F 2A1	5/1/2006	87	93	6	Prime	D	-	15

RALI 2006-QS8 A1	7/28/2006	290	301	11	ALT A	D	-	217
		$ 1,750	$ 1,803	$ 53				$ 535

The investment portfolio contained 94 securities with $72.6 million of temporarily impaired fair value and $1.6 million in unrealized losses at September 30, 2014. The total unrealized loss position has improved by $1.9 million since year-end 2013.

For securities with an unrealized loss, Management applies a systematic methodology in order to perform an assessment of the potential for other-than-temporary impairment. In the case of debt securities, investments considered for other-than-temporary impairment: (1) had a specified maturity or repricing date; (2) were generally expected to be redeemed at par, and (3) were expected to achieve a recovery in market value within a reasonable period of time. In addition, the Bank considers whether it intends to sell these securities or whether it will be forced to sell these securities before the earlier of amortized cost recovery or maturity. Equity securities are assessed for other-than-temporary impairment based on the length of time of impairment, dollar amount of the impairment and general market and financial conditions relating to specific issues. The impairment identified on debt and equity securities and subject to assessment at September 30, 2014, was deemed to be temporary and required no further adjustments to the financial statements, unless otherwise noted.

The following table reflects temporary impairment in the investment portfolio (excluding restricted stock), aggregated by investment category, length of time that individual securities have been in a continuous unrealized loss position and the number of securities in each category as of September 30, 2014 and December 31, 2013:

	September 30, 2014								
	Less than 12 months			12 months or more			Total		
(Dollars in thousands)	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count
U.S. Government agency securities	$ 993	$ (2)	1	$ 7,321	$ (83)	14	$ 8,314	$ (85)	15
Municipal securities	6,752	(72)	11	11,557	(394)	17	18,309	(466)	28
Trust preferred securities	-	-	-	5,347	(588)	7	5,347	(588)	7
Agency mortgage-backed securities	28,538	(161)	28	12,091	(298)	15	40,629	(459)	43
Asset-backed securities	-	-	-	5	(2)	1	5	(2)	1
Total temporarily impaired securities	$ 36,283	$ (235)	40	$ 36,321	$ (1,365)	54	$ 72,604	$ (1,600)	94

	December 31, 2013								
	Less than 12 months			12 months or more			Total		
(Dollars in thousands)	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count
Equity securities	$ 22	$ (1)	1	$ -	$ -	-	$ 22	$ (1)	1
U.S. Government agency securities	3,971	(85)	7	3,807	(29)	7	7,778	(114)	14
Municipal securities	16,770	(1,022)	24	3,160	(382)	4	19,930	(1,404)	28
Corporate debt securities	-	-	-	1,001	(1)	1	1,001	(1)	1
Trust preferred securities	-	-	-	5,051	(871)	7	5,051	(871)	7
Agency mortgage-backed securities	40,395	(999)	38	2,213	(52)	4	42,608	(1,051)	42
Private-label mortgage-backed securities	-	-	-	911	(31)	2	911	(31)	2
Asset-backed securities	-	-	-	48	(3)	3	48	(3)	3
	$ 61,158	$ (2,107)	70	$ 16,191	$ (1,369)	28	$ 77,349	$ (3,476)	98

Total temporarily
impaired securities

The municipal bond portfolio has an unrealized loss of $466 thousand at quarter end. However, the unrealized loss has declined significantly from $730 thousand at the end of the second quarter and $1.4 million at the prior-year end. The unrealized loss in this portfolio is deemed to be non-credit related and no other-than-temporary impairment charges have been recorded.

The trust preferred portfolio contains seven securities with a fair value of $5.3 million and an unrealized loss of $588 thousand. The trust-preferred securities held by the Bank are single entity issues, not pooled trust preferred securities. Therefore, the impairment review of these securities is based only on the issuer and the security cannot be impaired by the performance of other issuers as if it was a pooled trust-preferred bond. All of the Bank's trust preferred securities are single issue, variable rate notes with long maturities (2027 – 2028). None of these bonds have suspended or missed a dividend payment. At September 30, 2014, the Bank believes it will be able to collect all interest and principal due on these bonds and no other-than-temporary-impairment charges were recorded.

The PLMBS sector shows a gross unrealized gain $53 thousand. Even though there is no unrealized loss, due to the nature of these bonds, they are evaluated closely. These bonds were all rated AAA at time of purchase, but have since experienced rating declines. Some have experienced increased delinquencies and defaults, while others have seen the credit support increase as the bonds paid-down. The Bank monitors the performance of the PLMBS investments on a regular basis and reviews delinquencies, default rates, credit support levels and various cash flow stress test scenarios. In determining the credit related loss, Management considers all principal past due 60 days or more as a loss. If additional principal moves beyond 60 days past due, it will also be considered a loss. As a result of the analysis on PLMBS it was determined that a $20 thousand impairment charge was required at quarter end. It is primarily a result of the OTTI charge that these bonds are showing an unrealized gain at quarter end. The Bank has recorded $535 thousand of cumulative impairment charges on this portfolio. Management continues to monitor these securities and it is possible that additional write-downs may occur if current loss trends continue. The Bank is currently participating in a class-action lawsuit against one PLMBS servicer that centers on defective warranties and representations made as part of the underwriting process.

The following table represents the cumulative credit losses on securities recognized in earnings as of September 30, 2014 and 2013.

