Q3 2020 Earnings Call

Company Participants

- Clemens Jungsthofel, Member of the Executive Board, Chief Financial Officer
- Jean-Jacques Henchoz, Chairman of the Executive Board, Chief Executive Officer
- Klaus Miller, Member of the Executive Board, Life & Health
- Sven Althoff, Member of the Executive Board, Property & Casualty

Other Participants

- Andrew Ritchie
- Emanuele Musio
- Kamran Hossain
- Paris Hadjiantonis
- Thomas Fossard
- Vinit Malhotra

Presentation

Operator

Good morning, ladies and gentlemen. I welcome you to today's Hannover Re international conference call on the Q3 2020 results. For your information, this conference is being recorded.

At this time, I would like to hand you over to our host today, Mr.Jean-Jacques Henchoz, Chief Executive Officer. Please go ahead, sir.

Jean-Jacques Henchoz {BIO 17457677 <GO>}

Thank you very much, and good morning, everyone. Let me welcome you to this conference call presenting our results for the first nine months of the year. As usual, I'll start with an overview before our new Group CFO, Clemens Jungsthofel goes through the financials in detail. And I will then comment on the outlook for the year later on. For the Q&A, I'm additionally joined by my board colleagues, Klaus Miller, on the life side; and Sven Althoff for P&C.

Looking at the results for the first nine months. The Hannover Re Group has again proven its resilience, bearing in mind that we have absorbed a total pre-tax impact of around EUR860 million from COVID-19 in our P&C and Life & Health business segment, the group net income of EUR668 million and the return on equity of 8.3% are quite satisfactory.

Additionally, the Solvency II ratio of 222% remains comfortably above our 200% threshold. And with double-digit premium growth our new business production is fully intact in an improving market environment. Overall, there is of course still an element of uncertainty around the COVID-19 loss experience going forward. However, due to the provisions made for expected COVID-19 related losses, we're now in a position to provide guidance for the year-end results. As things currently stand, Hannover Re anticipates a group net income of more than EUR800 million for the full year 2020.

Going into the details of the results of our P&C reinsurance business. The additional EUR100 million related to COVID-19 claims in the third quarter are significantly lower than what we booked in Q1 and Q2, bringing the total loss estimate to EUR700 million. The major part 71% of the EUR700 million are still IBNR reserves. And the affected lines of business are also largely the same as before, namely business interruption, credit and surety and event cancellations.

Additionally, we have reserved for expected losses in some other lines as for instance D&O. The COVID-19 losses, together with a NatCat and man-made large losses where we observed increased activity in the third quarter, exceeded our budget for the first nine months by EUR400 million, bringing the year-to-date combined ratio to 101.4%.

In life and health reinsurance, the COVID-19 impact on the result was EUR160 million. The main driver here is our US business. Against this backdrop, the EBIT of EUR315 million is strong, also stripping out a positive one-off effect of EUR55 million within the investment income. Financial solutions continues to perform superbly. And the US mortality experience excluding the COVID-19 effect was in line with our expectations.

Finally, at 2.8% or 2.7% adjusted for the one-off effect in life and health, the return on investment is satisfactory and in line with our initial and now reconfirmed new target for 2020. The profitable premium growth in the first nine months is the main reason for the very positive operating cash flow of EUR2.6 billion in the first three quarters of 2020, which is already higher than full year figures for the previous year.

The strong cash flow in turn is fueling the growth in assets under management shown on the right side of the slide, which is particularly important in the current low yield environment, because the growing asset base is helping us to mitigate the impact from low reinvestment yields.

Looking at the details of the invested assets. The positive change in valuation reserves only partly offset the negative effects from currency translation resulting from the devaluation of the U.S. dollar. Altogether, assets under own management stood at about EUR49 billion at the end of the third quarter.

Looking at our capital position. Shareholders' equity increased by 2.8%. As you can see, the net income for the first nine months was sufficient to fully cover the dividend payment in Q2, which is even more pleasing, bearing in mind that the group absorbed a negative net COVID-19 impact of EUR860 million.

Within the OCI, the positive impact from the decrease in interest rates is more than compensating for negative effects from currency translation. On the left side of the slide, you can see that the capital composition is more or less unchanged. You might remember that we issued EUR500 million in hybrid capital in July. However, we also had a EUR500 million hybrid bonds with the first call date in September. And as we exercise the call option as planned, there is no visible effect on the total hybrid position. By the way, the same is also true of our Solvency II balance sheet, which means that we have also maintained a high degree of flexibility around our hybrid capacity.

On that note, I would like to hand over to Clemens, our CFO who will explain the figures in more detail.

Clemens Jungsthofel {BIO 20496428 <GO>}

Yes. Good morning, and thank you, Jean-Jacques. It's a pleasure for me to present the financials of the Hannover Re Group for the first time. So moving directly on to the segmental reporting.

I will start with the development of our property and casualty business group on Slide 7. Gross written premium grew by 16% adjusted for currency effects. The growth is highly diversified, which is pleasing with particularly strong contributions from North America and the APAC region. Overall the development was driven more by property than casualty business.

