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Bloomberg Transcript

Q4 2016 Earnings Call

Company Participants

- Karl Steinle, General Manager-Corporate Communications
- Roland Vogel, Member of the Executive Board - Chief Financial Officer
- Ulrich Wallin, Chief Executive Officer

Other Participants

- Andrew J. Ritchie, Analyst
- In-Yong Hwang, Analyst
- Jonny Urwin, Analyst
- Kamran Hossain, Analyst
- Michael Haid, Analyst
- Olivia Brindle, Analyst
- Paris Hadjiantonis, Analyst
- Vinit Malhotra, Analyst
- William Hawkins, Analyst
- Xin Mei Wang, Analyst

MANAGEMENT DISCUSSION SECTION

Karl Steinle {BIO 1986424 <GO>}

Good afternoon to everybody here in London at the Stock Exchange, and good afternoon to all of those joining us via the Internet. Welcome to Hannover Re's Analyst Conference. It's my pleasure to see that so many of you have taken up our invitation and showing therefore your interest in Hannover Re. Due to leading requirements, we had to release the key figures already four weeks ago. Today, we are delighted to present to you the full set of numbers in greater detail.

I must say that I'm rather impressed by your work over the past year. In total, you published all together, at least to my knowledge, more than 270 reports on Hannover Re and/or the reinsurance market, and this is about 30% more than in the previous year and that reflects your efforts to help and to steer investors through the current market environment. Thanks for your support and your hard work, and please do keep it up.

Today, we are also offering a dial-in option for all those who were not able to be physically here in London. As a reminder, the dial-in participants will be in a listen-only mode during the presentations. If any participant has difficulty to hear the conference, please press the star key and zero on your telephone keypad for operator assistance.

I would also like to draw your attention to the feedback questionnaire which we have distributed in advance and which you will find on your desk. As you know, we greatly appreciate your remarks because it lays the foundation for the preparation of our Investors Day in October. Feel free to either leave the feedback form at the table or send it in to Julia, Axel (sic) [Alex] (02:15), or myself.

First of all, Ulrich Wallin, our CEO, will kick things off with a brief overview of the 2016 financial year. Roland Vogel, our CFO, will then move on to present the financials in details. Afterwards, we will be happy to respond at length to all your questions. And I would like to point out that would you please wait for the microphone before asking questions so everybody can understand your question, even those who are not in the room today.

On that note, I'm delighted to hand over to Ulrich.

Ulrich Wallin {BIO 4863401 <GO>}

Yes. Thank you, Karl. Maybe you give me the first slide as well. Good afternoon also from me and thanks for coming on this lovely day in London. We put the headline of our current strategy cycle for three years and we change our strategy every three years. The current one is titled Long-term Success in a Competitive Business. And I can tell you our business is competitive. So that part is true, but we also have the fifth consecutive year of record results. So we feel maybe we're going towards the long-term success as well.

As Karl already mentioned, we gave you preliminary results about four weeks ago because our parent company who owns us for 50% did so, and we didn't want everybody to speculate until today what our contribution to their numbers might be. What we didn't tell you then is that we plan to pay a dividend of €5 per share for 2016, which is an increase in the ordinary dividend from €3.25 to €3.50 and an unchanged extraordinary dividend. We increased the ordinary dividend because we wanted to stay within the range of 35% to 40% of the IFRS group results.

While most of the news is pretty good for 2016, however, the top-line has been decreasing slightly in line with our expectation. This has to do with the continued soft market on the P&C side which means that we have to underwrite our business more selectively and we clearly put result over premium income at this market cycle and this is showing here.

We also saw decreased premiums in the Life & Health business that has to do with some last single premium transactions in China which continue to run, but we have not been writing any new ones unless they are single premiums as they are not showing up in the top-line this year and next year.

The other element is the UK-enhanced annuities. We continue to see decreasing premiums there due to the change in the tax environment here in the UK where you can more easily and more tax efficient take a lump sum from your pension fund and do not – so the advantage of buying an annuity is not as large as it used to be and as a result of that, less annuities being bought.

The bottom-line results look pretty decent; considering the low interest rate environment and the soft market on the P&C side, also considering that as you know last year we had a positive one-off effect to the tune of around €40 million which of course as it was a one-off, was not reoccurring and we didn't have another one-off to supplement it. So that had to be made up by the normal results of the business. And yes, we see group net income, €1.17 billion. We are slightly larger than the income was for 2015, and so in our 50th year of the existence of Hannover Re, we were able to report another record year. Remarkable increase of the IFRS capital of the company by 11.5% that was more than €900 million, which meant that also the book value per share is close to €75, is also at an all-time high.

Since 2016 for the first time, we measure our solvency ratio through the Solvency II regulatory framework where we have for the quantitative risk, our internal capital model being improved by the (08:20) both for the Hannover Re SE, as well as for the Hannover Re Group. And it's actually a partial model because the operational risk is added to the modeled results based on the standard formula. We are discussing with regulators to change that hopefully for 2018. That capital ratio stands at 230%, which is an increase from 220% where we were at the beginning of the year, and that increase is largely the result of increased retained earnings.

P&C business, we had very good year. The combined ratio, 30% – 93.7%. It's, of course, abated (09:27) what the underlying quality of the underwriting result has been. I mean as we do every year than computing the year-end result, we ask Willis Towers Watson to give us a pre-study of our reserves. And then, of course – I mean that reflects like, of our overall P&C reserves close to 80%. And then of course, we do the final studies. We finalize it throughout the year and we show that to you at our Investors' Days every year, as you know.

This year, according to that, we have a little bit lift in the redundancies, but not a lot. I mean, in and large, I would say the redundancy level has kept flat. Therefore, we would say that the reported combined ratio pretty much reflects the quality of the business. However, in previous year, when we were adding to the buffer, of course the underlying business was a bit better than we were actually reporting. That is, to a large extent, not the case this year.

Of course, there is a little bit interesting statistic that we show in our annual report where you see positive runoff results of previous year's loss reserves of around a little bit more than €800 million. This number has increased a bit also due to the fact that we continue to add to the buffers and, of course, in the old years, first in the Property business, the short-term business but then gradually also in the long-term business. If those are actually redundant loss reserves, what you expect once the losses get settled, there's no reason to keep them and you can't keep them. And that's a reason for the increasing positive runoff result.

The other thing is that, I mean there's always something going wrong every year. I mean this year, of course, we have the change in the (11:56) tables which will create some negative development on the loss reserves for the UK motor business. So that will, of course, not show at positive in the run-off results.