(Dollars in thousands)	Nine Months Ended	
	2014	2013
Balance of cumulative credit-related OTTI at January 1	$ 515	$ 490
Additions for credit-related OTTI not previously recognized	20	25
Additional increases for credit-related OTTI previously recognized when there is no intent to sell and no requirement to sell before recovery of amortized cost basis	-	-
Decreases for previously recognized credit-related OTTI because there was an intent to sell	-	-
Reduction for increases in cash flows expected to be collected	-	-
Balance of credit-related OTTI at September 30	$ 535	$ 515

The Bank held $1.9 million of restricted stock at September 30, 2014. Except for $30 thousand, this investment represents stock in FHLB Pittsburgh. The Bank is required to hold this stock to be a member of FHLB and it is carried at cost of $100 per share.

FHLB stock is evaluated for impairment primarily based on an assessment of the ultimate recoverability of its cost. As a government sponsored entity, FHLB has the ability to raise funding through the U.S. Treasury that can be used to support its operations. There is not a public market for FHLB stock and the benefits of FHLB membership (e.g., liquidity and low cost funding) add value to the stock beyond purely financial measures. Management intends to remain a member of the FHLB and believes that it will be able to fully recover the cost basis of this investment. In October 2014, the FHLB repurchased approximately $1 million of its stock from the Bank.

Loans:

Residential real estate: This category is comprised of consumer purpose loans secured by residential real estate and to a lesser extent, commercial purpose loans secured by residential real estate. The consumer purpose category represents traditional residential mortgage loans and home equity products (primarily junior liens and lines of credit). Commercial purpose loans in this category represent loans made for various business needs, but are secured with residential real estate. In addition to the real estate collateral, it is possible that additional security is provided by personal guarantees or UCC filings. These loans are underwritten as commercial loans and are not originated to be sold.

Total residential real estate loans increased $3.6 million over 2013, primarily in the consumer junior liens and consumer first lien loan categories. For the first nine months of 2014, the Bank originated $15.4 million in mortgages, including approximately $5.8 million for a fee through a third party brokerage agreement. The Bank does not originate or hold any loans that would be considered sub-prime or Alt-A, and does not generally originate mortgages outside of its primary market area. Home equity lending, reflected in consumer junior liens and lines of credit, has increased with the Bank’s home equity campaign in the second and third quarters of 2014.

Residential real estate construction: The largest component of this category represents loans to residential real estate developers ($8.9 million), while loans for individuals to construct personal residences totaled $1.3 million at September 30, 2014. The Bank’s exposure to residential construction loans is concentrated primarily in south central Pennsylvania.

Real estate construction loans, including residential real estate and land development loans, frequently provide an interest reserve in order to assist the developer during the development stage when minimal cash flow is generated. All real estate construction loans are underwritten in the same manner, regardless of the use of an interest reserve. Real estate construction loans are monitored on a regular basis by either an independent third party inspector or the assigned loan officer depending on loan amount or complexity of the project. This monitoring process includes at a minimum, the submission of invoices and AIA documents of costs incurred by the borrower, on-site inspections, and a signature by the assigned loan officer for disbursement of funds. The Bank has no residential real estate construction loans with an interest reserve.

Commercial loans and commercial real estate: Loans in this category include commercial, industrial, farm, agricultural, land development and municipal government loans. Collateral for these loans may include commercial real estate, farm real estate, equipment or other business assets. Total commercial real estate loans decreased to $323.6 million from $329.4 million at the end of 2013. At September 30, 2014, the Bank had $9.4 million in land development real estate construction loans funded with an interest reserve and capitalized $25 thousand of interest from these reserves on active projects. The largest sectors (by collateral) in the commercial real estate category are: land development ($52.2 million), office buildings ($38.4 million), hotels and motels ($37.1 million), farm land ($34.1 million), and auto dealerships ($18.1 million). Commercial loans increased by 8.1% compared to year end, an increase of $13.7 million. The largest sectors

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(by industry) in the commercial loan category are: construction ($55.2 million), retail trade ($53.2 million), food services ($42.7 million), and manufacturing ($37.8 million). The Bank is very active in its market in pursuing commercial lending opportunities, but supplements in-market growth with purchased loan participations. The Bank purchases commercial loan participations in an effort to increase its commercial lending and diversify its loan mix, both geographically and by industry sector. Purchased loans are originated primarily within the south central Pennsylvania market and are purchased from only a few select counter parties. These loans usually represent an opportunity to participate in larger credits that are not available in market, with the benefit of lower origination and servicing costs. For the first nine months of 2014, the Bank purchased $12.1 million of loan participations and commitments. At September 30, 2014, the Bank held $133.1 million in purchased loan participations in its portfolio.

Consumer loans decreased $2.0 million due primarily to regular payments and maturities. The Bank believes consumer portfolio will continue to run-down, as consumers are unwilling to increase their debt and nearly all consumer auto financing has shifted to dealer financing.