Looking at the large loss situation for Hannover Re. The loss activity from natural catastrophes and man-made losses has clearly increased significantly compared to the first half year, almost exhausting the Q3 standalone budget of EUR336 million. On the other hand, the additional net impact from COVID-19 at EUR100 million was materially below the numbers we saw in Q1 or Q2. Overall, 71% of the estimated EUR700 million of total impact still consist of IBNR reserves.

As Jean-Jacques explained, there remains of course an elevated level of uncertainty around the further loss experience. However, the high level of IBNR also provides significant headroom for actual claims to be reported and we do feel comfortable with our reserving position as of today.

As a result of the reserving for COVID-19-related claims expectations, the large loss budget for the first nine months of 2020 was exceeded by EUR400 million, accounting for roughly 3.8 combined ratio points. Adjusting the reported combined ratio of 101.4 for this budget over run, the figure would have been close to our 97% target for 2020.

In terms of the runoff of our reserves, it's fair to say that in the nine-months 2020, our runoff result was positive and overall in line with our expectation. Altogether, I would guess the confidence level should not have changed materially since year-end 2019. But I would at least not assume that we added anything to our reserve buffer.

On the investment side, net investment income decreased by around EUR100 million with lower contributions mainly from private equity, from real estate and from our inflation-linked bonds within the ordinary return. Compared to the second quarter, impairments were modest in the third quarter and on a nine-month basis offset by an increase in realized gains. Other income and expenses were positive by EUR67 million mainly driven by positive currency effects. Altogether, the EBIT margin decreased to 5.6%, mainly due to the weaker underwriting result.

On Slide 8, total net large losses including COVID-19-related claims accounted for EUR1.149 million in the first nine months of 2020, exceeding the budget of EUR749 million by EUR400 million. Compared to the first half year, the difference between the gross and net loss, as you can see on the slide has increased. This is because the high NatCat activity in Q3 triggered our retro program. And additionally, a part of our COVID losses are covered by our retro as well.

Overall, the EUR1.14 billion net loss already exceeds our full year budget by EUR175 million. This means that 2020 will be the fourth consecutive year with large losses above the expectation, which of course is not only true for Hannover Re, but it also applies to the industry as a whole. And that should trigger even more positive pricing moments going forward.

On Slide 9, you can see our large loss list. It reflects the increased loss activity as mentioned earlier in the third quarter. Largest loss on the NatCat side, as you can see here, what's the so-called (the record) storm event in the US, followed by Hurricane Laura. On the man-made side, the port explosion in Beirut accounted for EUR67 million on a net basis. Due to the very benign first half year, total large losses would still have been below budget excluding COVID-19. Looking at the numbers for COVID-19. In Q3, the gross loss increased by EUR264 million to EUR873 million.

In comparison, the net development of EUR100 million was significantly lower. The reason for this is that we receive more and more information from our clients enabling us to allocate IBNR reserves to individual treaties. And we also take into consideration, of course, our retrocession protection. This was not possible with the IBNR booked in the first half year.

You will remember that where we had reported a gros loss very close to the net, even though the underlying assumption for the gross loss was already higher. In the event of further increases in the gross position, it's fair to say in the fourth quarter, we can at least partly expect corresponding relief from our retrocessions, which will then limit the impact of course on our net position.

On Slide 10, that shows the profitability of our P&C portfolio by line of business. Overall, COVID-19 affected several regions and lines of business, as you can see here. But Europe and credit and surety were the most severely impacted ones. The weaker technical profitability in the Americas was mainly the result of the mentioned weather-related U.S. losses in the third quarter. Agricultural business was mainly affected by the Bushfires in Australia and some COVID effects.

On the positive side, the technical profitability of our facultative business as well as our aviation and marine business was very favorable. Altogether, combined ratio was at 101.4.

On Slide 12, looking at the development of our life and health business group. Growth was mainly driven by a large financing treaty. You will remember that probably from last year from earlier calls that we wrote in Q4 2019 in Australia. However, this was partly mitigated by the expected reduction in premium volume due to the effect of recaptures in our U.S. mortality portfolio, as a result of our management actions in the previous year.

Altogether, gross written premium in life and health increased by 5% adjusted for currency effects. The impact from COVID-19 was EUR160 million in the first nine months, of which 43% is booked as IBNR. The main driver was our US mortality book. But other areas, like for example our Australian disability business are also affected.

Overall, we are still seeing significant differences between population mortality and the effect on our portfolio, largely due to socioeconomic factors and a age structure. Apart from COVID-19, the result of our life and health business group was quite favorable. The legacy US mortality portfolio performed in line with our expectation. And the earnings contribution from our financial solutions business in particular, continued to be excellent.

On top of this, we recorded an extraordinary gain of EUR55 million from an equity participation as part of our investment income. Adjusting for both the EUR160 million COVID-19 impact and this positive one-off, the EBIT would have been very favorable at around EUR420 million.

Looking at the individual third quarter. The normalized EBIT on the life and health side would have been EUR143 million. The net investment income decreased mainly due to the EUR100 million positive one-off effect recorded in 2019. You will remember that which was only partly offset by the one-off effect in this year. Otherwise, the ordinary income was favorably supported by an overall positive contribution from the change in fair value through P&L, even though the impact from our ModCo derivative was negative by EUR9 million.

