Q1 2018 Earnings Call

Company Participants

- Roland Vogel, Chief Financial Officer & Member of the Executive Board
- Ulrich Wallin, Chairman of the Executive Board & Chief Executive Officer
- [0682QB-E Ulrich Wallin]

Other Participants

- Andreas Schäfer, Analyst
- Andrew J. Ritchie, Analyst
- Frank Kopfinger, Analyst
- Guilhem Horvath, Analyst
- Kamran Hossain, Analyst
- Roland Pfänder, Analyst
- Thomas Fossard, Analyst
- Vikram Gandhi, Analyst
- Vinit Malhotra, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen, and welcome to today's Hannover Re International Conference Call on Q1 2018 Results. For you information, this conference is being recorded. At this time, I would like to hand the call over to your host today, Mr. Ulrich Wallin, Chief Executive Officer. Please go ahead, sir.

[0682QB-E Ulrich Wallin]

Thank you. Good morning, ladies and gentlemen. I'd like to welcome you to our conference call presenting our results for the first quarter of 2018. As usual, I'm joined by our CFO, Roland Vogel. Before we start, I'd like to extend my special thanks to all those participating from the UK because you have a bank holiday today.

Unfortunately, we are bound with our Q1 conference call to the date of our AGM which takes place today. Sorry for any inconvenience we may have caused. I'm pleased to be able to report to you that our results for the first quarter of the year fully support our guidance for 2018. We managed to substantially grow our business and our gross written premium grew by 17.6% which equates to 27.5% at constant exchange rates.

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This growth was mainly driven by a number of large transactions from our P&C business group. As most of this business was written newly in the first quarter, it created a significant and earned premium reserve and as a result the net premium earned increased by only 7%. We are quite pleased that the EBIT grew by 8.5% which is somewhat more pronounced than the growth of our net earned premium income which we feel underlined the quality of the net earned premium growth.

The group net income only grew by 3.3% to €273 million. The lower growth of the group net income compared to the EBIT growth is the result of the one-off tax burden due to the reorganization of our U.S. Life & Health business following the U.S. tax reform which was enacted at the end of last year. We are, however, not expecting any further negative effects from the U.S. tax reform so that the tax rate of our Life & Health business should normalize in the coming quarters.

At 13%, the return on equity remains well above our minimum target of 900 basis points above the risk-free rate. Despite the fact that expressed in euros the book value per share slightly reduced due to the further strengthening of the euro, in particular, against the U.S. dollar, our solvency ratio remains comfortable at around 260%.

Our property-casualty reinsurance business in the first quarter saw a very dynamic growth both for the bottom as well as for the top line. Considering our continued conservative loss reserving policy, we are satisfied with the combined ratio of 95.9%, which meets our respective target.

Also our life and health business had a very good first quarter, with an EBIT growth of 6.9% to €96 million, driven in particular by our worldwide excluding U.S. business, as well as by the U.S. financial solutions business. Our legacy U.S. mortality business, whilst continued to be loss-making, developed better than we had expected following our complete remodeling of that business towards the end of last year. The premium growth amounted to 9.2% at constant exchange rate, which is well above our target.

I already commented on the one-off tax burden as a result of the U.S. tax reform. Once again, our return on investment developed very favorable and came in at 3.3% on an annualized basis for the assets under own management.

On this positive note, I would hand over to Roland, who will explain to you these figures in more detail.

Roland Vogel {BIO 16342285 <GO>}

Good morning. Thank you, Uli. I'll try to keep positive and I should be able to keep my comments brief, as the Q1 2018 results do not include too many material one-off effects. I would like to take this opportunity to point out that together with our Q1 results, we've also published our Solvency II SFCR reports for the full year 2017. This provide a lot of additional qualitative as well as quantitative information on top of the solvency ratios that we have already published with our year-end results. You will find them on our company website. The remarkable top line development of 27.5% adjusted for currency's effects in

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the first quarter of 2018 is driven by both business units but derives to a large extent from our P&C business, we will come to that.

The difference in gross - of gross in that premium is due to the change in unearned premiums which will be earned throughout the year, so the differences will become smaller as the year goes on. The retention ratio even increased slightly as compared to the last year. The income and the expenses on a group level decreased mainly due to FX effects. The increase in group net income was a little bit less pronounced compared to the EBIT resulting from an unfavorable tax rate. The reason for that unfavorable tax rate is a one-time increase based on the restructuring of group internal retrocessions before the background of the U.S. tax reform, we mentioned that already late 2017 and during the first quarter of 2018 we were able to achieve all required approvals from the supervisory authorities as well as ratings to implement our new structure. Such business transfers caused a one-off tax burden of around €22 million. For the ongoing tax rate, we do not expect sustainable changes.