I will come to the (12:14) tables later when I talk about next year, but I mean the high positive run-off result also shows you that, again in 2016, nothing went really wrong. I mean, we didn't have anything like U.S. transportation or some umbrella reserves or something like this (12:37) developed adversely. We didn't have anything like this in 2016. So that also is the reason for the very positive run-off results. Otherwise, large losses in 2016 slightly about 10% above 2015, but still below the results that we saw – still below the budget.

Life & Health, I would call it a solid result. It's not as good as we reported last year because the lack of the one-off effect. It continues to be as we expected. I mean at the Investors' Day, I showed you a slide saying that the EBIT in the next few years will be between €300 million and €350 million. We come in at €343 million, so well within that range. So, pretty much in accordance with expectation, but the individual segments have developed quite heterogeneously. We had, again, a very positive result from the financial solutions business, not quite as profitable as last year because last year we had the one-off effect and deadline. Our French branch business is back into profitability. So that's the €65 million positive swing, but at the same time, we continue to have some negative results in the first three quarters on the large block of U.S. mortality business that we purchased in 2008.

We also had random increase of frequency and larger claims in the fourth quarter, and therefore, that has nothing to do with the U.S. mortality in this case for change, also nothing to do with the French branch. It was just randomly higher claims which happens in a quarter. So the fourth quarter in Life & Health wasn't quite so strong.

Overall, as I've said I think quite a solid result. And on the investment side, 3% return on investment from assets under management, also aided by some realized gains pretty much in accordance with expectation even little bit better than that. But I will leave the details of the number to Roland and only give you the positive overview.

Roland Vogel {BIO 16342285 <GO>}

Thank you, Uli. At least you stole a little bit of powder, but I think that is your right as a CEO to do that. Based on your comments, it seems as if we could concentrate on reserves and U.S. mortality and dividends. We have a little bit more with us, and I will guide you through those numbers briefly. I will try to concentrate on some messages and comments and start with the cash flow number.

As you can see, the €2.3 billion operating cash flow, far higher than the net income number which also I emphasized here a little bit because it should give us a little bit an indication about reserve developments, at least a positive cash flow over and above the net income numbers, and the numbers we earned on the investment side should give us a little bit of certainty that the reserves haven't been weakened. And as Uli mentioned, this seems obviously to be a little bit the topic of the day and we will come to that.

The €2.3 billion look a little bit volatile as compared to last year. Early last year, we did adjust the numbers for one large Chinese contract where we showed before the end of the year, got €500 million in. Early 2016, €300 million went out. If we adjust for that, which we haven't done because we want to comply with the numbers as presented in the Annual Report, 2016 would have even be slightly better, only slightly better than 2015.

So very reliable, stable cash flow number which also is reflected in the assets under our management on left hand side. €42 billion nearly, that increase driven by exchange rates, by free additional cash flow and also small increase in valuation reserves as you will see on the next slide.

Uli mentioned already that our shareholders' equity number went up another double digit percentage points with 11.5% or €900 million. If you go back to 2012, you see that that number even increased by approximately 50%. In 2016, you see the composition on the right hand side. Here, the net income as the major contributor then the dividend payment – last year's dividend payment which also included to special dividends, then additional contributions from the variation reserves and small contributions also from the currency translation which then end with nearly €9 billion of shareholders' equity on the left hand side.

You'll still see that grey – sorry, the green bar up there, which represents our issued hybrid capital. We will come to that later on, that there is potential to even increase more if that would be needed.

The dividend per share, Uli mentioned the dividend policy, I think there is nothing to add too much. I think in 2009 when there were some changes in management and we were trying to get more stability in dividend payments than before. If you look at the numbers here, I think we achieved that to quite some extent last three years where we didn't have that much growth, where the large losses came in under budget, where the capital position was positive.

We did pay the special portions of the dividends. That continues in 2017. I don't see any reason why the composition of the dividend next year wouldn't look alike. Of course, we also – we always know that things can happen, but I think as demonstrated here, a rather reliable and hopefully transparent approach to paying dividends.

Now, the ROE, our major profitability target and indicator. You see on the left hand side, the development of the E, which has always been increasing over the course of the time. Now, the profits were keeping up with that to quite some extent. We've added, if you compare this slide to the previous one, additional percentage point numbers which represent the spread over and above risk free and the 900 basis points which represent our strategic profitability target.

So this spread over and above the thresholds or our strategic goal is rather in line or rather stable. Yes, it had been even better last year, but with the 3.8% in 2016 that compares with 3.9%, I think that should demonstrate that the profitability or the excess profitability we have been providing is again rather stable although the ROEs go down slightly with the increase of the E. But also we should bear in mind that the risk free rates go down as well.

You see on the right hand side that the portion over and above the threshold even has been increasing. If we compare 15 years or 10 years or the 5 year average where the excess profitability was even larger than in the long-term comparisons.

A little bit of different picture as we are used to for quite some time. We had been number one here. And it's, from my point of view, interesting to see the reason why we are only at number two this year, because it's not the year 2016 which has been added, because in 2016, we are still number one. So the reason why we lost the prime position here is the 2011 year which went out. You might remember that 2011 was the year of the second largest natural catastrophe burden. So we had, you could say, outperformed our competitors in 2011 so remarkably that the absence of that year now leads to us being and have downgraded to number two.

The chart will also give you the indication that if we would have higher losses natural catastrophes over and above the expected levels, again we would expect to potentially add another year 2011 again and show more reliable numbers.

Other than that, we feel rather comfortable. You may know and remember that our prime goal was to be among the best three in the world, and we are still there.

The group numbers in more detail on the next slide. I think there is not too much to be added. We have the gross premium income. The top line goes down, FX adjusted by 2.1%. Interestingly enough, if we adjust the net premium earned by the FX, we still – we even saw a slight increase which indicates that we have increased our net retention.

That is especially true for one of the large life transactions which Uli had already mentioned, which did not repeat itself. That was retroceded to a very large extent, so we lost the gross premium. We also lost the retro premiums. This is why the numbers deviate to quite some extent.

We had repaid a hybrid transactions in mid-2015, so we did benefit from half of that effect in 2015. We had a full year lower volumes of hybrid. This is why the interest on hybrid goes down. Accordingly, other income, again, in the positive range, the more positive range. It is, again, impacted by currency exchange rates positively, a little bit lower than before we have, and we will come back to that. Saved our LOC costs to quite some extent, so this also is also is reflected in the other income line. Apart from that, the tax ratio where we did provide a little bit of cushion last year based on the result of a tax audit, didn't repeat itself, so we are back to normal. And this also why the EBIT goes down slightly, the net income goes up, that is based on the tax rate being back to normal.