Other income and expenses primarily driven by further increase in the contributions from our deposit accounted financial solutions business. Currency effects were slightly negative. At 5.3%, the tax ratio is low, mainly due to good results from subsidiaries in jurisdictions with a low tax rate and the tax reduced investment gains from the aforementioned participation. In the third quarter standalone, we have seen the same effects and in combination with losses at individual subsidiaries. The tax rate was even negative.

On Slide 13, sort of as an additional information beyond the IFRS numbers. This slide shows an overview of the new business written in the third quarter 2020 as well as upcoming business opportunity on the life and health side. Both the new business and the pipeline business are rather diversified by region and reporting category, but particularly our financial solution business is an area where we continue to see very healthy demand.

Just for the sake of completeness, since we've focused only on the most important deals here in this overview. This, of course, does not mean that we don't see any opportunities in markets or regions, not mentioned on this slide. Altogether, the value of new business achieved in the first nine months already comfortably surpasses our full year target of at least EUR220 million.

So moving on to our investments on Slide 15. I think it's pleasing to see that despite the very challenging market environment on the capital markets, the return on investments of 2.8%, including ModCo and excluding ModCo actually, it's -- so the aforementioned amount doesn't really contribute to that number. So 2.8% return on investment is still in line with our initial full year target, even excluding the EUR55 million positive one-off effect in life and health that I mentioned earlier, the ROI would still have been 2.7%.

The decrease in ordinary investment income is driven on the one hand by lower contribution from our inflation-linked bond portfolio. You know that we purchased that to hedge our inflation risk. And there is some balancing effect, of course, on the underwriting side as well. On the other hand, by the returns from private equity, which were also weaker compared to our expectation in a normal market environment and compared to the very high contributions in the last -- particularly the last two years.

Realized gains are on a similar level to last year, where we have benefited from the restructuring of our participation in Viridium. This year, realizations are mainly coming from our fixed income portfolio. And impairments and depreciations were higher than last year, mainly due to the impairments for alternative investments in the second quarter. Impairments recognized in the third quarter were fair to say very moderate. Unrealized gains increased remarkably to EUR3.2 billion, driven by significantly lower interest rates and further normalization of credit spreads due to the recovery of corporate bond markets.

On the next slide, Slide 16, you can see that we have actually not changed too much in our asset allocation. I think the slide is quite familiar to most of you. So we have not changed the asset allocation and we do not intend to do so. You might remember, even before the crisis started, we had begun to sort of scale back some of the proportion of bonds attributable to our US SME portfolio. And we have used the price correction in the stock market in March to carefully reenter the listed equities, buying around EUR250 million.

As mentioned in earlier quarterly results calls, we have been following a passive derisking approach with new money being invested in high quality assets only. However, in the meantime, this has come to an end. And we do carefully start back to normalize our credit risk taking. Contribution, as you can see here, on the ordinary investment income is diversified as usual, this time with a slightly lower share from private equity.

So this conclude my remarks. And I hand back to you Jean-Jacques.

Jean-Jacques Henchoz {BIO 17457677 <GO>}

Thank you very much, Clemens. Let me now cover the outlook section on Slide 18. And first, our updated guidance for 2020. Based on our assessment of the impact of the COVID-19 pandemic, we feel comfortable enough to provide guidance on our financial results again, and expect group net income of more than EUR800 million for 2020.

You might ask why the Q4 performance needed to achieve. The EUR800 million looks modest. But as you already heard, some negative effects are to be expected in life and health as in previous quarters. And additionally, the investment return in our assumptions is slightly lower than the 2.8% for the first nine months. For the full year, it should still be around 2.7%.

Gross written premium for the group is expected to show high single-digit percentage growth at constant exchange rates. Finally, we expect to pay an ordinary dividend of EUR4 per share for the year 2020, in line with the previous year. The payout of a special dividend will be partially dependent on the growth opportunities that actually materialize in the upcoming P&C renewals in January and the amount of capital tied up by this growth.

Based on increasing demand for reinsurance and improving market conditions, it is pleasing to see that many lines of business are growing. Even more importantly, we also expect these trends to continue in the next renewal seasons for 2021. The profitability outlook for the full year 2020 is more or less in line with the combined ratio overview Clemens showed earlier, largely reflecting the COVID-19 impact.

In life and health, we can similarly see which lines of business are affected by the pandemic, namely mortality and morbidity. On the positive side, as already stated, our currently most important profit driver financial solutions continues to perform very well. And the profitability of our longevity business is also strong.

Even if hardening market cycles are generally not a theme in life and health reinsurance, we have seen earlier that our new business production is fully impact -- fully intact, sorry, and that the pipeline looks quite healthy. Demand in financial solutions continues to be favorable and is also visible this time in our premium development, due in particular to a large financing deal in Australia. Additionally, we see promising growth potential in the Asian market. And the growth of our mortality business is impacted by the effect of recaptures in our U.S. mortality portfolio.

As usual, we also provide a first look at our expectations for the next financial year together with the publication of our Q3 numbers, even though the market environment is currently more dynamic than usual.