On the next slide, you can see that the operating cash flow in the first quarter was particularly strong driven by strong reinsurance growth as well as pleasing results on the investment side. Such developments were partly mitigated by negative impacts on the valuation from rising interest rates and hardening euro.

On the other hand, as a proceeding step before we issued our first senior bond with the volume of €750 million early in Q2 2018, we had entered into a bank loan with the same amount. Background here was the support of the transfer of capital between companies as a result of the U.S. tax reform driven restructuring.

Overall, assets under own management increased slightly to the mentioned €40.5 billion. If we look at the capital side, you can see that the positive earnings this quarter did not entirely compensate for the negative currency effects and also the yield impacts hence leading to a 2.1% decrease in shareholders' equity. The recently issued bonds, I mentioned already, was just a senior note and will not change or affect the hybrid bucket. That means we still have enormous flexibility on our balance sheet. By the way, we issued the senior notes for the upcoming growth of financing L&H business particularly in Asia and Australia.

The P&C gross premium increased by a remarkable 38.8%, so nearly 40% of FX-adjusted basis. This is mainly driven by the successful business written by our structured reinsurance team and overall is in line with our reporting on this year's January renewals. This growth also includes some larger transactions of our traditional business line, especially in Asia and Australia. Traditional lines thereby contributed approximately 12 percentage points to the nominal growth of around 28% in P&C.

Net premium earned increased by 22.4% adjusted for currency exchange rates, and that was based on the increase in the unearned part of the premium as already mentioned. A 3.4% of net premium income, major losses were again below budget. For the first quarter, the underwriting result is on a good level as the combined ratio of 95.9% comes in below the full year maximum target of 96%.

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As in previous years, we stuck to our reserving practice and kept a large loss expectations as part of our IBNR reserves. We've also not changed our reserving for the application of the Ogden rates in the UK, all case reserves here are still based on the negative 72 basis points discount rate.

It is also important to bear in mind that the increase in structured reinsurance business generally leads to higher combined ratios as the lower – less (00:11:29) transfers justifies also lower margins. With more than a quarter of our P&C premium coming from structured reinsurance in Q1, the achievement of our 96% target is therefore actually pleasing. So, early in the year, any comments on the development of our confidence level in the reserves are actually uncertain and we have not changed our approach to setting up reserves and with large losses under budget, we do not expect any material changes to the year-end level.

Ordinary investment income was stable and other income and expenses broadly unchanged. Altogether, net income for our P&C business stands at €235 million, up by 9% compared to an already big (00:12:23) first quarter of the previous year.

Major losses were significantly lower than in the previous year despite the fact that the net loss from natural catastrophes and man-made events in the first quarter 2017 had already been below the expected level, therefore, the annual budget amounts to approximately €94 million. As usual, the list of major losses in the first quarter is comparatively low. Next, to Friederike, only one property and one credit claim made it on large loss list in Q1.

On the next slide you can see that the picture is quite a mixed one. Overall, the combined ratio is below the maximum tolerable combined ratio. The main contributors to the good underwriting result of the first quarter were Continental Europe, marine, credit, and surety, and of course the nearly loss-free Cat XL business. North America here was impacted by negative reserve development from the previous years, here especially the Californian wildfires which occurred late in the year developed slightly negatively.

Aviation saw some general aviation claims within the UK business we increased our non-proportional motor business, which comes in with high initial loss ratio assumptions remarkably above 100%.

For life and health segment, the reinsurance gross written premium increased slightly by 2% or a little bit more by 9.2% adjusted for currency exchange rates. New business production was particularly favorable in Asia and the UK. The technical result has improved by quite a margin overall. This stems mainly from worldwide business excluding the U.S. and in particularly from the morbidity business.

After a number of quarters of underperformance, our U.S. mortality legacy portfolio did better and delivered a result above our current expectations given that the underwriting results on this slide here also includes the income from funds withheld. It is worth mentioning that income from funds withheld declined by €17 million due to the discontinuation of two large treaties.

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As explained earlier, the significant decrease in the other income and expenses can be explained by currency effects in the first quarter. Apart from this, the result from U.S. financial solution treaties recognized according to the deposit accounting method contributed €45 million, a figure largely unchanged from the previous year.

Having set a new target of EBIT growth of 5% per annum, we fared quite well and achieved 6.9% increase compared to the previous years in Q1. I already explained the one-off effect of about €22 million from the U.S. tax reform driven changes which percentage-wise have an even higher impact for the business improve on its own.