The following table presents a summary of loans outstanding, by primary collateral as of:

(Dollars in thousands)	September 30, 2014	December 31, 2013	Change Amount	Change %
Residential Real Estate 1-4 Family				
Consumer first liens	$ 104,823	$ 103,573	$ 1,250	1.2
Consumer junior liens and lines of credit	37,454	34,636	2,818	8.1
Total consumer	142,277	138,209	4,068	2.9
Commercial first lien	58,320	58,466	(146)	(0.2)
Commercial junior liens and lines of credit	5,664	5,939	(275)	(4.6)
Total commercial	63,984	64,405	(421)	(0.7)
Total residential real estate 1-4 family	206,261	202,614	3,647	1.8
Residential real estate - construction				
Consumer	1,286	3,960	(2,674)	(67.5)
Commercial	8,854	8,559	295	3.4
Total residential real estate construction	10,140	12,519	(2,379)	(19.0)
Commercial real estate	323,570	329,373	(5,803)	(1.8)
Commercial	184,049	170,327	13,722	8.1
Total commercial	507,619	499,700	7,919	1.6
Consumer	6,625	8,580	(1,955)	(22.8)
	730,645	723,413	7,232	1.0
Less: Allowance for loan losses	(8,935)	(9,702)	767	(7.9)
Net Loans	$ 721,710	$ 713,711	$ 7,999	1.1
Included in the loan balances are the following:				
Net unamortized deferred loan costs	$ 511	$ 372		

Unamortized discount on purchased loans	$ (25)	$ (92)
Loans pledged as collateral for borrowings and commitments from:		
FHLB	$ 602,666	$ 607,524
Federal Reserve Bank	57,143	45,809
	$ 659,809	$ 653,333

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Loan Quality:

Management utilizes a risk rating scale ranging from 1 (Prime) to 9 (Loss) to evaluate loan quality. This risk rating scale is used primarily for commercial purpose loans. Consumer purpose loans are identified as either a pass or substandard rating. Substandard consumer loans are loans that are 90 days or more past due and still accruing. Loans rated 1 – 4 are considered pass credits. Loans that are rated 5 are pass credits, but have been identified as credits that are likely to warrant additional attention and monitoring. Loans rated 6 (Special Mention) or worse begin to receive enhanced monitoring and reporting by the Bank. Loans rated 7 (Substandard) or 8 (Doubtful) exhibit the greatest financial weakness and present the greatest possible risk of loss to the Bank. Nonaccrual loans are rated no better than 7. The following factors represent some of the factors used in determining the risk rating of a borrower: cash flow, debt coverage, liquidity, management, and collateral. Risk ratings, for pass credits, are generally reviewed annually for term debt and at renewal for revolving or renewing debt. The Bank monitors loan quality by reviewing four measurements: (1) loans rated 6 or worse (collectively "watch list"), (2) delinquent loans, (3) other real estate owned (OREO), and (4) net-charge-offs. Management compares trends in these measurements with the Bank's internally established targets, as well as its national peer group.

Watch list loans exhibit financial weaknesses that increase the potential risk of default or loss to the Bank. However, inclusion on the watch list, does not by itself, mean a loss is certain. The watch list includes both performing and nonperforming loans. Watch list loans totaled $65.9 million at quarter-end compared to $76.3 million at the prior year- end. The watch list is comprised of $22.5 million rated 6 and $43.4 million rated 7. The Bank has no loans rated 8-doubtful or 9-loss. The credit composition of the portfolio, by primary collateral is shown in Note 7 of the accompanying financial statement. Included in the substandard loan total is $18.6 million of nonaccrual loans. The Bank's Loan Management Committee reviews these loans and risk ratings on a quarterly basis in order to proactively identify and manage problem loans. In addition, a committee meets monthly to discuss possible workout strategies for OREO and all credits rated 7 or worse. Management also tracks other commercial loan risk measurements including high loan to value loans, concentrations, participations and policy exceptions and reports these to the Credit Risk Oversight Committee of the Board of Directors. The Bank also uses a third-party consultant to assist with internal loan review with a goal of reviewing 60% of commercial loans each year. The FDIC defines certain supervisory loan-to-value lending limits. The Bank's internal loan–to-value limits are all equal to, or have a lower loan-to-value limit, than the supervisory limits. At September 30, 2014, the Bank had loans of $22.8 million that exceeded the supervisory limit.

Delinquent loans are a result of borrowers' cash flow and/or alternative sources of cash being insufficient to repay loans. The Bank's likelihood of collateral liquidation to repay the loans becomes more probable the further behind a borrower falls, particularly when loans reach 90 days or more past due. Management monitors the performance status of loans by the use of an aging report. The aging report can provide an early indicator of loans that may become severely delinquent and possibly result in a loss to the Bank. See Note 7 in the accompanying financial statements for a note that presents the aging of payments in the loan portfolio.

Nonaccruing loans generally represent Management's determination that the borrower will be unable to repay the loan in accordance with its contractual terms and that collateral liquidation may or may not fully repay both interest and principal. It is the Bank's policy to evaluate the probable collectability of principal and interest due under terms of loan contracts for all loans 90-days or more, nonaccrual loans, or impaired loans. Further, it is the Bank's policy to discontinue accruing interest on loans that are not adequately secured and in the process of collection. Upon determination of nonaccrual status, the Bank subtracts any current year accrued and unpaid interest from its income, and any prior year accrued and unpaid interest from the allowance for loan losses. Management continually monitors the status of nonperforming loans, the value of any collateral and potential of risk of loss. Nonaccrual loans are rated no better than 7 (Substandard).