Gross written premium is expected to grow by around 5%. And you might be surprised that the number is not higher in light of a hardening P&C market. But firstly, we didn't want to put too much pressure on our underwriters by giving a higher volume target. As usual, the focus is on the bottom line contribution. And secondly, I would point to the potential negative impact the economic downturn might have on the primary insurance market and indirectly also possibly on proportional reinsurance business.

Of course, it's early days and we will review this target after the one-one renewals when we have more transparency on their outcome. The return on investment is impacted by the lower reinvestment yields. And additionally, we expect some lower contributions from inflation-linked bonds with the resulting decline to 2.4% in the next year. Regarding the inflation-linked bonds, please bear in mind that we buy those to hedge the inflation risk of our P&C reserves. And therefore economically, there is an offset in our liabilities.

On the positive side, assets under management are expected to grow further due to the positive cash flow helping to mitigate the impact on the absolute investment income. Altogether, we anticipate group net income in the range of EUR1.15 billion to EUR1.25 billion, and therefore, on a similar level to the initial expectation for this year.

Looking at the components of this guidance. The contribution from our P&C business should improve compared to our assumptions for the last year, whereas the investment return is slightly under pressure in the low yield environment. The development of life and health is expected to be more stable. In general, there is, of course, a higher degree of uncertainty than usual. And various factors such as the availability of COVID-19 vaccines will have an influence on the further course of the pandemic.

Therefore our guidance is subject to the premise that we do not see a significant COVID-19 impact on our life and health business, and as usual, that major loss expenditure remains within the budgeted level and that there are no unforeseen distortions on capital markets. The large loss budget for the next year will be increased to EUR1.1 billion, largely driven by the growth of our business.

Finally, we will continue to adhere to our general dividend policy going forward, with a payout ratio of 35% to 45% for the ordinary dividend and the addition of a special dividend, if our performance is in line with expectations and the capitalization of the company remains comfortable.

This concludes our remarks, and we would be happy to answer your questions. Thank you.

Questions And Answers

Operator

(Question And Answer)

We will now begin our question-and-answer session. (Operator Instructions) Our first question is from Emanuele Musio, Morgan Stanley. Please go ahead. Your line is now open.

Q - Emanuele Musio {BIO 19781440 <GO>}

Good morning. Thanks for taking my question. Actually, I have two questions. Looking at your guidance for 2021, I am quite surprised that you are aiming at earnings in line with 2019, basically. However, since then, the rate have gradually improved. The momentum will start quite strongly in 2020, partly as a consequence of lower investment returns that you mentioned already, right? And so, was just curious to know a bit more about your assumption for 2021 maybe in terms of COVID-19 and loss expectation? Or maybe you are implying that rate improvements are still not enough? Or maybe you are just setting the bar low in view of uncertainties and maybe the idea is to gradually raise the bar as clarity emerge? Any comment of this would be much appreciated.

And the second one is still on objectives. I mean it is, I think broadly shared view that 2021 will see further pricing improvements, although the improvement will learn through full in 2022. So as far as gross written premium growth in 2021 is concerned, you aim at just 5%. So I struggle to understand because it might be argued that lower top-line growth in a hardening market should go to the benefit of profitability, but this is not reflected in your net income guidance.

So what is the missing link here? You said, you don't want to put pressure on underwriters, but arguably rates have gone up by more than 5%. So even if you renew your existing book at better rates, shouldn't you see more than that, more than 5%? I mean, what is the average rate improvement across your book to-date? So if you can please help me understand a little bit more about these two elements.

A - Jean-Jacques Henchoz {BIO 17457677 <GO>}

Thank you very much. So maybe just a couple of general comments, and I'll pass on to my colleagues just to go into the specifics.

I think we're faced with a situation, which of course, is rather uncertain. And it's much harder this year to anticipate the development in '21. So the range is a little bit -- the range of outcome is a bit wider. But nevertheless, we felt sufficiently confident to affirm range in terms of net income and growth. I think in terms of growth, the biggest challenge we're facing is the uncertainty on the economic outlook. So this is very hard to quantify. And we felt this would of course have a bearing on the eventual growth outlook therefore 5%, which might come a bit more modest than anticipated.

So maybe both P&C and life and health, I'll ask Sven to start with P&C with the assumptions, expectations for '21 and then Klaus on the life and health outlook.

A - Sven Althoff {BIO 19104724 <GO>}

Yes. Thank you, Jean-Jacques.

When it comes to the profitability, our expectation is that we will have substantial rate increases at set to 1:1 and later renewals. But as I already explained during our Investors Day, this will not directly translate 1:1 into an improved combined ratio. It will to some degree, but the features, which will eat part of the rate increase, which will be achieved as our view on risk. That has naturally changed, where we had losses and where those model -- losses go into our models. And therefore, our view on risk for some classes of risk lines of business have increased, requiring part of the rate increases we will achieve.

And secondly, as you know, we are buying significant amount of retrocessional coverage. Whilst we are confident that we will achieve pricing, which is risk-adjusted similar to the pricing we have in 2020, the underlying business has grown as you can see looking at our Q3 premium figures. So therefore the premium for those covers will increase in line with exposure growth also eating part of our gross rate increases that we are going to achieve.