This effect will not go away over the course of the year but as a one-off impact it should be diluted or it should dilute down from quarter-to-quarter. Looking at the investment, the development of the first three months of 2018 is very satisfactory with investment income above our return expectation for the full year remarkably above that expectation. The ordinary investment income was on the previous year's high level and therefore favorable given that the decrease or the decrease of dividends from our listed equity portfolio which we saw in Q3 (00:16:55) last year.

Realized gains were a little bit higher than in the previous years, but all in all virtually in line with the full year's expectation, here is to no longer continue with our Barbell strategy and our intention to decrease our exposure to lower quality credits as they have performed so well in the past before that background, the sale of some of these investments came with the realization of positive valuation reserves.

The change in the fair value of financial instruments is predominantly driven by the change above the ModCo derivatives, but as you can see, this is only through to (00:17:39) margin extent. Overall the return on investment was 3.3% making us pretty confident to achieve the full year's target of 2.7% given that interest rates particularly the dollar and British sterling have increased and spreads in European and U.S. corporates have widened a little bit in the first quarter. The valuation reserves decreased compared to year-end which on the other hand is associated with a higher reinvestment yield.

The next slide here shows the usual overview of how the different asset classes contributed to the ordinary investment income compared to where we are invested. On the right-hand side, you can see that we have some changes in our asset allocation with some minor changes in the first quarter. The left-hand side illustrates the very strong performance of our private equity portfolio and the continued positive contribution from real estate. As I have explained, the 13% from the private equity is expected to trend towards a more normal level over the course of the year. But the impact on our real estate portfolio should, well, even increase slightly over the course of the year.

I think this should conclude my remarks about the financials. As usual, I leave the target markets and the outlook to Uli.

Ulrich Wallin {BIO 4863401 <GO>}

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Thank you, Roland. Yes. If – considering that we had a good result already during the first quarter of last year, it is quite pleasing that the result for the first quarter 2018 supports almost all of our strategic targets. We are particularly happy that both of our business groups achieved (00:19:42) results reporting all their targets from the target matrix.

Coming to the second quarter renewals, particular the 1st of April renewals. The renewals were actually quite similar from a market environment point of view compared to the renewals at January 1. Loss-free business was mainly renewing flat with only very slight increases. More meaningful rate increases were restricted to treaties, which suffered losses during the year or during the last year. The business remains very competitive. There's continued imbalance between supply and demand favoring the reinsurance buyers.

Nevertheless, we were reasonably satisfied as a result of the renewal for Hannover Re as we were able to achieve a double-digit growth again which is not too dissimilar to the January 1 renewal for our traditional property-casualty treaty business. The main part of the renewal was, of course, Japan where almost all the business renews at 1st of January. On the property side, which is the most reinsurance business being bought, the rates were absolutely flat. Some reported as flat as a pancake. As a result, we applied unchanged capacity from a catastrophe point of view. And overall, we saw a slight decrease of our premium income. This mainly comes from a reduction of some of our proportional treaties, which were the result of some portfolio management actions.

On the casualty side, there was further losses relating to pharmaceutical risk which were reported in the first quarter. And of course meant that, here, the rates were increasing again, however we applied a rather restrictive policy to the terms and conditions of those casualty treaties.

On the other hand, we saw significant increases in the Caribbean; there in particular, the loss-laden (00:22:21) business from Puerto Rico was up for renewal. So, there, of course, we saw significant increases and also an increase in volume. Also we cautiously increased our involvement in the agricultural business from India, which resulted in a doubling of the premium income there, even though from a relatively small level.

In North America, we were able to achieve some growth on the property business due to rate increases, but continued our cautious approach to the casualty business, but our premiums develop rather flat. The renewals on the property catastrophe excess of losses very much resembles the experience from 1st of January which meant that the rate (00:23:19) increases overall were a little bit disappointing and we kept our capacity and utilization unchanged.

And this resulted in a slight increase in the premium income due to some rate increases. Giving (00:23:39) the favor of development of the premiums in the first quarter and on the renewal at 1st of April, we were able to up our guidance for the development of the gross written premium to now more than 10%.

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Likewise, the favorable investment result in the first quarter already explained by Roland is slightly improved the return on equity on investment guidance from around 2.7%-plus to at least 2.7%, only a very subtle change.

Regarding the group net income and the dividend payout guidance is unchanged as regards to the dividend payout, considering the current development of our business and the very comfortable solvency ratio, we would consider again to pay a special dividend also for 2018 which should result in an overall dividend payout at least to the level of last year. Naturally, this is an early indication and it's of course subject to the development of the business during the remainder of the year.