The P&C side, I think what is worth mentioning here, we do see that the combined ratio comes in below 94% and in the Q4 standalone, even below 90%, driven by, as we've mentioned already, some positive run-offs, but also the large losses coming in below expectations.

To come back to the reserving levels one more time, Uli mentioned that before, as part of our year-end procedures, we have lots of people coming in and looking at the reserves. That starts with our auditors. That is our internal actuaries, as well as the pre-study from Towers Watson. Their indication was that the reserving level and the reserve redundancies have at least stayed where they were.

So, one should assume that if there was a positive run-off, which should have decreased reserve redundancies, that we have at least added as much to keep the reserving level where it was. Uli mentioned already, we might most likely not have added as much as we did last year. You should assume that the reserving level was flat. Apart from that, I think the result, extraordinarily well. I think it was the best result on the P&C side we've ever produced, which of course, came – was taken with delight.

If we look at the details, the picture becomes a little bit more mixed. We see – if we look at the single markets and compare them with the MtCRs, which we have defined. You see that North America came in well below the MtCR, good results, good volumes as well. Continental Europe made it, barely.

Marine looks as it was a very, very attractive line of business, which of course it isn't. We will present the outlook where, at least, Marine is promising okay-ish profitability. It is even more – so, here, the positive run-off, namely Sandy, Deepwater Horizon, and Costa Concordia did benefit this line of business remarkably. So, if we could write more business with 38.5% combined, that would be great, but unfortunately this is not available today.

This is even more true for Aviation. Here, we feel that just by coincidence, the claims are very low. So, this combined ratio does, by far, not represent the state of the market in Aviation.

Credit and surety, here, it is a little bit the other way around. You will see on the large loss list that we had one large loss. So we still see the profitability as being attractive. So there are also growth expectations and goals in 2016 based on these larger single losses, again, one of which even made it to the large loss list. We have exceeded the MtCR by quite some margin.

Cat, the non-proportional cat business, as you can see, came in, again, very positively. But also here, the under-usage of our large loss budget is reflected. Overall, 93.7%, the combined ratio down there, well below the MtCR, or at least below the MtCR. So this demonstrates the profitability of our P&C portfolio remarkably.

Large losses, a brief look. You see that the large loss burden has increased as compared to last year from €570 million to €630 million. Had we not increased our large loss expectations or budget, then the €630 million (31:00) had not been too far away from €690 million. So, in that respect, we had seen some large losses. And I would also like to remind you, so if we take out the €200 million out of our result, which we had not spend as large losses, if you tax those, you would come in at particularly €150 million (31:26). So even with large losses in line with the budget, we would have made €1 billion.

Well, that is the list. I think nothing to comment here. The wildfires in Canada, the Hurricane Matthew, I think these were the largest and I already mentioned the one credit claim here on the bottom of the page.

So now to the other business line. You see that the life business has been increasing. I think Uli has mentioned that before. There were some discontinued larger contracts, Australia and China. Uli already explained the enhanced annuity business here in the UK, which came down as well.

We should also always bear in mind that especially the financial solutions business written in the U.S. doesn't produce that much premium. So premium is not always the best indicator for the business, nor is the EBIT margin, especially when it comes to the financial solutions business, you see at the bottom of the page why would you – how can you make 18% as an EBIT margin when your target is 2%.

Here, if you produce business and margin without producing premium, then the EBIT margin is not the best indicator. Why do we show it? Yes, I think that goes back to the times when we had financing business, pre-financing business, where the 2% was an okay margin requirement. And, again, please bear in mind that, here, the EBIT margin is not the best indicator for the profitability of the business.

We do mention the negative impacts from the legacy business. We did that before. We have, I think, done everything to improve the numbers, which also is presented, as I mentioned, as were the savings of the LoC costs and other income and expense line, which improves remarkably. Also, some of the deposit accounted margins show up in that line, so this is not just coincidence.

The other income and expense line on the life & health segment represents business results as well. Still, the higher mortality burden, which we have experienced in 2015, where we had good expectation that this might not repeat itself, happened again. We are still working on it. We do commute business. We increase rates. This is a block in run-off.

But unfortunately, in 2016, we didn't see the improvements which we have expected, which then leads to the deterioration of the net underwriting results. We should bear in mind it's not as drastic as it shows here, because also the net underwriting result last year did show the one-off approximately also €40 million from a commutation of a larger contract.

Uli mentioned overall the result is fully in line with our expectations, with nearly the €350 million, which defined the upper mark, and I will leave it then to Uli to show you the outlook for the next year.

One other picture which might look a little bit strange, and I have to admit we are comparing apples-to-oranges here, so please bear with us, we look at gray MCEV numbers. The gray is MCEV numbers are even adjusted in 2015, because in 2015, we already used the capital costs, which would, at that point in time, have been introduced by Solvency II. And the blue bar represents the pre-tax Solvency II value of new business number.

Still, even if we would have adjusted for that, we would have looked at a remarkable increase. So, especially by the end of the year, our colleagues all around the world, but also especially, again, financial solutions in the U.S. were able to lock in new business, which should also materialize IFRS profits in 2017.

Already, as they were entered into late in the year, the P&L in 2016 was not affected by that value of new business. So, we are rather happy and confident that this will materialize over the future. And you see the target of €220 million for the year and the achievement which was achieved.

Investments, you see that the ordinary investment income goes down quite remarkably. It's not – again, not as drastic as it is represented here. Please bear in mind the €39 million of the life contract where we did get the money back last year was – or had to be presented as ordinary income. Moreover, we had some extraordinary gains from our private equity portfolio, also in the ordinary line in 2015. So, yes, it goes down slightly, but it isn't as drastic. The realized gains go up.

Also here, it is not actually that we were trying to use the valuation reserves to improve gains. But nearly every turnover in the portfolio is leading still to realize gains. We did not, for instance, realize any gains in our new listed equity portfolio, where we have in the impairment line nearly €30 million depreciations or impairments after Brexit. Of course, right now, you see that our unrealized gains and losses have improved. A good €100 million come from the listed equity portfolio. So, it would have been easy to realize that gains (38:50) and mitigate the impairments after Brexit, which we didn't do.