On the growth side, in addition to what Jean-Jacques has already explained, I can offer two additional comments. One is that rate increases does not necessarily always translate into premium increases. There are lines of business, which are driven by turnover or other classes of business, which have a link to the underlying pricing of, for example, the commodity. And in a situation of a severe economic downturn, therefore the underlying premium or exposure basis is somewhat erod. D and therefore rate increases do not necessarily mean premium increases on a one-to-one basis. And secondly, you know that the business is not only re-rated at the reinsurance level, but also at the insurance level. So therefore, for certain covers, the confidence of our ceding companies will be increased so they may retain a little more of the business net.

And secondly, the re-rating of the reinsurance may lead to restructuring of programs also meaning that ceding companies may take higher net positions at the more frequency part of their programs. So that would be my explanations on the P&C side.

A - Klaus Miller {BIO 16886879 <GO>}

Okay. On the life side, we basically have to look at the U.S. and the performance there. The claims Jean-Jacques mentioned the EUR160 million are more than two-thirds from the U.S. And I would expect that to be the case also next year. All the other countries do not contribute significantly to any COVID claims so far. And in the U.S., we have certainly an expectation that for Q1, Q2 in 2021, we will still see losses of the same magnitude as we have seen in the last two quarters. This might and probably will be compensated to a large extent by new business. We see a huge demand on financial solutions side.

And if you look at the Page 13 of the presentation, where you see the value of new business and you just do a simple calculation, you probably have to use your ruler to figure out the value of your business, because we didn't put the number on the page. But it's about EUR 380 million. And if you deduct the EUR 160 million COVID claims, then you end up exactly with the planned value of new business. So on the lifestyle, it looks like we are fulfilling our plans completely and this should continue and might be evne more favorable in 2021. But we will definitely see COVID claims. It all depends on the fact when the U.S. starts managing the pandemic.

A - Jean-Jacques Henchoz {BIO 17457677 <GO>}

Maybe just one last piece of information on '21. Overall, we have the 5% growth. This is a bit of a mixed bag. The P&C growth is expected to be beyond that while life and health will be slightly below in the short term. So this shows a little bit of differentiation with the hardening market reflected in the numbers and the importance of financial solutions in life and health, which doesn't have such a strong impact on top line.

Q - Emanuele Musio {BIO 19781440 <GO>}

Okay. Thank you.

Operator

Our next question is from Kamran Hossain, RBC. Please go ahead, sir. Your line is now open.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi. Good morning, everyone. First question is based on the dividend, how to think about that? I guess the regular parts of the dividend is very clear. So a discussion there. But what are the key trigger points to think about on capital position versus the special cost of the dividend or one that you have paid in recent years. Is this S&P capital-linked? Or was there some other trigger? And if you were to hit your plan that you have at the moment for the renewals, given it sounds like you're being relatively conservative on kind of what you're assuming there. Does that mean you've got enough capital to pay that special part of the dividend or not? And the second question is looking at next year, your cat budget's increased, I think, 13% year-on-year well ahead of the premium growth you're suggesting. Is this mix change at some assumption change or bits of both? Any thoughts on that would be helpful. Thank you.

A - Jean-Jacques Henchoz {BIO 17457677 <GO>}

Thank you. Clemens will respond on the dividend and capital management and Sven on that net cat.

A - Clemens Jungsthofel {BIO 20496428 <GO>}

Yes. Thank you. Well, Kamran, on the dividend. Well, you can see that in our Solvency II number, which is very stable at 222% as of Q3. So in all regimes and of course as you rightly mentioned, we do have the rating agency models, et cetera. We've always had good buffers both -- in both regimes, I would say. And we do, at the moment still have sufficient water under the keel in terms of our capitalization.

However, I think it's fair to say that -- and you've seen that in 2020, our business has grown at a stronger pace than our capital in all regimes. And if the opportunities appear as we do expect them, particularly on the P&C side, they will absorb further capital. And we really -- that's why we put it slightly cautious like that on the special dividend side. I mean we really want to be in the best possible position to take full advantage of the improving market conditions. So we really do not want to limit attractive growth opportunities by any capital needs. So we will have a probably better position at the end of the year, our Q4 position. But that's the reason why we have been careful in wording our guidance in terms of the special dividend really to be able to make a better call, when we see the Q4 numbers and when we are through the renewals particularly on the P&C side.

A - Klaus Miller {BIO 16886879 <GO>}

As regard to your question on the major loss budget, could you please repeat your question? I didn't fully understand parts of your question.

Q - Kamran Hossain {BIO 17666412 <GO>}

Yes. Sure. The -- I guess, the large loss budget seems to have grown -- or for next year seems to have grown 13%. You're implying 13 -- sorry, 13% versus 5% premium growth. So I was just trying to understand is this a mix change in business? Or are you rising kind of more cat business? Or is this an assumption change given the last four years have been running ahead of budget, I guess, not just for you, but for the industry as well?

A - Klaus Miller {BIO 16886879 <GO>}

Okay. Thank you very much. The answer to that question is that it's a mix between our over achievement in 2020. As you know, when we started the year, we didn't expect a double-digit premium growth on the P&C side. And of course the EUR975 million, we had written down in 2019 already. So therefore, a part of the adjustment is growth related in 2020. And the second part, of course, is then growth related as an expectation into 2021.