But the market development continues to be somewhat disappointing considering the large loss burden from last year. Nevertheless, the less (00:25:13) we feel that we are in a good position to earn the cost of capital or even in excess of the cost of capital in most areas of our diversified property casualty reinsurance portfolio.

We are particularly pleased with the development of the volume as well as the profitability in Continental Europe, there our business already last year performed excellently. In addition, growth will be particularly pronounced in the structured reinsurance business as well as in the worldwide reinsurance business due to the large transactions which have already been mentioned.

Regarding our life and health business, we expect continued excellent profitability in our financial solutions business, particular stemming from the U.S. On the other hand, the U.S. mortality business will continue to be a burden to the bottom line which also means that in this category, we are likely not able to achieve result supporting the cost of capital.

On the other hand, our non-U.S. mortality business continues to develop very favorable with EBIT margins close to double digit numbers. Premium growth, we expect mainly to come from the morbidity business where we also expect improved results, which meet our cost of capital requirements.

On the longevity business, we see a rather stable development both on the bottom and on the top line, which however could change regarding the premium growth at this business, it's really quite bulky. And it depends if some of our quotations on the larger transactions come to fruition.

Overall, we feel that we are well-positioned to continue to be successful in the reinsurance business in the short and in the longer term future. As you know that our recent strategy revision creating value through reinsurance, we concentrate our efforts almost entirely to the reinsurance business that we feel we have a favorable competitive position.

On the property and casualty business, we are confident that we will continue to be able to reach our combined ratio target and increase the bottom and the top line of the business. Of course, the fact that an increased portion of the business stems from the

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structured reinsurance business which has a lower risk transfer but also lower risk margins, as Roland explains the combined ratio target becomes a little bit more challenging.

On our life and health reinsurance business, we expect that 2018 will continue to be negatively influenced by losses from our legacy U.S. business. The extent of the negative influence will also depend on the recaptures, which may occur as a result of our more aggressive in-force management actions regarding rate increases. From 2019 onwards, however, we expect positive development of the profitability of this business. Continued stable returns on investment will definitely be aided by the increasing interest rate in particular in respect of U.S. dollar investment.

On that note, ladies and gentlemen, we come to the end of our presentation covering the good start we have made for 2018 and we'll be delighted to answer your questions. Thank you very much.

Q&A

Operator

Ladies and gentlemen, we will now begin our question-and-answer session. The first question is from Kamran Hossain, RBC. Your line is now open. Please go ahead.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi. Good morning, everyone. Two questions for me. The first one, just on the outlook for the mid-year, I guess on your comments and from the call you've talked about plenty of excess capacity to the existing, but at the same time, you've kind of reported that you're seeing very, very strong increases on loss effect (00:30:31) of business. So just intrigued about your views on how the mid-year, I guess June, July renewals will go. So, that's question one.

Second question also on pricing, you've talked about, I guess, the underlying casualty business stabilizing. Just interested on your thoughts on I guess a withdrawal of capacity from a large player in that market announced last week and how do you think that might affect that market going forward? Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes. Regarding the outlook for mid-year pricing – thank you for your questions, Kamran. What I would say, I mean of course on 01/06, the Florida renewal season will be quite interesting even though a number of treaties are multi-year, so the effects will probably be not at large. I'm afraid that I'm not very optimistic on the Florida renewals because that business is dominated by the ILS market, and for the ILS market, Florida is key for their portfolio and, I mean, the demand for reinsurance in Florida is not increasing this year as far as we can see, but the supply definitely will.

So, I'm optimistic that we will see rate increases on Florida particular this movement of the Irma loss recently. But I don't think all the hopes of the market will be fulfilled in that

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renewal. The remainder of the mid-year (00:32:19) renewal I think they'll follow the 01/01 and 01/04 theme. There, I mean, loss making treaties, we'll see increases I expect particular on the U.S. property business outside Florida I expect further increases like we have seen before.

On the casualty business, it's really difficult one to read because, I mean, there are definitely areas certainly in the U.S. where we see increases like commercial load-off (00:33:00), and also, I mean, we have seen increased loss activity on D&O (00:33:05). So, their prices which have been reduced for years seem to be catching up. I mean, but I think in the short term, the business will continue to be competitive there despite the withdrawal you were talking about. I think it all depends on the development of the runoff results from previous years seems to be that the cautions of redundancies and the loss reserves of the casualty business are drying up, and we may even see deficiencies. And that development coupled with the inflationary development will depend what happens to the casualty business. For us for the time being, we apply, as I said, a rather cautious approach to casualty business.

Q - Kamran Hossain {BIO 17666412 <GO>}

Thanks for the color.