Overall, the 3% I think are a little bit more than we were trying to achieve. You see also the unrealized gains and losses go up. That doesn't look very impressive here. We had lots of volatility as you might remember over the course of the year, short after – I think after the Brexit in the aftermath, I think nearly €1 billion of additional valuation reserve has been created. Then after the Trump election, within one-and-a-half week, €800 million were gone again. But with the €200 million, again €100 million coming from the listed equity portfolio, we still have a comfortable buffer also on the asset side.

I think there is no real news from that split, where the ordinary income comes from. So, I will skip that one. The portfolio, as it composed today, you can see what we have introduced as the barbell strategy, if you look at the numbers. (40:17) the government bucket goes up, and also the lower corporate goes also up or the investment grade goes down a little bit, the non-investment grade, I can tell you, goes up, at least behind the dot. We have also increased the listed equities. As you can see also, the real estate goes up slightly, fully in line with our investment strategy, but no drastic changes here as well.

So, what I have also brought with me is a little bit more detail about the preliminary Q4 numbers of our Solvency II reporting. It is interesting to learn that German regulator or the regulators as such did insist on providing us to them preliminary Q4 numbers. We will then also have to publish the full-year 2016 numbers. There should be no difference. Maybe we find one or the other mistake we will have to correct, but we do not expect the numbers to change. The final full year numbers will be published in May.

Uli mentioned the major points, and those who follow us for quite some time do know that we do provide different metrics here. You see it on the right-hand side, last year's numbers as a comparison. So the regulatory Solvency II number did increase from 221% to 230%.

We have our internal measure. You will see the differences in detail on the next slide. Here, we adjust for the minority haircuts as well as the operational risk model. So internally, this is the view we see as a real economic view. Our 1-in-200 years measure would be 262%. The AA minus equivalent number of 1-in-3,333 years equivalent is 130%. So a comfortable buffer.

I already indicated here, you see the details of the adjustments we do from the regulatory view to our group internal economic view. The haircut for minority interest represents €626 million. The add-on for the standard formula risk represents €436 million. Uli mentioned that we do expect to have a full model in 2018, which then should be associated with the saving of the €440 million or nearly €440 million than as from last year. Here, you see the contributors to, on the one hand, the risk capital, on the other hand, the basic own funds. The drivers here were, to some extent, of course, the profitability within the year. Also, the currency exchange rates did increase our risk capital as well as our basic own funds, so I wouldn't go in too much detail.

The market risk, if you compare the numbers, has increased. But also, the diversification effects have increased with the increase of the standalone risks as well, so we still do feel very comfortable. I also have brought with me here the reconciliation between the IFRS numbers. I think we did the exercise more than once. You see the differences, the adjustments for assets under our management or the health or maturity (44:32) all the assets, which are not valued at market.

Then, the adjustments for the technical provisions, discounting, redundancy of loss reserves that is reflected in the increase or the decrease of liabilities here as well. We see some adjustments. Of course, then, these adjustments have to be taxed the minority haircut one more time.

Here, I did refer, a few minutes ago, to the unused or unutilized hybrid bucket of nearly €1.7 billion, which is represented by the shaded green bar here in the middle, which then leads at the end to the basic own funds according to Solvency II. That again I think the full Solvency II reporting, as I mentioned, will be ready and audited by May.

I think that concludes my presentation. And as always, as I see, the target matrix popping up, I leave it to Uli to continue.

Ulrich Wallin {BIO 4863401 <GO>}

Thank you again, Roland. Okay. Little bit on to target matrix and the outlook. (45:59) exciting here. I mean most targets have been met, notably, the profitability targets. The growth targets, not. This is due – as explained due to the soft market, as well as a low interest rate environment, but at least we saw some increase in the net income.

That then brings me right to the outlook, going to the individual lines. North America, I mean, of course, we already reported quite a bit on our renewal call and so all of that is still valid. So profitable growth on North America continues into 2017, not based on single large transactions, but the many treaties that we with our significant more than 600 clients in the U.S.

Continental Europe, a little bit of mixed bag, stable and good profitability in Germany. We see some increases in France because we managed to improve our market position there. Eastern Europe, business sanctions in Russia as well as currencies, et cetera, I mean, are reduced in value even against the euro as it's coming down a bit. Profitability should be sufficient to cover the cost of capital.

Marine, we continue to believe that we have a profitable book there. Unfortunately, with a soft market, it will be a smaller profitable book, even though not much smaller. Aviation, while here we believe that the rates are no longer sufficient to cover the cost of capital, we already reduced our involvement through the - at 01/01 (47:52). So, it's clearly a soft market portfolio now that we have like we have prior to 9/11. And we also bought quite a lot of retro on it just to safeguard. The results, it's, by the way, the line of business where we have the highest percentage of redundant loss reserves.

Credit and surety, we see some growth. We have further improved our already leading market position. We are not the market leader, but we are, I think, among the top two. Results, we should bounce back to earning the cost of capital. We have - in loss-making treaties, we could improve the - I mean, the terms and conditions for the reinsurers. And, therefore, we think the business should earn the cost of capital again.

UK, we see growth. I mean, we had a very good renewal season. This is maybe a good topic to tell you a little bit how we see the Ogden tables. I mean, we write about £50 million UK motor excess of loss. We write very little proportion of the motor business in the UK. We write some in our financial reinsurance section, but due to the bells and whistles on those treaties, we're not seeing much of exposure there.

Most of them, we commute the underwriting years after 24 months, so not much exposure there. But of course, from the UK motor excess of losses, we only write to higher layers, the minimum attachment point is £5 million, average would be about £7.5 million to £8 million. So, on the single person losses, even with the new Ogden tables, many of them will not be able to reach us.

If I look at the loss reserving on those £50 million of premium, we have £240 million of loss reserves, £260 million of those are own loss reserves. And even if you look - I mean, this is just the last four underwriting years, because we believe that the last four underwriting years will be the most exposed. If you go back further, then the overall loss reserves are in excess of £400 million.

Again - of course, if you go back, the IBNR percentage a little bit lower there. It's only half of the loss reserves. If you go back all the way, are actually higher - actually own reserves. So, we believe we are very conservatively reserved here. And we also pending a more detailed analysis of the individual claims which we are currently undertaking, we would believe that our current loss reserves would probably be sufficient to deal with the new Ogden tables. I mean, we might still put some additional reserves on, but as I said, we are engaged in a rather deep dive there into the individual claims.

Due to our high attachment points, we have a pretty good transparency on the claims that have the potential to hit our layers because at €5 million or average €7.5 million to €8 million, those are serious claims that expose us there and so we know about them.