When it comes to mix of business, we are not expecting any fundamental changes as far as the mix of business is concerned. But what can be said is that we have made a little more room in our internal model for writing natural catastrophe-exposed business given the re-rating we are expecting. So we have adjusted our risk appetite from somewhere in the 16% range to 18% of economic capital according to Solvency II. So there is a little higher risk appetite, but not substantially.

Q - Kamran Hossain {BIO 17666412 <GO>}

That's great. Thank you.

Operator

Our next question is from Vinit Malhotra, Mediobanca. Please go ahead sir. Your line is now open.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes. Good morning. Thank you. I hope you can hear me.

A - Jean-Jacques Henchoz {BIO 17457677 <GO>}

Yep.

Q - Vinit Malhotra {BIO 16184491 <GO>}

So the question -- the first one is on the gross loss on COVID in third quarter of EUR264 million. I just wanted to better understand is the allocation to the IBNRs and is the allocation to the individual treaties, is that something that is just the mechanical procedure? Or is that being actively driven in other words? And also is this gross-to-net already in 3Q a bit faster than we expected -- or you expected? And just some commentary on that would be interesting.

And second thing is just on the life mortality, the recent headline figures in the U.S. Is the population and the portfolio, the difference -- I think in an earlier call, Klaus, you might have mentioned, 20% population and 5% for Hannover's own book. Is the recent -- more recent trend still in line with the earlier kind of relationship? Or is it that there is a bit of more divergence between the population and what you would expect from Hannover Re portfolio. And I'm more referring to even a qualitative comment from the more recent data, not just 3Q, please. Thank you very much.

A - Jean-Jacques Henchoz {BIO 17457677 <GO>}

Thank you. So the gross-to-net situation COVID will be answered by Sven and U.S. mortality by Klaus.

A - Sven Althoff {BIO 19104724 <GO>}

Yes. For the P&C COVID side, we had seen more loss reserves advised by our ceding companies in the third quarter compared to the second quarter. The IBNR setting is not a mechanical exercise. It's to a large degree a management decision. But as Jean-Jacques mentioned, we have kept the overall level of IBNR at 71%, still relatively close to the 80% we were showing in the second quarter. So it was important for us given the ongoing uncertainty to keep the IBNR level at a relatively similar level compared to the second quarter.

Given that we have a little more clarity, talking to our ceding companies from where we can expect those losses, it was easier for us in the third quarter to book some of the IBNR against individual contracts. And to the extent we have done that certain retention levels are satisfied on the retrocessional side. That piece of the equation is more mechanical than at that stage. And the same goes for our K-securitization. Once a business qualifies for session under K, we have a full follow fortunes principle. And therefore to the extent we are booking -- specific IBNRs on those contracts, this would filter through to our K transaction. And lastly in Q3, we have started to already -- to also see a lot advisers under our ILS fronting activities. And they are, of course, directly channeled to the investor base for which we are doing the fronting.

Q - Vinit Malhotra {BIO 16184491 <GO>}

And so even for the fourth quarter, you still think you're still very comfortable with the situation on COVID P&C, Sven?

A - Sven Althoff {BIO 19104724 <GO>}

We are comfortable. I wouldn't say very. I mean, the pandemic is ongoing. We have the second wave of partial lockdown mechanisms. You and I, we have both no idea whether that's a November topic or whether this will lead well into 2021. So from that point of view, we feel that we are well reserved, that we have good cushions on the IBNR side. But there's still significant uncertainty as far as the extent and the duration of the lockdown is concerned, and the economic consequences coming with that.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Thank you.

A - Sven Althoff {BIO 19104724 <GO>}

Yes.

A - Klaus Miller {BIO 16886879 <GO>}

Yes. On the life side, I might have to disappoint you. My former answers are still valid. We don't have much new information. The second and third quarters of the U.S. Population mortality has been as you mentioned, at 20% higher than expected. About 70% of that is explained by the COVID claims directly. That means that's the death certificate same COVID. The rest is first of all variations in the classification of COVID claims at the state level. Reporting is not that great. Then also significant impact might come from fewer people seeking medical treatment for serious medical issues because of a fear of COVID, so they don't go to the hospital. And there is also very likely we would call it deaths of despair like suicide, opioids, things like that. This translates into a portfolio death rate of perhaps less than 5% because of the age distribution. The average age of COVID deaths, I guess in the U.S. and this is the market we track closely, because most of our claims come from there, is the age is still about 68. It's significantly higher in other countries like, Germany. We have 80 to 82 and basically no claims in our portfolio. In the U.S., you have permanent business. In the UK, you have a little bit of what you call all of life business. But this is relatively negligible for our portfolio at least in the UK.

Then the claims we see are significantly lower than the average plan, what we have. We have only seen eight claims above $1 million so far. And that is significantly lower than we would usually expect. So this explains the big difference, but it all depends on the age distribution in your portfolio. And as you might remember, we have been able to get rid of a lot of this in the last two years by recaptured. I hope that answers your question, but I'm sure you will ask it again in three months' time. And then I might have another answer.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Right. We'll look forward to that. Thank you very much.

A - Klaus Miller {BIO 16886879 <GO>}

Sorry.