Operator

The following question is from Vinit Malhotra of Mediobanca. Your line is now open. Please go ahead.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Thank you. So, just two questions focusing on Life Re, please. I'm a bit curious that the – I mean, the ongoing flu season or just in the U.S. was quite bad. I mean, the data suggests very high level, maybe a one-off, but very high level of mortality. But your comments are completely sort of ambivalent to that. Could you just comment about the guidance and what you're [Technical Difficulty] (00:34:46-00:34:55)?

A - Ulrich Wallin {BIO 4863401 <GO>}

Vinit, I don't know whether you can hear us without any problem. The line doesn't work.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Is it better?

Operator

I think you're pressing digits on your key pad. Now, it's better.

A - Ulrich Wallin {BIO 4863401 <GO>}

Okay. Go ahead.

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Q - Vinit Malhotra {BIO 16184491 <GO>}

Is it better? Is it better? Even better? Hello?

Operator

Yes. Please go ahead.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes. Sorry, thank you. So, apologies for the technology. I'm out of the office today. Sorry. The Life Re, so two questions on Life Re, please. The first one is that we have seen the U.S. mortality affected by very high flu-related deaths. Could you comment on whether your guidance incorporates that? And what your experience was in 1Q?

And second question is on the 5% EBIT growth target, how should we interpret that going forward? What should be the baseline, if it implying that on a normal basis, you want to grow 5% from 2019 onwards? Or how should we look at that? Thank you very much.

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes, Vinit. Thank you for those questions. Well, on the flu season, we haven't seen it in the first quarter, is that – it's however, a little bit the result of the reporting which is a little bit delayed on that business. And as the business is also underwritten by our subsidiaries, it's also relatively early close of (00:36:27) of the quarter. So, the flu season effect will be more pronounced in the second quarter.

Early indications are not supporting that in the figures as yet, but of course, I mean it has to be brought in mind that we have changed our expectations to higher mortality as well. But, yeah, so far so good, I would say, from the experience we have seen, but we will certainly have a much better color on that for the second quarter. But as, I mean, even in the first quarter, on the U.S. mortality, we didn't make money. The only thing is we've only lost half as much as we thought that we would lose.

On the 5%, yeah, that's on a normalized basis. I mean, we just want to increase on a normalized basis going forward, the EBIT by 5% every year, say on average, say in a five-year period. But of course the basis for that should not be the low EBIT that we have experienced in 2017 and we are expecting for 2018, but more a normalized EBIT.

We have done that and we have done away with the EBIT margins because with the particularities of the business, we would have to take those – I mean margin requirements on an EBIT margin, on a much more granular basis in order to make sense. We obviously have seen that on the financial solution business, which is deposit accounting (00:38:32), which of course we haven't, not booking any premium but booking positive results, which of course skews that kind of metrics. Therefore, we thought we make it a little bit more simple and go for an EBIT growth.

Does that answer the questions?

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Q - Vinit Malhotra {BIO 16184491 <GO>}

Oh, yes. Thanks very much. Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, thank you, Vinit.

Operator

The next question is from Frank Kopfinger of Deutsche Bank. Your line is now open. Please go ahead.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Yes. Good morning, everybody. I have two questions. My first one is also on Life Re. How should we think now after the strong start in Q1 about your €200 million EBIT guidance for 2018? After the start, I would just would like to have some of your thoughts by how much you think you run now ahead of your plans?

And then, secondly, you mentioned within the geographical split on the combined ratios that there was also a deterioration of your California wildfire loss. Could you quantify the impact there, please?

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes. Thank you, Frank. On the life business, I mean, it's quite volatile on a quarterly basis. So, I would not dare to say that we run ahead of our EBIT target. Of course, if you divide the €200 million by 4, you might say, well, it's almost twice that what we were expecting. But, I mean, we have actually started to be very – a little bit more aggressive for managing the rates of the business efforts. And, of course, we expect that we will see some recapture as a result. And, therefore, I think that depending on the recapture for the €200 million might either be challenging or comfortably reachable. So, it's a little bit early to say over the year we will get better clarity on that one.

Then on the California wildfires, here we saw increased loss advises (00:40:55) there. Also on some treaties there we didn't expect it. And therefore, we had an increase there of around €21 million. The remainder of the cat losses remained on a net basis, a little bit more stable because, in particular, Maria and Irma are sitting just in the lower end of our whole account protections. And as a result of that, any further development of them will not have an effect on the net position. We think there that the combination of the K (00:41:38) transaction recovery – and the only recovery even taken into account reinstatement premiums, the losses are pretty much fixed there.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Okay. Perfect. Thanks.