Facultative, yeah, I mean, we think we will continue to improve the profitability there. It has been good, but there is room to improve it, but that will be to the detriment of the top line. The worldwide treaty business, we have readjusted our agricultural business a little bit in response to terms and conditions. We also reduced our business in China. So we will see some reduced volumes there.

On the contrary, the structured reinsurance and ILS, we see tremendous growth. As we, in detail, explain to you in our – on the occasion of our renewal call, that will be also the driver for the growth of our P&C business this year.

In the property catastrophe, we are still under-weight. However, if we have losses in line with what we have seen in the last five years, we would still have good results there. If the losses reach the expected levels, then of course we will struggle to earn the cost of capital. That's the reason why we are under-weight and that's the reason why we bought more at recession on the catastrophe business.

Life & Health, overall we expect increased profitability which will largely come from our financial solutions business. This is business which is IFRS EBIT accretive quite rapidly. The good thing is that the average duration of the treaties whilst shorter than the traditional risk treaties, particularly on the life side, is still around 10 years I would say and therefore, the treaties that we already have on board will continue to provide profitability in future.

We managed to write some new business, actually, quite attractive new business as you have seen in the value of new business. We also managed to renew our most profitable treaty up to now in the U.S. which we did not expect, but we managed to come up with a deal that is still accretive for our client and so will continue to produce profits for us.

On the risk solutions side, we see a more stable situation. We expect to earn the cost of capital. We still expect through the negative impacts from the U.S. mortality business here, but that should be outweighed by the new business that we write across the world.

Morbidity, improved situation here. We have new business opportunities which should increase the profitability there. And longevity, I mean, it's largely what we write these days as pension blocks. Pension block business, the way we account it, if things go according to the actuaries' plan, the margin should increase quite significantly after 7 to 10 years. Unfortunately, we have very few treaties. I think it's only one of the pension blocks that is already more than seven years old. So, I mean, this will be – hover around the 2% to 2.5% mark, as far as EBIT margin is concerned.

Bringing that all together, the guidance, we increased on the occasion of our renewal call. We now expect growth of our business again, low-single digit, maybe 3%, 3% to 5%, something like that, driven by the P&C business, whilst the life business would be more flattish. Return on investment, 2.7%, provided that the capital markets behave and we see no turmoil that we had seen in 2008. Group net income, more than €1 billion. We are pretty confident that we will be able to reach that even if the large losses only stay within the budget. So if we have €825 million of large losses, we still should be more than €1 billion, mainly driven also by the increased profitability that we expect from Life & Health.

And the dividend policy will be entirely unchanged if all those numbers transpire as guided. Of course, that means that the large losses stay in the budget, no turmoil in the capital markets, then we most likely will pay again extraordinary dividend. And then so – I mean, the line should continue as we have seen in the last three years. Then the rationale of the medium-term business development for Hannover Re. There's our conservative – continued conservative loss reserves, strong market position, and better terms and conditions on our retro sessions (57:53). We feel that we should be able to keep the combined ratio below 96%, hence the overall underwriting result should be rather stable.

We still expect that the market will change, and the results of the – the average result of the reinsurers are deteriorating. And like in 2012 and 2009, we expect that we will be able to grow our market share there. Life & Health, we saw that from 2019 onwards, we would – up until 2019; we would be within the range of €300 million to €350 million EBIT. We now are confident that already in 2017; we will be above the €350 million upper threshold of this €300 million to €350 million. So, the threshold should be more for 2017 between €350 million and €400 million. This is based, of course, on the new business that we have written and on the quite attractive pipeline through the new transactions.

Net investment income, we expect rather stable. We expect continued increase in our funds under own management, and we also are quite pleased to see the increased interest rates in the U.S. because almost half of our assets under own management are U.S. dollars. So that will help with the, I mean, reinvestment yield which should aid us with keeping the investment income rather stable.

That concludes our remarks, Roland's and mine. And we look forward to your questions. Thank you very much.

Q&A

A - Karl Steinle {BIO 1986424 <GO>}

(01:00:05) thank you. We will now begin our Q&A session. Just as a reminder, please wait for the microphone so that everybody can hear your question, especially the colleagues joining us via the conference call.

We shall proceed first with the questions from the attendees in the room and then move on to the questions coming from the conference call. The first question I've already spotted by Vinit, and we continue with Kamran and then go to left side.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Thank you. This is Vinit from Mediobanca. Just on the reserving - just taking up on your comment that reserves are - confidence level is similar to last year. Just from looking at the full-year to full-year combined ratio, then adjusting for the budget, seeing where the reserve releases is, it looks like it's probably that the conservatism is only increasing, I would reckon, whereas you maintain that it is at par because we heard (01:01:42) for a few years that the auditors do not like this phenomena. So first of all, is this understanding correct? Secondly, is the auditors okay if it is correct? Because, obviously, this builds up the buffer a little bit.

And then second, very quick check on the growth in credit. Uli, you mentioned that the treaties should improve and there was one large loss. But if we track the credit surety segment's combined ratio through the quarters, the whole of 2016, each quarter was north of 100%. Is it - is the optimism based on the fact that it's a short-tail book and you're going to re-price quickly? Or if you could just comment on that. Thank you, please.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, if you look at the credit, that's clearly short-tail. But that has not been the driver of the higher combined ratios, maybe with the exception of one treaty of China. The driver has been more from the surety side and they are largely, I would say, from Latin America and Spain where we have seen increased claims.

As far as the Asian situation is concerned, I think that's solved. We expect to see combined ratios below 100 there now. On the surety, it's a little bit more volatile, I would say. The only thing is we tend - I mean, there's tendency to reserve relatively highly at the beginning, and then often we can see recoveries at a later stage. I mean, for example, the large Spanish loss, the - I mean, the project - that was the project that was stopped as a result of that bankruptcy meanwhile have continued to be contracted (01:03:50) again.

So we expect some recoveries there, but that will take time. I mean, these things are not coming within a year. That's the reason why we expect combined ratios on the credit business - credit and surety business at around, I would say, 95% for the current year.

The reserving question, I would hand to Roland.

A - Roland Vogel {BIO 16342285 <GO>}

Yeah. I'm not exactly sure, Vinit, what drove you to assume that we are even more conservative. As mentioned before, I think we have not added to the reserve redundancies remarkably this year. This already is a remarkable difference if we compare it to last year where we added more than €300 million. When it comes to the auditors, I can tell you that the overall reserve volume has increased more than €1 billion, even currency adjusted. So, in that regard, the confidence range they apply I think is the 40% as well as the 80 percentile has increased together with the volumes, and their considerations of what is in the range and what is not in the range. So, the red card we have received last year was a yellow card this year because the range has increased a little bit more than that. So, in that regard, we're still at the upper range, but there is still also flexibility to some extent.