Operator

Our next question is from Thomas Fossard, HSBC. Please go ahead. Your line is now go ahead. Your line is now open.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes. Good morning, everyone. I've got two questions. The first one would be related to the special dividend again. Sorry about that. Understand your remark regarding still a question mark on how strong the one-one renewals could be. But if I remember well, you issued a EUR500 million subordinated bond in Q2, if I'm right. And that was not for, I would say, clear refinancing purposes. I see that at that time, you indicated that you raised a bond in order to have some additional flexibility if business opportunities were stronger than expected. So could you maybe rephrase your special divi comment, taking into consideration the EUR500 million hybrid bond?

And my second question will be related to COVID-19 additional reserves, you booked in Q3 on credit and surety and also in the other lines. That's where obviously the increase has been. But clearly we have not seen yet any substantive news flows on these two lines. So maybe you could shed some light on what has driven the increase in those two lines in terms of additional reserves? Thank you.

A - Jean-Jacques Henchoz {BIO 17457677 <GO>}

Clemens, special dividend first.

A - Clemens Jungsthofel {BIO 20496428 <GO>}

Yes. Thomas, happy to clarify to add some information to the hybrid situation and the special dividend. In general, yes, it's -- you're perfectly right. We did raise a hybrid bond in the second quarter. However, and I probably have not been so clear on that earlier. I apologize. So I think we -- that was only, one, to refinance the early call bond that we called in the third quarter. So that was actually a refinancing act, which we always knew that wouldn't really add capital to our position.

As you know, yes, there is headroom for further financing activities. Of course, we will look into that. But again, that's the reason why we've been cautious in terms of the special dividend. And of course, please bear in mind that when you look at our guidance for 2020, the more than EUR800 million already translate to roughly 60% payout ratio for the basis dividend, of course. So that's something that we kept in mind as well. But again, we will revisit that position earlier in 2021.

I hope, Thomas, that answers the question to some extent on the hybrid front.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes, thank you.

A - Sven Althoff {BIO 19104724 <GO>}

When it comes to the COVID losses, let me start with the credit side. Yes, you're right. We have a relatively little news as far as individual insolvencies is concerned. Here, the various state stimulus programs for the economy are doing their job. So we have strong stimulus packages. We have rules in place, lifting the requirements for declaring insolvencies. So therefore this problem not gone away, but it's pushed us into the future. Let me put it this way. So from a pure accident year point of view, there would be very little need to do any reserving on the credit and surety as regards COVID this year. So you have to see the EUR180 million we have booked here as a precaution for future insolvencies, which most likely will not happen 2020, but in later years. The exact timing, of course, is unknown. The reason for the increase from Q2 to Q3 has to be understood in the context that of course, we have earned additional premium in the third quarter. So therefore, we have booked some additional IBNRs on that additionally earned premium adding to the precaution we had taken in Q2.

When it comes to business interruption, we have more advances from our ceding companies from a variety of regions. I guess the best publicized situation in the last couple of weeks has been the UK with the FCA test case and the outcome of first ruling. Ceding companies, of course, have translated that ruling into losses as far as their portfolio is concerned have advised those losses to us. And we have booked them accordingly. And as I've mentioned before, we have taken this as, yes, a requirement to proportionately build additional IBNRs on top of that in order to stay at a comfortable level when it comes to actually advice claims to IBNRs and the overall reserve situation.

Q - Thomas Fossard {BIO 1941215 <GO>}

So thank you. Maybe one word, if you could on the other lines, so maybe the financials and D&O lines where things have increased as well?

A - Sven Althoff {BIO 19104724 <GO>}

Yes. There was a relatively proportionate increase in all lines of business. If you look at Q2 where we had booked EUR600 million and Q3 the EUR873 million, which we have booked on a gross basis, we have added to our Q2 results in all those lines of business. But depending on the news we received from the ceding companies to a varying extent, the largest increase we have certainly shown is on the property business interruption side. But there were also additional ins against lines of business like D&O.

Q - Thomas Fossard {BIO 1941215 <GO>}

Okay. Thanks, Sven.

Operator

Our next question is from Paris Hadjiantonis, Exane BNP Paribas. Please go ahead. Your line is now open.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Yes. Hi from my side as well. I hope everybody's doing well. The first question will be on Solvency II. And what is assumed currently in terms of COVID-19 losses going forward? I think Klaus implied earlier that some low triple digit million for higher mortality claims from the U.S. is already assumed, but can you please give us an idea both on Life Re and I don't know whether there's anything on the P&C side as well?

I mean relating to that question, since you are assuming some losses from mortality and looking at your guidance for 2021. I know you're trying to provide a normalized basis. But can you be a bit more clear on whether or not these assumed losses on Life Re are already included in the guidance you have given for 2021?

And then a small one, again on the Life Re side. Looking at your appendix, Slide 23, about one-third of the life and health losses are coming from non-mortality, so morbidity and other. Can you just give us some light on what exactly is driving this morbidity and other losses? Thank you.

A - Jean-Jacques Henchoz {BIO 17457677 <GO>}

Thank you. So Clemens will comment on what's baked into the Solvency II numbers, and then Klaus will take the other questions then.