Loan quality, as measured by the balance of nonperforming loans, is virtually unchanged from year-end. However, the performance ratios related to nonperforming loans have improved since December 31, 2013. The following table presents a summary of nonperforming assets:

(Dollars in thousands)	September 30, 2014	December 31, 2013
Nonaccrual loans		
Residential Real Estate 1-4 Family		
First liens	$ 1,240	$ 2,599
Junior liens and lines of credit	118	107
Total	1,358	2,706
Residential real estate - construction	1,155	538
Commercial real estate	14,351	19,001
Commercial	1,687	2,398
Total nonaccrual loans	18,551	24,643
Loans past due 90 days or more and not included above		
Residential Real Estate 1-4 Family		
First liens	163	302
Junior liens and lines of credit	11	41
Total	174	343
Commercial real estate	152	207
Commercial	23	44
Consumer	16	10
Total loans past due 90 days or more and still accruing	365	604
Total nonperforming loans	18,916	25,247
Other real estate owned	3,737	4,708
Total nonperforming assets	$ 22,653	$ 29,955
Nonaccrual loans to total gross loans	2.54%	3.41%
Nonperforming loans to total gross loans	2.59%	3.49%
Nonperforming assets to total assets	2.21%	3.04%
Allowance for loan losses to nonperforming loans	47.24%	38.43%

The following table identifies the most significant loans in nonaccrual status. These six nonaccrual loans account for 87% of the total nonaccrual balance. The table also indicates those significant nonaccrual loans that are classified as troubled debt restructurings (TDR). A TDR loan is maintained on nonaccrual status until a satisfactory repayment history is established. It is possible that other nonaccrual loans could be removed from nonaccrual status in 2014. However, it is also possible that other loans may become delinquent and nonperforming loans could remain at a high level due to lengthy workout periods on these loans. All loans on the watch list that are not on nonaccrual or past due 90 days more are considered potential problem loans. Potential problem loans at September 30, 2014 totaled $47.4 million compared to $51.6 million at year-end 2013.

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The following table provides information on the most significant nonaccrual loans as of September 30, 2014.

(Dollars in thousands)	Balance	ALL Reserve	Nonaccrual Date	TDR Status	Collateral	Location	Last Appraisal(1)	
Credit 1 - Commercial real estate	$ 3,040	$ -	Dec-10	N	1st lien on 92 acres undeveloped commercial real estate	PA	Dec-13	$ 3,304
Credit 2 - Residential real estate and commercial real estate	875	-	Aug-11	N	1st lien on commercial and residential properties and 70 acres of farmland	PA	Aug-14	$ 1,235
Credit 3 - Residential real estate	2,008	-	Mar-12	Y	1st and 2nd liens on commercial real estate, residential real estate and business assets	PA	Oct-13	$ 4,320
Credit 4 - Commercial real estate	7,521	-	Sep-12	Y	1st lien residential real estate development - 379 acres and other commercial and residential properties	PA	Apr-14	$ 7,332
Credit 5 - Commercial / commercial real estate	1,899	19	Mar-13	N	Liens on land, commercial and residential real estate and business assets	PA	Sep-14	$ 2,965
Credit 6 - Commercial real estate	770	-	Mar-14	N	1st lien on commercial real estate	PA	Jun-13	$ 1,550
	$ 16,113	$ 19						

(1) Appraisal value, as reported, does not reflect the pay-off of any senior liens or the cost to liquidate the collateral, but does reflect only the Bank’s share of the collateral if it is a participated loan.

Credit 1 has been charged down by $3.5 million since being placed on nonaccrual due to declining appraisal values. This credit is part of a participated loan and the lead bank has begun foreclosure action. Credit 2 is in the process of foreclosure and the real estate is listed for sale. Credit 3 is a TDR that is not performing in accordance with

the modified terms. Credit 4 is a TDR and is performing in accordance with its modified terms. The Bank holds real estate collateral, but the loan is not considered collateral dependent for repayment. Credit 5 reflects a $549 thousand charge-off in the wnd quarter of 2014 and the borrower and guarantor have filed bankruptcy. Credit 6 is a new nonaccrual loan in 2014 and is performing under a forbearance agreement with the Bank. During the third quarter of 2014, a significant nonaccrual credit of $883 thousand was paid-off with third party financing.

In addition to monitoring nonaccrual loans, the Bank also closely monitors impaired loans and troubled debt restructurings (TDR). A loan is considered to be impaired when, based on current information and events, it is probable that the Bank will be unable to collect all interest and principal payments due according to the originally contracted terms of the loan agreement. Nonaccrual loans and TDR loans are always considered impaired. For impaired loans with balances less than $250 thousand and consumer purpose loans, a specific reserve analysis is not performed and these loans are added to the general allocation pool. In accordance with financial accounting standards, TDR loans are always considered impaired until they are paid off. However, an impaired TDR loan can be a performing loan. Impaired loans totaled $25.4 million at quarter-end compared to $30.9 million at year-end 2013. Included in the impaired loan total is $16.5 million of TDR loans. Note 7 of the accompanying financial statements provides additional information on the composition of the impaired loans, including the allowance for loan loss that has been established for impaired loans.

A loan is considered a troubled debt restructuring (TDR) if the creditor (the Bank), for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. These concessions may include lowering the rate, extending the maturity, reamortization of the payment, or a combination of multiple concessions. The Bank reviews all loans rated 6 or worse when it is providing a loan restructure, modification or new credit facility to determine if the action is a TDR. If a TDR loan is placed on nonaccrual status, it remains on nonaccrual status for at least six months to ensure performance. All TDR loans except one, Credit 3 in the table of significant nonaccrual loans, are in compliance with their modified terms. See Note 7 in the accompanying financial statements for a note that identifies TDR loans in the portfolio.

The Bank holds $3.7 million of other real estate owned (OREO), comprised of five properties compared to $4.7 million and eight properties at December 31, 2013. The most significant OREO holdings are listed in the table below.

Property 1 was written down by $181 thousand in 2014 and a parcel was sold in July 2014. The appraised value for Property 2 reflects an "as is" valuation. A second appraisal that reflects the commercial and industrial development potential of the property, which is the most likely use for the property, was $6.9 million. The Bank has reported the lower of the two valuations.