Operator

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The following question is from Guilhem Horvath of Exane PNB Paribas. Please go ahead.

Q - Guilhem Horvath {BIO 18460437 <GO>}

Yes. Good morning. My first question is on the investments. Can you elaborate a little bit on the decision you made to change your investment strategy and to stop the Barbell strategy and the reason for that?

And the second is coming back on this U.S. tax reform. Can you elaborate a little bit on what you did exactly? I'm a bit surprised to see these one off being quite small at the end compared to the guidance, some of your competitors gave. So, can you elaborate a little bit on the complexity of the changes you've made here to comply with the new U.S. tax reform? Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

I think Roland that's for you.

A - Roland Vogel {BIO 16342285 <GO>}

It sounds so. Yeah, the investment strategy, we have been pursuing our Barbell strategy with the increasing liquidity with more govies and taking a little bit more risk on the lower quality side over the last, I think, two to three years which we've held, had worked out fine.

We've achieved where we want it to be. Still then we saw especially in the U.S. dollar that the lower quality credits were performing extremely well. So, that had worked out fine. Still, it was quite clear that the potential upside going forward here we felt would be very limited. And on the other hand, we also saw that the illiquidity premium we were getting there was really going down. This is why we stopped it. Then, of course, you have to decide where do you put that money, we invested a little bit more across the board and leave the lower credit aside especially in the U.S. dollar but also in the euro. That means we are for getting (00:43:48) a little bit of extra premium there, but it is really we did a calculation over the – for the whole portfolio. The ROI is not the potential expected ROI. It's affected only to a really minor extent by that strategy that is the changes.

And again, to come back to your question, it is really the minimal upside after the good performance, which we have seen and the achievement of our strategy beforehand. With regard to the tax reform, you could say that were a little bit lucky. We had already established a few years ago a Bermudian company which has opted to pay taxes in the U.S. And in that regard, that was the optimal point to transfer the business to. It is outside the U.S. so it can do the XXX financing business. And the other hand, it pays taxes in the U.S. so it's not affected by the base erosion and the the U.S. tax bid (00:45:00), so that the company was already existing, we needed more capital, we needed some approvals from the supervisory authorities. We needed a rating that was achievable in the short timeframe. It was a lot of work but it was achievable. So, we had to transfer capital and business between those companies to address the issues of the bid (00:45:26) which was achieved. Now, we were retroceding (00:45:29) business through lower tax

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environments before and but also to Germany with higher taxes and overall the run rate should again not be affected materially.

Q - Guilhem Horvath {BIO 18460437 <GO>}

Okay, very clear. Thanks.

Operator

The following question is from Andrew Ritchie. Your line is now open. Please go ahead.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Hi there. I just wondered if you could clarify on the structured solutions business. Is all of that now in - I appreciate your (00:46:02) earned premium but in gross written, is that the expected volume pretty much booked for 2018 as we can see already? What would be the limit on writing - continue to write lots more of this business? What would be the reason not to keep writing it, if it is so seemingly low risk?

The other question just a clarification. Your U.S. life business that you were booking at 12% tax rate is not only booked to 21% moving from Ireland to Bermuda. Why does that not affect the ongoing tax rates? It's just the assumption that you won't make money in the U.S.?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, on the structured solution business, of course we are continuing to develop that business and I think it's fair to say that throughout the year we will see additional writings of that business. Recently, we were successful on a number of transactions which we could account as deposit accounting. So, they will only show up on the bottom line and not on the top line. But it is continuing attractive business. So, we expect further growth from that business throughout the year. Of course, it has to be said that this business has a few very large transactions.

So, if you look ahead in the coming years, it can be quite volatile because, I mean, this business is only sold if it makes sense for the seeding (00:47:38) company and their capital management. Things might change and so this business might go - it goes up at this point in time. And there's also a possibility that it might go back - go down at other times. As my colleague, who is responsible it, Jürgen Gräber always says that it's breathing volume which at this point in time is breathing in quite a lot out of (00:48:00) sales.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Okay.

A - Ulrich Wallin {BIO 4863401 <GO>}

And on the taxes, I would again hand to - go back to Roland because it's such a complicated issue.

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A - Roland Vogel {BIO 16342285 <GO>}

Look, I think that calculation at the comparison of before restructuring and after restructuring is really based on multiplying an expected income with an existing tax rate. Those have changed. Some of that business was taxed in Ireland with 12.5% and is taxed with 21%,. Some of that business beforehand taxed in Germany with 32% and is now tax with 21%. What we lose on the Irish side was, of course, a little also driven by the lower expected profit based on the fact that the legacy U.S. mortality business had its effect on the protected income for the future. And if we look at the transfer of the business, the expected profits, and multiply that with the applicable tax rates, it's a rush (00:49:22) and the expected overall tax rate is around where it had been before.