A - Ulrich Wallin {BIO 4863401 <GO>}

And I think – if I may add, I think it's still fair to say that we would have to expect an upward pressure on the combined ratio due to the continued soft market. Whilst particular this year the rate reductions or the rating quality did not deteriorate that much, but it did deteriorate overall. I mean, we're in the fifth year of the soft market, and therefore, we always expect that that the underlying combined ratios would increase. That's also the reason why we felt so comfortable to have sales (01:06:41) buffers because we – I mean, we did not expect actually at the outset of 2015 that we would increase the confidence level again. That just happened for two reasons in 2015; one, the underlying claims were particularly low; and secondly, due to a continued low inflation, the advised and paid claims that were emerging in 2015 were below the calculation – the actual calculation that was performed based on the end of the 2014 numbers.

I would say, if you look at the emergence of the claims that we had seen, paid was not (01:07:43) actually down, but the advised loss reserves from our clients, they were much more in line, which was expected by the actuaries when they computed their calculations at the end of 2015. And that, of course, also has an effect. And therefore, if you have a redundancy in the loss reserve, it's difficult to look at that like money, like a fixed asset that you can look at like money, because it's just the result of an actuarial calculation.

What is a little bit assuring is that despite the fact that the premium did not increase the overall volume of the loss reserves also increased and also the volume of what we call the segment reserves, which is the – our own IBNR reserves, which we are setting out in accordance with IFRS principles, this segment reserve also increased in the current year. Therefore, the main reason for that the redundant loss reserves did not increase was really the emergence of the advised and paid losses in 2016.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Thank you.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi. It's Kamran Hossain from RBC. Two questions. The first one, on the dividend. I guess, you showed steady growth in that this year to five-year as total. Next year, the way I understand is you got to step-up in German GAAP earnings next year. Is next year the greatest opportunity to have a step-up in the dividend payout ratios? That's the first question. Any kind of thoughts on that?

And the second question, just coming back to Ogden. We've seen some headlines in the trade press in the last few days, say, suggesting price rises for non-proportional motor reinsurance might be in the range of 50%. By the sounds of the impact on Hannover Re, no impact at all. So maybe could you give a bit of an outlook on what we should expect for motor reinsurance prices for the rest of this year? Thanks. And also as well, if you have any material renewals.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, if you look at our reserving on the motor business, I mean, we are reserving combined ratios of around 135% on UK motor excess of loss. If that would actually be the final outcome, which, of course, the underwriting and pricing actuaries are not believing, then we shouldn't write that business at all. So like – I mean, if you look at our underwriting years like between 2002 and, I would say, 2010, I mean, there we have combined ratios which are more mature, more in the region of 80%. And, of course, if you talk to underwriters, they would expect that the 135% that we are currently booking, I mean, that would – they think that would come down to similar levels, particular as we have seen rate increases in the current years due to the PPOs.

And, I mean, we probably have higher motor excess of loss rates than most of the markets because we only wrote full coverage, including full cover for PPOs, whilst many markets would only write the capitalization of the PPOs, which is different terms and conditions. And the pricing differential between the two products is about 30%. So, we are already getting higher rates on our motor excess of loss.

The fortunate thing is that the emergence of the PPOs have been more benign than we have actually thought, so we have a little bit of a buffer there. But nonetheless, I mean, if the annual claims costs are increasing by 10% for the UK motor business, which I think some early – some early analysis of Willis Towers Watson that was published shows, of course, that will be – I mean, non-proportional be weighted on the excess of loss business, particular for those carriers that buy very low down. Almost all the development will then be in the excess of loss. So if the price deficiency due to the Ogden rates on UK motor is 10%, I think a 50% increase on the motor excess of loss is – I mean, it's a very good guess, I would say. I mean, at this point in time, we're analyzing the numbers really in order to come at this pricing. I would say that the majority of our UK motor excess of loss business renews at 01/01 (01:13:17). Those that renew at 01/04 (01:13:19) is a particular difficult one to tackle, but together with our clients, we will. But I mean, I think we will – there will be significant rate increases on UK motor.

It's also because of the uncertainty. I mean, until we've really looked at the individual claims, which we are currently doing, there's uncertainty on the impact, and if an underwriter is uncertain and the market for UK motor excess of loss is not that large because of the unlimited nature that many reinsurers that wouldn't even write that business, therefore, I mean, I think we will be able to sell significant higher prices there.

A - Roland Vogel {BIO 16342285 <GO>}

And maybe I can comment on the indications about the German GAAP results and their impact on – or potential impact on any dividend policy. I think we've explained the dividend policy more than once, it never did actually depend on German GAAP numbers. We don't see that much dependence on U.S. GAAP numbers. We would look at that really from an economic or IFRS point of view.

Our German GAAP result in 2015 was more than €900 million. At that point in time, there were some indications that our German GAAP balance sheet seems to be a bit weak. We never confirmed that we never saw it like that. We used the increase of the valuation of one of our subsidiaries. By the way, if there was a tax-free measure to increase the German GAAP result, we add it to retained earnings. So we felt that this demonstrates that we have lots of measures to also make the German GAAP balance sheet a little bit stronger.

Then, as we all know and we have explained before, we are looking forward to a crucial impact on the equalization reserve and the 2001 year disappearing out of that equation. We have already applied some measures in 2016. So again, the German GAAP result in 2016 was extraordinary high. It was €950 million (01:15:49). Also, here – so we will use that amount to pay out a little bit more than €600 million, so we will have the chance to add to, well, either to retained earnings or the profits carried forward which gives us a dividend buffer and adds to continuity in the dividend payments.

We look forward to, again, another very good German GAAP results based on the equalization reserve releases coming through this year again. But also here, I would not say that this has a direct or crucial, immediate impact on our ability or our strategy to pay dividends, if that is...

A - Ulrich Wallin {BIO 4863401 <GO>}

I mean, I think we look at two things here. One is, of course, the dividend for the current year, but also the – I mean, consistency of the dividend. And, of course, I mean, if you go back to the beginning of the century, due to a much lower capital base that we had then, we were not be able to pay a consistent dividend.