During 2014, the Bank has incurred a net loss of $184 thousand on OREO and an expense of $46 thousand to hold and maintain OREO.

The following table provides additional information on significant other real estate owned properties:

September 30, 2014

(Dollars in thousands)	Date Acquired	Balance	Collateral	Location	Last Appraisal	
Property 1 (2 properties)	2011	$ 538	unimproved real estate for residential development	PA	Jan-14	$ 970
Property 2	2012	2,758	1st, 2nd, and 3rd liens residential development land - four tracts with 200 acres	PA	Apr-14	$ 2,950
		$ 3,296				

At September 30, 2014, the Bank had $717 thousand of residential properties in the process of foreclosure compared to $1.1 million at the end of 2013.

Allowance for Loan Losses:

Management performs a monthly evaluation of the adequacy of the allowance for loan losses (ALL). The ALL is determined by segmenting the loan portfolio based on the loan's collateral. The Bank further classifies the portfolio based on the primary purpose of the loan, either consumer or commercial. When calculating the ALL, consideration is given to a variety of factors in establishing this estimate including, but not limited to, current economic conditions, diversification of the loan portfolio, delinquency statistics, results of internal loan reviews, historical charge-offs, the adequacy of the underlying collateral (if collateral dependent) and other relevant factors. The Bank begins enhanced monitoring of all loans rated 6 (OAEM) or worse, and obtains a new appraisal or asset valuation for any loan rated 7 (substandard) or worse. Management, at its discretion, may determine that additional adjustments to the appraisal or valuation are required. Valuation adjustments will be made as necessary based on factors, including, but not limited to: the economy, deferred maintenance, industry, type of property/equipment, age of the appraisal, etc. and the knowledge Management has about a particular situation. In addition, the cost to sell or liquidate the collateral is also estimated and deducted from the valuation in order to determine the net realizable value to the Bank. When determining the allowance for loan losses, certain factors involved in the evaluation are inherently subjective and require material estimates that may be susceptible to significant change, including the amounts and timing of future cash flows expected to be received on impaired loans. Management monitors the adequacy of the allowance for loan losses on an ongoing basis and reports its adequacy quarterly to the Credit Risk Oversight Committee of the Board of Directors. Management believes that the allowance for loan losses at September 30, 2014 is adequate.

The analysis for determining the ALL is consistent with guidance set forth in generally accepted accounting principles (GAAP) and the Interagency Policy Statement on the Allowance for Loan and Lease Losses. The analysis has two components, specific and general allocations. The specific component addresses specific reserves established for impaired loans. A loan is considered to be impaired when, based on current information and events, it is probable that the Bank will be unable to collect all interest and principal payments due according to the originally contracted terms of the loan agreement. Collateral values discounted for market conditions and selling costs are used to establish specific allocations for impaired loans. It is possible that as a result of the credit analysis, a specific reserve is not required for an impaired loan. For impaired loans with balances less than $250 thousand and consumer purpose loans, a specific reserve analysis is not performed and these loans are added to the general allocation pool. The specific allowance decreased significantly from $1.0 million at June 30, 2014 to $99 thousand at September 30, 2014. At June 30, $948 thousand of the specific allowance was established for Credit 6 in the table of significant nonaccrual loans. As a result of a $549 thousand charge-off and improved collateral values on this credit during third quarter, the specific allowance on this credit was reduced to $19 thousand. Note 7 in the accompanying financial statements provides additional information about the ALL established for impaired loans.

The general allocation component addresses the reserves established for pools of homogenous loans. The general component includes a quantitative and qualitative analysis. When calculating the general allocation, the Bank segregates

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its loan portfolio into the following sectors based primarily on the type of supporting collateral: residential real estate, commercial, industrial or agricultural real estate; commercial and industrial (C&I non-real estate), and consumer. The residential real estate sector is further segregated by first lien loans, junior liens and home equity products, and residential real estate construction. The quantitative analysis uses the Bank's eight quarter rolling historical loan loss experience adjusted for factors derived from current economic and market conditions that have been determined to have an effect on the probability and magnitude of a loss. The historical loss experience factor was 1.21% of gross loans at September 30, 2014 compared to .99% at December 31, 2013. The qualitative analysis utilizes a risk matrix that incorporates qualitative and environmental factors such as: loan volume, management, loan review process, credit concentrations, competition, and legal and regulatory issues. These factors are each risk rated from minimal to high risk and in total can add up to a maximum qualitative factor of 37.5 basis points. At quarter-end, this factor was 20.5 basis points unchanged from year-end 2013. These factors are determined on the basis of Management's observation, judgment and experience.

Real estate appraisals and collateral valuations are an important part of the Bank's process for determining potential loss on collateral dependent loans and thereby have a direct effect on the determination of loan reserves, charge-offs and the calculation of the allowance for loan losses. As long as the loan remains a performing loan, no further updates to appraisals are required. If a loan or relationship migrates to risk rating of 7 or worse, an evaluation for impairment status is made based on the current information available at the time of downgrade and a new appraisal or collateral valuation is obtained.

In determining the allowance for loan losses, Management, at its discretion, may determine that additional adjustments to the fair value obtained from an appraisal or collateral valuation are required. Adjustments will be made as necessary based on factors, including, but not limited to the economy, deferred maintenance, industry, type of property or equipment etc., and the knowledge Management has about a particular situation. In addition, the cost to sell or liquidate the collateral is also estimated and deducted from the valuation in order to determine the net realizable value to the Bank. If an appraisal is not available, Management may make its best estimate of the real value of the collateral or use last known market value and apply appropriate discounts. If an adjustment is made to the collateral valuation, this will be documented with appropriate support and reported to the Loan Management Committee.