A - Clemens Jungsthofel {BIO 20496428 <GO>}

Yes. Paris, exactly as you assume, there's a different picture on P&C and life and health both under IFRS and Solvency II regime under P&C, I think, it's fair to say what we show in our IFRS numbers is reflected in our Solvency II numbers already. So that really translates sort of into each other. On the life and health side, I would probably make some general remarks and then hand over to Klaus to add a bit more specifics on the numbers probably. But in general, I think in IFRS, it's pretty much the same as on the P&C side unless you do see future losses that don't want to be too technical, but that do not surpass the loss recognition test. So then you are able to account for future losses under IFRS regime other than that. And our current numbers do not reflect that. But Klaus will shed some light particularly on the Australian business.

In -- on Solvency II, I think it's fair to say we haven't really adjusted our long-term assumptions both for mortality and morbidity. That is not reflected in Solvency II. However, on the short term, let's say probably the next quarter and probably somewhat into 2021 is reflected in Solvency II reserves already. But Klaus, you might be able to shed some more light on that.

A - Klaus Miller {BIO 16886879 <GO>}

Yes. Let's start with the Solvency II numbers. I have just the numbers for the U.S., and this is about EUR100 million for the fourth quarter and 2021. About EUR30 million is for the fourth quarter and the rest for the year 2021 under Solvency II. There is no loss recognition in the U.S., because the buffers are high under IFRS. So you won't see that in the same cushion or buffer you won't see under IFRS.

And the other thing, Clemens already mentioned. In Australia the disability business was loss making the last couple of years and this has been a significant problem for us in the past. And we had loss recognition under IFRS 4. So that any changes we make to our IFRS numbers would go straight to the bottom line. And here we expect some economic downturn in 2021, which usually leads to higher disability claims in the sense that reactivation probabilities will go down. This could happen for various reasons, but definitely it will happen for COVID-19 reasons. There will be an economic downturn. That's what we expect for 2021. And we have about, I guess, EUR44 million in additional reserves put aside for the economic downturn-related lower reactivation rates in 2021. So this is a cushion for next year. But this is only possible under IFRS 4, because we are already in loss recognition for the disability business in Australia.

A - Clemens Jungsthofel {BIO 20496428 <GO>}

So Paris, to be clear that is really what you see under both regimes, right, under Solvency II. And IFRS as Klaus mentioned, something that we don't see in 2020, but we expect in 2021. However, we have taken care of that already as a sort of a second order effect related to COVID, to some extent, already in our 2020 numbers.

A - Klaus Miller {BIO 16886879 <GO>}

According to my definition, this is even a third order effect. The first order is COVID claims -- named COVID claims. The second is the claims I mentioned earlier from death of despair few sites -- or fewer people seeking medical treatment and die of a heart attack, because they don't go to hospital. The third order effect -- impact would be an economic downturn, which across the world has an impact on our disability claims. Does that answer your question?

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Yes, thank you. Just to come back to the guidance, Klaus, you are saying that in the U.S. mortality, you're talking about EUR17 million impact in 2021 and then also some on the morbidity side in Australia. Are these already reflected in your guidance for 2021 in terms of IFRS profits?

A - Klaus Miller {BIO 16886879 <GO>}

Yes.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Yes, okay.

Operator

Our next question is from Andrew Ritchie, Autonomous. Please go ahead. Your line is now open.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Hi there. Just a very quick question. I'm assuming your willingness to talk about the dividend means that you're assuming the regulator in Germany, BaFin, will be as pragmatic year-end dividend discussions as they were with the FY '19. Is that your working assumption? Have you been given any indications so far on that?

A - Jean-Jacques Henchoz {BIO 17457677 <GO>}

So we didn't have a direct discussion yet on this, but we expect based on the dialogue we've had in the past months to have a pragmatic perspective from the regulator in Germany. That's the assumption. I feel optimistic that this will be confirmed as we start the

New Year. But my assumption is that we'll have -- based on the numbers, based on the performance and the strong reserving position and the business outlook that BaFin would confirm the dividend.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Okay. Thanks.

Operator

(Operator Instructions) We haven't received further questions. I will hand back to the speakers.

A - Jean-Jacques Henchoz {BIO 17457677 <GO>}

Well, thank you very much for taking part of this call and for the questions. So we wanted to convey the message that our year-to-date figures are now solid enough to provide guidance. Of course, some moving parts and some potential for changes in the fourth quarter. There is some NatCat activity, in particular, but we feel confident in the EUR800 million are stated with a high confidence level.

We have robust reserving with COVID-19. The impact is yet to be confirmed, but I think there's more solidity in the numbers. And we understand more and more where we are. The primary wordings are changing, the reinsurance wordings will be changing. So the exposure will be reduced quite significantly. And on the guidance 2021, clearly lots of uncertainties. We took account of the economic outlook, which might not be very, very positive. But we see increasing momentum in P&C. We expect the hardening of the market and that's the main opportunity for us in 2021. And once we have this highlighted and more visibility on how we fare, I think we can confirm the dividend assumptions for the next year. So we'll have an opportunity in the New Year to comment on the renewals. Of course, we will give you an update on the outlook on '21 and obviously, the dividend decisions, which as always is being taken in the New Year.

Thank you very much for your attention, and have a good day.

Operator

Ladies and gentlemen, thank you for your attendance. This call has been concluded. You may disconnect.