A - Ulrich Wallin {BIO 4863401 <GO>}

And if I may add, of course, a fair amount of that business remains in our U.S. subsidiary, and that is actually quite profitable. So, the results of our U.S. subsidiary have been quite profitable. And, of course, there the lowering of the tax rates is actually helping us, because the profits from our U.S. company is actually taxed not - no longer than 35% but only this 21%.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

I guess the critical thing is presumably the financial solutions business in the U.S., which is the most profitable bit, that's not incurring a heavier tax load?

A - Roland Vogel {BIO 16342285 <GO>}

Partly, that's true. It's only true to the extent it's not kept (00:50:12) in the U.S., which some of it is but there's no good reason for seeding (00:50:17) it. But then, of course, an island now in the Bermuda, U.S. taxpayer, that business is bundled with the underperforming U.S. mortality business.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Okay.

A - Ulrich Wallin {BIO 4863401 <GO>}

So, in the short term, of course, the tax is even should we be able to bring the U.S. mortality business to its full profitability. And, of course, I mean, the tax rate will presumably be a little bit higher.

A - Roland Vogel {BIO 16342285 <GO>}

Right.

<": Okay. "

A - Ulrich Wallin {BIO 4863401 <GO>}

But that's a problem we would like (00:50:47) to have.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

All right. Great. Thank you.

Operator

The following question is from Thomas Fossard of HSBC. Your line is now open.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes. Good morning. Two questions on my side. The first one would be related to the Life and Re (00:51:03) business and the U.S. legacy book. So, I guess that now we entered Q2, I guess that you have already started to approach clients in terms of higher rate submission and potentially starting to engage on the need to implement recapturing. Could you give us a feel of what you see? What has been the client's reaction so far to what you have proposed to them? I mean, is there any surprise or any granularity that you could provide that would truly help us to better understand what could be achieved in Q3 and Q4 on that front?

And the second question will be related to the P&C Re business. Obviously, very strong growth on the structured solutions side, could you help us to understand what has been the drag on the combined ratio in Q1 from the 95.9% and what is expected to be the drag on a full year basis? Of course, you – keeping your guidance of below 96% unchanged, but with such a strong rate of growth (00:52:17) in the business, if you could guide a bit on what we should expect on the traditional side and then the drag from the structured solutions? Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

Okay. On the reaction from the clients to rate increases, I mean so far, we are engaged in that actually for a number of years now. In all situations, we found an agreement with the seeding (00:52:47) companies how to deal with it. So it has not been controversial. We have a little bit more pronounced action now in the second quarter, little bit too early to say what the reactions is. I mean so far neutral, a little bit better than we were expecting actually. But that will be hammered out in the next six months. So I mean, we will see where we go. That's for that.

I mean, on the combined ratio, of course, I mean the large portion of the structured reinsurance business will cost us about 1 percentage point in the combined ratio this year which means that the 96% would mean a 95% or even a little bit below 95%, maybe 94.5% on the traditional reinsurance business. I mean, if the large losses remain of this in the budget, we feel that the quality of the business would support such a combined ratio.

It's slightly better than it was the quality of the business; it's slightly better than it was last year from pricing point of view and on a fiscal year basis. Admittedly, it's not on a fiscal year basis, it's not quite as good as 2016. But we still feel that with our competitive advantage of our low expense ratio, that that should be achievable even without increasing our writings of property catastrophe business and hoping that the losses won't happen. Does that answer the question?

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Q - Thomas Fossard {BIO 1941215 <GO>}

Yes. Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

Thank you.

Operator

The next question is from Andreas Schäfer of Bankhaus Lampe. Your line is now open.

Q - Andreas Schäfer

Thanks a lot. So, there's just one question left from my side, with respect to the unrealized capital gains, not only on the fixed income side but also on other assets and the unrealized capital gains dropped quite strongly, I think, something like more than €70 million. Could you explain a bit what kind of asset classes are strongly impacted by this drop and is it really related to the rise in interest rates?

A - Roland Vogel {BIO 16342285 <GO>}

I think that is quite clearly, as it did (00:55:26) and obvious, the increases in interest rates especially in the U.S. dollar have caused the decrease in our valuation reserves to that extent. The rest is really driven by the real estate portfolio, also the private equity portfolio. We really haven't lost anything material there. We might even also see a few more realizations over the cost – over the course of the year.