The following table shows the loans that were evaluated for the allowance for loan losses under a specific reserve (individually) and those that were evaluated under a general reserve (collectively), and the amount of the allowance established in each loan class as of September 30, 2014:

	Residential Real Estate 1-4 Family						
(Dollars in thousands)	First Liens	Junior Liens & Lines of Credit	Construction	Commercial Real Estate	Commercial	Consumer	Total
September 30, 2014							
Loans evaluated for allowance:							
Individually	$ 1,193	$ 51	$ 1,155	$ 20,338	$ 1,343	$ -	$ 24,080
Collectively	161,950	43,067	8,985	303,232	182,706	6,625	706,565
Total	$ 163,143	$ 43,118	$ 10,140	$ 323,570	$ 184,049	$ 6,625	$ 730,645
Allowance established for loans evaluated:							
Individually	$ -	$ -	$ -	$ 71	$ 28	$ -	$ 99
Collectively	1,129	322	234	5,423	1,601	127	8,836
Allowance at September 30, 2014	$ 1,129	$ 322	$ 234	$ 5,494	$ 1,629	$ 127	$ 8,935
December 31, 2013							
Loans evaluated for allowance:							
Individually	$ 2,354	$ 50	$ 537	$ 25,107	$ 1,996	$ -	$ 30,044
Collectively	159,685	40,525	11,982	304,266	168,331	8,580	693,369
Total	$ 162,039	$ 40,575	$ 12,519	$ 329,373	$ 170,327	$ 8,580	$ 723,413
Allowance established for loans evaluated:							
Individually	$ 9	$ -	$ -	$ 89	$ 1,002	$ -	$ 1,100
Collectively	1,099	278	291	5,482	1,304	148	8,602
Allowance at December 31, 2013	$ 1,108	$ 278	$ 291	$ 5,571	$ 2,306	$ 148	$ 9,702

During the third quarter of 2014, the Bank recorded $0 provision expense and therefore, nothing was added to the allowance for loan losses (ALL) thorough the provision for loan loss expense. This compares to a provision expense of $350 thousand for the same period in 2013.

Charged-off loans usually result from: (1) a borrower being legally relieved of loan repayment responsibility through bankruptcy, (2) insufficient collateral sale proceeds to repay a loan; or (3) the borrower and/or guarantor does not own other assets that, if sold, would generate sufficient sale proceeds to repay a loan.

The Bank recorded net loan charge-offs of $584 thousand for the third quarter of 2014 and $1.2 million year-to-date. In 2013, net charge-offs were $412 thousand and $958 thousand for the third quarter and year-to-date period, respectively. The largest charge-off in 2014 was $549 thousand on Credit 5 in the significant nonaccrual table.

The following table presents an analysis of the allowance for loan losses for the periods ended:

	Residential Real Estate 1-4 Family			Commercial			
(Dollars in thousands)	First Liens	Junior Liens & Lines of Credit	Construction	Real Estate	Commercial	Consumer	Total
Allowance at June 30, 2014	$ 1,079	$ 266	$ 261	$ 5,412	$ 2,366	$ 135	$ 9,519
Charge-offs	-	-	-	-	(611)	(67)	(678)
Recoveries	2	-	-	49	23	20	94
Provision	48	56	(27)	33	(149)	39	-
Allowance at September 30, 2014	$ 1,129	$ 322	$ 234	$ 5,494	$ 1,629	$ 127	$ 8,935
Allowance at December 31, 2013	$ 1,108	$ 278	$ 291	$ 5,571	$ 2,306	$ 148	$ 9,702
Charge-offs	(257)	-	(27)	(348)	(623)	(147)	(1,402)
Recoveries	5	-	-	49	56	61	171
Provision	273	44	(30)	222	(110)	65	464
Allowance at September 30, 2014	$ 1,129	$ 322	$ 234	$ 5,494	$ 1,629	$ 127	$ 8,935

	September 30, 2014	December 31, 2013	September 30, 2013
Net loans charged-off as a percentage of average gross loans	0.22%	0.49%	0.17%

Net loans charged-off as a percentage of the provision for loan losses	265.30%	123.18%	49.00%
Allowance as a percentage of loans	1.22%	1.34%	1.58%
Net charge-offs	$ 1,231	$ 3,597	$ 958

Deposits:

Total deposits increased $53.0 million during the first nine months of 2014 to $898.9 million. Non-interest bearing deposits increased $16.8 million, while savings and interest-bearing checking increased $47.5 million and time deposits decreased $11.1 million. The increase in non-interest bearing checking accounts occurred primarily in municipal checking accounts ($5.6 million), retail checking accounts ($5.4 million) and small business checking accounts ($4.6 million). Interest bearing checking increased by $33.5 million, primarily from commercial deposits. The Bank's Money Management product increased $17.2 million due primarily to an increase in commercial deposits. Retail time deposits decreased since year-end, as customers moved funds to more liquid accounts. As of September 30, 2014, the Bank had $5.6 million in CDARS reciprocal time deposits included in brokered time deposits.