I mean, if you look at 2001 with the World Trade Center incident, 2005 with the hurricanes, and 2008 with the financial crisis, we were not able to pay dividends in those years because we needed all those funds and that capital in order to defend our rating and at the same time be able to benefit from the market opportunities that were following those events. We feel that we have moved on from that situation and are in a stronger position now. So we would say on the reoccurrence of the situation like we had in 2001 or 2005 or even 2008, we should still be able to pay a dividend at least to the tune of the ordinary dividend. So we look at both sides.

Of course, I mean the German GAAP earnings have been quite favorable, I mean two years in a row now and we expect this continue into 2017, which means that, I mean we have increased, retained earnings and have significantly increased profit carryforward. So, I mean, of course, there is room for increases in the dividend clearly.

A - Karl Steinle {BIO 1986424 <GO>}

Okay. We continue on the left-hand side with Andrew Ritchie.

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

Hi. It's Andrew Ritchie from Autonomous. Just to clarify on reserves again, I'm afraid. Presumably then the assumption is, when you were surprised that you've increased the redundancy in 2015, I presume you're surprised that you kept the redundancy stable in 2016, because I'm assuming that you are expecting the redundancy to fall over the next couple of years if you really want to keep the combined ratio flat. Is that still the correct assumption? That's what you said in the past.

A - Ulrich Wallin {BIO 4863401 <GO>}

It's absolutely true. The reason why that didn't happen in 2016, again, is that we didn't have things that went wrong. I mean, normally, you always expect something goes wrong. For example, in 2014, we had strengthened our reserve on some Argentinean liability claims to quite some extent, because the Argentinean cost did not reflect in their judgment, the terms and conditions of the policy, because they were a little bit unhappy, if they would have done that that there would be no claims.

And those things happen. I mean, we have to – in the old days forming the (1:19:57) Hannover, we had some reserves strengthening on some HMGA (1:20:02) business. But in the last couple of years, nothing like that was occurring and that, of course, helped. If our regular to be expected level of mishaps would have happened, then the redundant levels would have decreased clearly.

Of course, we try not to make too many mistakes, which we know from the last soft market at the end of the 1990s, is the largest source of bad results. We are not always successful with that, but the last two years were pretty good. But – I mean, of course, we are not expecting to add to the redundancies in 2017. That's very clear. We are in the fifth year of the soft market. We think that we can keep the combined ratio to have a stable underwriting profit. But due to the environment around us and the rating environment, based on the full utilization on the budget, that would then presumably mean that the redundancies would reduce slightly.

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

That's helpful. Thanks. Just two other quick questions. The retro you mentioned in the outlook, in practical terms, how does the – how do the changes in retro help 2017? It's not helping the large loss budget, which is flat. So maybe just, Roland, if you could just clarify how that is?

And the final question, it seems the financial solutions business you wrote is coming through or expected to come through to IFRS quicker than we have been accustomed to. Is that the case or is this just kind of coming through from previous years? Why is it coming – especially to come through (1:22:08) to IFRS income so quickly? Thanks.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, firstly on the retro. We bought an aggregate excess of loss cover to cover our large loss budget for property catastrophe losses. We did not use that to reduce the large loss budget, which in theory we could have done. That's the reason there we are better covered. And so, I mean, we could – I mean, in 2017, we could better absorb than in previous years natural catastrophe losses that go over and above the large loss budget.

On the...

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

Large loss budget is more secure than another years, essentially, that's what you mean?

A - Ulrich Wallin {BIO 4863401 <GO>}

That's right. That's right. Then the – why are we thinking? I mean, normally, the financial solutions treaties are much more accretive and go much more quickly into IFRS earnings, because, I mean, if you look at a traditional mortality solutions cover, if you write new business, you write policies with durations on average, say, 25, 30 years, and of course also most of these treaties have rates that are increasing throughout the duration of the underlying policies, because, of course, the risk increases with age of the insurers. That means that the profitability is clearly back-loaded.

In the financial solutions treaties, that's not the case, because, here, I mean, for a large extent, we finance redundant (1:24:03) loss reserves or other cash flows. Those are more imminent. Most of the financing, non-cash financing treaties are actually pretty short-dated. I mean, many of them are only three to five years.

The treaties that finance redundant (1:24:27) reserves, they normally have durations of 20 years, but they have – there are certain breakpoints. I mean they can be cancelled on a certain circumstances by the seeding companies. Therefore, it would not be terribly clever to backload the profitability. So on those treaties, the profitability is much more frontloaded and that is why they are accretive to IFRS earnings more rapidly.

A - Roland Vogel {BIO 16342285 <GO>}

Well, if I may add, plus, you would not look at new business values for such a long time if there is a breakpoint, if there is a recapture rate, you would only calculate the value of new business up until that date, which is a shorter duration than other longer term contracts.

A - Karl Steinle {BIO 1986424 <GO>}

Okay. We will continue to the left-hand side with Xin Mei and then I've seen another question on the right-hand side from Johnny.

A - Ulrich Wallin {BIO 4863401 <GO>}

I think there's another one on the left side, over there.

A - Karl Steinle {BIO 1986424 <GO>}

I'm sorry.

Q - Xin Mei Wang {BIO 16662657 <GO>}

Hi. Xin Mei Wang from Morgan Stanley. I just wanted to ask about the life and health outlook. So you're very confident on next year's results given the financial solutions. I was just wondering given the volatility we've seen in 4Q in the mortality business, so what makes you confident in reaching that number next year or does that €350 million to €400 million sort of bake in some conservatism for continued volatility or are you very confident that those issues are dealt with or can be dealt with now and you're going to see that again?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, I think if you look at the volatility on the mortality solutions business, that is pretty high on a quarterly basis. It's less on an annual basis. I mean we tend to have quarters that are very good, and then we tend to have quarters that are not so good.

I mean the expectation of increased profitability, we already, I mean took into account some further losses from the mortality solutions business in the U.S. But, I mean, that is out rated by the financial solutions business. We also have attractive new business in our Bermuda company, also in China, we were able to improve and write significant new business, that's risk business, on the back of our joint venture that we have regarding the mortality business. That was actually quite good.

There might be more of that in other Asian countries, so things are developing there and that's why we are quite bullish on our life and health's profitability, despite the fact that from that old underwriting years in the U.S., we are expecting further losses.

Q - Xin Mei Wang {BIO 16662657 <GO>}

Thank you.

A - Karl Steinle {BIO 1986424 <GO>}

Okay. Then, we continue with Jonny Urwin.