So, in that regard, the decrease in valuation reserves, which comes with a slight decrease in our capital position is really what we have been asking for over the last years, complaining about the low yield environment. Now, the low yields are slightly increasing and that is associated with the decrease in the valuation reserves. It is, I would say, I don't have the percentage bit (00:56:38) but the vast majority is really driven by the fixed income portfolio and the rising interest rates.

Q - Andreas Schäfer

Okay. Thanks.

Operator

The next question is from Vikram Gandhi of Societe Generale. Your line is now open.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Hi. Morning, everybody. Just a couple of questions. Firstly, can you comment on how should we think about the run-off result for this quarter? Would you say it is €100 million the quarterly run rate less the negative €20 million development that you mentioned on the California wildfires?

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And secondly can you comment again on the rationale of the debt raising and its connection to the Life Re business? I'm sorry my line was bad and couldn't catch your opening remarks. Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

Roland, do you want...

A - Roland Vogel {BIO 16342285 <GO>}

Yeah. I can take it. As we mentioned at various occasions before not too easy to have the runoff result hammered out, I would say we have seen some positive runoff next to the negative development of the wildfires. We have also set up reserves according to the usual practice. So we might have buildup. So, overall the number was a little bit higher than the one that you mentioned from a quantitative point of view but with the remarkable initial conservative reserving again we feel that the confidence level should not be impacted materially. Again it was a little bit higher from a quantitative standpoint than the number that you mentioned.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Okay. Thank you.

A - Roland Vogel {BIO 16342285 <GO>}

Well, a little bit more than about €100 million even including the negative development of the wildfires.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Okay.

A - Ulrich Wallin {BIO 4863401 <GO>}

Answer for the debt.

A - Roland Vogel {BIO 16342285 <GO>}

And the rationale of the debt sorry. So there was – so we had really strong demand from our live colleagues to also do cash free financing business again various large transactions in the pipeline that together with capital requirements plus also the increase in private equity and real estate that was a little bit of strain on the liquidity of the SE, not a full group but the SE as the financer of all these things and also to be flexible, a little bit more flexible again in our investment strategy.

We felt that it would help to have more cash available. We had prepared debt for Q2 because that was the time when we had expected the materialization of the requirements from the life financing around the world. Then, we had the U.S. tax reform with some capital movements within the group. So, you can imagine that we no longer need that much money in Ireland, and we need more money in Bermuda. It takes a little bit to convince the Irish authority to give that fee so we needed, which we then can take to send over to Bermuda.

And on that basis, we felt it would be good to have €750 million a little bit earlier on to give us the flexibility to do the restructuring. And on that basis, we'd entered into that bank loan and that was with the majority of the banks involved continuing were then transferred into the senior loan in Q2.

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Q - Vikram Gandhi {BIO 18019785 <GO>}

Okay. That's very clear, Roland. Thank you very much.

Operator

The next question is from Roland Pfänder of ODDO BHF AG. Your line is now open.

Q - Roland Pfänder

Yes. Good morning. Two short questions from my side. First, regarding your interest income from funds withheld. You mentioned that you discontinued two treaties, so is it a new level we reached here or might that figure deteriorate further?

Second question, I think if I'm not mistaken, I saw that your aviation business volume – you're a little bit more positive here, are there any reasons for this you could speak here on this? Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes. I mean, interest from funds withheld, I mean, this was really due to the fact that two cash financing treaties which were on the funds withheld basis were recaptured because financing was being paid back plus the margin. There's quite, quite normal – in fact, I mean for the entire year we are not expecting this to deteriorate through further or to come down further because of the various financing opportunities we are currently working on. So, I mean, in the forecast this number is not coming down compared to last year. But it really depends on the individual transactions.

Aviation was the income is relatively flat there, not going down further, that is in line with the development of the premiums. I mean, airlines are slightly hedging up. And also on the aviation excess of loss, it's a more stable situation than it was before, therefore the income is also stable. I mean, there's a little bit of reshuffling in the portfolio. I mean the one larger client they decided not to buy any, any proportionate aviation reinsurance any longer. At the same time, there's another one we have a very longstanding relationship. So, we were able to increase our line in the aviation quota share, and excess of loss (01:03:07) was slightly up. So, that putting all together, I think we have found the low level point on the aviation I would say. At least, I hope that because that was a class, I was underwriting myself for so long.

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Q - Roland Pfänder

Okay. Thank you.

Operator

There are currently no further questions. There are no further questions. I hand back to the speakers.

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A - Ulrich Wallin {BIO 4863401 <GO>}

Yes. So, thank you very much for calling in. And, again, for those of you in the UK, have very nice bank holiday. Sorry for interrupting it early in the morning. For everybody else, have a very nice and productive day. Thank you very much again.

Operator

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

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