(Dollars in thousands)	September 30, 2014	December 31, 2013	Change Amount	%
Noninterest-bearing checking	$ 138,346	$ 121,565	$ 16,781	13.8
Interest-bearing checking	207,526	180,450	27,076	15.0
Money management	387,560	370,401	17,159	4.6
Savings	62,645	59,394	3,251	5.5
Total interest-bearing checking and savings	657,731	610,245	47,486	7.8
Retail time deposits	97,167	108,283	(11,116)	(10.3)
Brokered time deposits	5,621	5,631	(10)	(0.2)
Total time deposits	102,788	113,914	(11,126)	(9.8)
Total deposits	$ 898,865	$ 845,724	$ 53,141	6.3
Overdrawn deposit accounts reclassified as loans	$ 108	$ 106		

Borrowings:

The balance of securities sold under agreements to repurchase, which are accounted for as collateralized financings, decreased $22.3 million from year-end to $1.6 million. The Bank is transitioning customers from this product to a deposit sweep product, which provides full FDIC coverage. This will free-up collateral that was required to cover these balances and will increase the Bank's liquidity. The long-term debt from the FHLB decreased due to the Bank prepaying several small term loans and also to scheduled amortization.

Shareholders' Equity:

Total shareholders' equity increased $6.7 million to $102.1 million at September 30, 2014, compared to $95.4 million at the end of 2013. The increase in retained earnings from the Corporation's net income of $6.6 million was partially offset by the cash dividend of $2.1 million. The Corporation's dividend payout ratio is 32.5% for the first nine months of 2014 compared to 41.3% in 2013.

As part of its quarterly dividend decision, the Corporation considers current and future income projections, dividend yield, payout ratio, and current and future capital ratios. In July 2014, the Board of Directors declared a $.17 per share regular quarterly dividend for the third quarter of 2014. This compares to a regular quarterly cash dividend of $.17 paid in the second quarter of 2013. On October 23, 2014 the Board of Directors declared a $.17 per share regular quarterly dividend for the fourth quarter of 2014, which will be paid on November 26, 2014.

In addition, the Corporation considers how dividend decisions may affect the Dividend Reinvestment Plan (DRIP), which has raised $543 thousand in new capital this year with 29,142 new shares purchased. The Corporation continually explores other sources of capital as part of its capital management plan for the Corporation and the Bank. The Corporation did not repurchase any shares of the Corporation's common stock during the first nine months of 2014.

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Capital adequacy is currently defined by regulatory agencies through the use of several minimum required ratios. At September 30, 2014, the Corporation was well capitalized as defined by the banking regulatory agencies. Regulatory capital ratios for the Corporation and the Bank are shown below:

			Regulatory Ratios	
(Dollars in thousands)	September 30, 2014	December 31, 2013	Minimum	Well Capitalized Minimum
Total Risk-based Capital Ratio				
Franklin Financial Services Corporation	15.04%	14.24%	8.00%	N/A
Farmers & Merchants Trust Company	14.75%	13.78%	8.00%	10.00%
Tier 1 Risk-based Capital Ratio				
Franklin Financial Services Corporation	13.77%	12.97%	4.00%	N/A
Farmers & Merchants Trust Company	13.48%	12.52%	4.00%	6.00%
Tier 1 Leverage Ratio				
Franklin Financial Services Corporation	9.51%	9.14%	4.00%	N/A
Farmers & Merchants Trust Company	9.24%	8.81%	4.00%	5.00%

Economy

The Corporation’s primary market area includes Franklin, Fulton, Cumberland and Huntingdon County, PA. This area is diverse in demographic and economic makeup. County populations range from a low of approximately 15,000 in Fulton County to over 220,000 in Cumberland County. Unemployment in the Bank’s market area has remained virtually unchanged over the past year and ranges from a low of 5.1% in Cumberland County to high of 7.1% in Fulton County. The market area has a diverse economic base and local industries include, warehousing, truck & rail shipping centers, light and heavy manufacturers, health-care, higher education institutions, farming and agriculture, and a varied service sector. The Corporation’s primary market area is located in south central Pennsylvania and provides easy access to the major metropolitan markets on the east coast via trucking and rail transportation. Because of this, warehousing and distribution companies continue to find the area attractive. The local economy is not overly dependent on any one industry or business and Management believes that the Bank’s primary market area continues to be well suited for growth as the recession eases.

The following provides selected economic data for the Bank’s primary market:

Economic Data

	September 30, 2014	December 31, 2013
Unemployment Rate (seasonally adjusted)		
Market area range (1)	5.1% - 7.1%	5.9% - 9.2%

Pennsylvania	5.8%	7.3%
United States	6.1%	6.7%
Housing Price Index - year over year change		
PA, nonmetropolitan statistical area	-1.4%	1.3%
United States	5.8%	4.6%
Franklin County Building Permits - year over year change		
Residential, estimated	11.5%	18.2%
Multifamily, estimated	-16.5%	-68.5%

(1) Franklin, Cumberland, Fulton and Huntingdon Counties

Unlike many companies, the assets and liabilities of the Corporation are financial in nature. As such, interest rates and changes in interest rates may have a more significant effect on the Corporation's financial results than on other types of industries. Because of this, the Corporation watches the actions of the Federal Reserve Open Market Committee (FOMC) as it makes decisions about interest rate changes. The FOMC continues to hold short-term rates at historic lows. The FOMC continued its tapering of bond purchases that it began at the end of 2013 and it is expected that the quantitative

easing program will end in 2014. It continues to monitor employment and inflation data as it considers the timing of an increase in the Fed Funds rate. Many analysts believe that the FOMC will begin to increase rates in 2015.

Liquidity

The Corporation must meet the financial needs of the customers that it serves, while providing a satisfactory return on the shareholders' investment. In order to accomplish this, the Corporation must maintain sufficient liquidity in order to respond quickly to the changing level of funds required for both loan and deposit activity. The goal of liquidity management is to meet the ongoing cash flow requirements of depositors who want to withdraw funds and of borrowers who request loan disbursements. The Bank regularly reviews it liquidity position by measuring its projected net cash flows (in and out) at a 30 and 90-day interval. The Bank stresses this measurement by assuming a level of deposit out-flows that have not historically been realized. In addition to this forecast, other funding sources are reviewed as a method to provide emergency funding if necessary. The objective of this measurement is to identify the amount of cash that could be raised quickly without the need to liquidate assets. The Bank also stresses its liquidity position utilizing different longer-term scenarios. The varying degrees of stress create pressure on deposit flows in its local market, reduce access to wholesale funding and limit access of funds available through brokered deposit channels. In addition to stressing cash flow, specific liquidity risk indicators are monitored to help identify risk areas. This analysis will help identify and quantify the potential cash surplus/deficit over a variety of time horizons to ensure the Bank has adequate funding resources. Assumptions used for liquidity stress testing are subjective. Should an evolving liquidity situation or business cycle present new data, potential assumption changes will be considered. The Bank believes it can meet all anticipated liquidity demands.

Historically, the Corporation has satisfied its liquidity needs from earnings, repayment of loans and amortizing investment securities, maturing investment securities, loan` sales, deposit growth and its ability to access existing lines of credit. All investment securities are classified as available for sale; therefore, securities that are not pledged as collateral for borrowings are an additional source of readily available liquidity, either by selling the security or, more preferably, to provide collateral for additional borrowing. At September 30, 2014, the Bank had approximately $85 million (fair value) in its investment portfolio pledged as collateral for deposits and Repos. Another source of available liquidity for the Bank is a line of credit with the FHLB. At September 30, 2014, the Bank had approximately $35 million available on this line of credit and $16 million of unsecured lines of credit at correspondent banks. At September 30, 2014, the Bank had an excess borrowing capacity of $224.5 million, which includes the amount available on the line of credit. The Bank has established credit at the Federal Reserve Discount Window and as of quarter-end had the ability to borrow approximately $29 million.

Off Balance Sheet Commitments

The Corporation's financial statements do not reflect various commitments that are made in the normal course of business, which may involve some liquidity risk. These commitments consist mainly of unfunded loans and letters of credit made under the same standards as on-balance sheet instruments. Because these instruments have fixed maturity dates, and because many of them will expire without being drawn upon, they do not generally present any significant liquidity risk to the Corporation. Unused commitments and standby letters of credit totaled $272.0 million and $239.6 million, respectively, at September 30, 2014 and December 31, 2013.

The Corporation has entered into various contractual obligations to make future payments. These obligations include time deposits, long-term debt, operating leases, deferred compensation and pension payments. These amounts have not changed materially from those reported in the Corporation's 2013 Annual Report on Form 10-K.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

There were no material changes in the Corporation’s exposure to market risk during the nine months ended September 30, 2014. For more information on market risk refer to the Corporation’s 2013 Annual Report on Form 10-K.

Item 4. Controls and Procedures

Evaluation of Controls and Procedures

The Corporation carried out an evaluation, under the supervision and with the participation of the Corporation’s management, including the Corporation’s Chief Executive Officer and Chief Financial Officer, of the effectiveness of its disclosure controls and procedures, as defined in Exchange Act Rules 13a-15(e) and 15d-15(e). Based upon the evaluation, the Corporation’s Chief Executive Officer and Chief Financial Officer concluded that as of September 30, 2014, the Corporation’s disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in the Corporation’s reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms.

The management of the Corporation is responsible for establishing and maintaining adequate internal control over financial reporting. The Corporation’s internal control system is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Part II – OTHER INFORMATION

Item 1. Legal Proceedings

The nature of the Corporation's business generates a certain amount of litigation involving matters arising in the ordinary course of business. However, in management's opinion, there are no proceedings pending to which the Corporation is a party or to which our property is subject, which, if determined adversely to the Corporation, would be material in relation to our shareholders' equity or financial condition. In addition, no material proceedings are pending or are known to be threatened or contemplated against us by governmental authorities or other parties.

Item 1A. Risk Factors

There were no material changes in the Corporation's risk factors during the nine months ended September 30, 2014. For more information, refer to the Corporation's 2013 Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3. Defaults by the Company on its Senior Securities

None

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

None

Item 6. Exhibits

Exhibits

3.1 Articles of Incorporation of the Corporation. (Filed as Exhibit 3.1 to Annual Report on Form 10-K for the year ended December 31, 2005 and incorporated herein by reference.)

3.2 Bylaws of the Corporation. (Filed as Exhibit 99 to Current Report on Form 8-K filed on December 20, 2004 and incorporated herein by reference.)

31.1 Rule 13a – 14(a)/15d-14(a) Certifications – Principal Executive Officer

31.2 Rule 13a – 14(a)/15d-14(a) Certifications – Principal Financial Officer

32.1 Section 1350 Certifications – Principal Executive Officer

32.2 Section 1350 Certifications – Principal Financial Officer

101 Interactive Data File (XBRL)

FRANKLIN FINANCIAL SERVICES CORPORATION

and SUBSIDIARIES

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Franklin Financial Services Corporation

November 10, 2014	/s/ William E. Snell, Jr William E. Snell, Jr. President and Chief Executive Officer (Principal Executive)

November 10, 2014	/s/ Mark R. Hollar Mark R. Hollar Treasurer and Chief Financial Officer (Principal Financial Officer)