Q - Jonny Urwin {BIO 17445508 <GO>}

Thank you. Jonny Urwin from UBS. Just one question for me. Can you give us some color on how you're seeing claims inflation trends develop globally, I guess, in the U.S. in particular? And where are we versus the sort of levels you're baking in through reserves (1:28:01)? I guess is we're still pretty far away. Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

Yeah. I mean, the actual inflation trends that we are currently seeing are still quite low, I would say. I mean, if you compare it, say, to 5 to 10 years ago, we are clearly lower. There is, of course, I mean, a clear exposure that inflation might pick up, because I think the unemployment rate in the U.S. is quite low. I mean, one could probably talk of full employment. And also, the economy is going reasonably (1:28:43). We probably have to expect some further budget deficit that might increase, and that might in the end lead to some high inflation. We still have some inflation protection in place through inflation linkers, but that of course, could also be a source of reducing the redundancies and the loss reserves.

Of course, I mean, if you have higher claims due to inflation picking back up, it's certainly better to come from conservative loss reserves than from strict best estimate loss reserves.

Q - Jonny Urwin {BIO 17445508 <GO>}

Thank you.

A - Karl Steinle {BIO 1986424 <GO>}

Okay. Another question is coming from Paris, and then we'll continue with Will Hawkins.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Yes. Thank you. Paris from Credit Suisse. Very quick question from me. Given the developments you are seeing in the capital markets, can you give us an idea of how your reinvestment rate has changed?

A - Roland Vogel {BIO 16342285 <GO>}

Yes, it's an interesting question. I just prepared a presentation for next week where we had a brief look at reinvestment rates. You know that we had presented more than once the approximately 15 basis points we lose, which are then explained between the market yields and the portfolio yields. We went down from 2.9% to 2.7%, which might indicate that this is even accelerating.

Interestingly enough, the opposite is true. We went down with our projections in 2017 (1:30:33) something, which was then rounded up, which makes it also a little bit easier for me to achieve that goal.

But on the other hand, the decrease in the expectation for 2018 was minimal. So, the reinvestment yields are picking up. There are various factors adding to that. On the one hand, especially the shorter term turnover in the portfolios, which represent the majority of the maturities in such a year, are to quite some extent already taking place, again, to higher rates, especially in the U.S. dollar, where we have invested short-term money over the last one, two, three years. And in the meantime, we can invest at higher rates.

So, moreover, the technical reinvestment rates, as we usually present it, which reflects the portfolio as it is composed today, if I would reinvest exactly how I invested today, so this is easy to calculate. This is why it's a reliable number. It does not include any changes in the composition. Still, we do change the composition, and I have presented in October here some opportunities where we reflect among (1:32:04).

So, the reinvestment yield right now, the technical reinvestment yield is at 1.8 something. I have indicated that we would, of course, no longer invest so much in covered bonds. So, right now, the portfolio yield of my covered bonds is higher than 2%. The reinvestment yield is below 1%. So we are avoiding that area. So the change in the portfolio makes itself also. Moreover, if there are maturities and the whole portfolio moves a little bit in shorter duration, then you can reinvest a little bit longer term. So all this is adding up. So we again see the overall portfolio yield in 2018 nearly flat. And also going forward, we see that bottoming out at least over 2%. So the decrease in yield should decrease.

A - Karl Steinle {BIO 1986424 <GO>}

Okay. Because I do not see any further questions from the conference call, just as a reminder, if you would like to ask question, please press zero one on your telephone keypad. So we continue with Will Hawkins, and later after that, with Ivan (1:33:33).

Q - William Hawkins {BIO 1822411 <GO>}

Hi. Thank you. William Hawkins from KBW. None of these are new questions, but I just wanted to sort of check again. When you were talking about your €1.7 billion of unutilized Tier 2 capacity in the Solvency II ratio, are you just trying to communicate to us there that you've got a comfortable ratio or are you trying to communicate that you may do something to make use of that unutilized capacity at some point?

And then adjunct to that point, what would the unutilized capacity be on a rating agency basis, presumably you don't have as much flexibility as you're implying for other leverage ratios from rating agencies?

And then secondly, sort of again it's not new I know, but on slide 17, your capital adequacy ratio whichever one you pick is massively above your current threshold. So, again, in theory, that would be implying that your capital management should be more aggressive than it is currently. So, can you just explain again whichever ratio it is, the 230% versus 200% Solvency II? How do you think about – you still got that buffer upon the buffer? I suppose the last factual question, what would the surplus against the S&P AA requirement be? Thank you.

A - Roland Vogel {BIO 16342285 <GO>}

Maybe I'll start with the hybrid (1:34:56). I think your first indication was true, there is no plan to issue something today, there is no reason to do that. You've mentioned the comfortable ratios in whichever solvency regime we are. So, there are no current plan. It is just demonstrating the flexibility. Maybe it's just that the CFO is in such a comfortable situation where he has never been before, within the history of Hannover and you know that very well.

We, of course, are always exhausted that to the extent possible, because we needed it. Now, we have the buffer, there are no plans to use it. But in case there are opportunities, we have the flexibility.

With regard to any other solvency models, the same amount would be fully – would have a full capital credit in the A.M. Best as well as the Standard & Poor's model.

A - Ulrich Wallin {BIO 4863401 <GO>}

Yeah.

A - Roland Vogel {BIO 16342285 <GO>}

So I wouldn't lose anything.

A - Ulrich Wallin {BIO 4863401 <GO>}

Okay. And on solvency (1:36:10) capital adequacy ratio according to Solvency II at 230%. This is for the subgroup and for the SE. So the company itself, as I said, is more like 243%. Why are we not being more aggressive on capital management taking into account that we are significantly above the threshold while we have also seen quite a bit of volatility in that number due to market value changes and, of course, they are fully reflected in that number. Therefore, we're a little bit cautious there.

I mean, it has been quite stable, I would say, the last four quarters. But prior to that, we have seen quite some volatility in those numbers, which gave us actually quite a little bit of concern, I must say. So we've - actually, looking, I mean for various avenues that we might have to react in case the solvency number falls - comes closer to the threshold. Luckily, it looks a little bit better now, mainly based on the - actually, the retained earnings.

But, I mean, managing capital, we are doing that, but - I agree that we could do it more aggressively. But, I mean, as I said, we say we want to have a long-term success. So, we're not only looking at the next year but also longer term.

A - Roland Vogel {BIO 16342285 <GO>}

Uli, I would also mention, I think we're trying to explain as to why we feel that our ROEs are still very attractive. We still - even if we didn't grow in 2016, for the first time, for just a long, long time before, we do see growth opportunities. We do include in our presentations the potential volatilities from interest rate increases. So, in that regard, as long as the ROEs are as attractive as they are, we do not feel that pressure.

A - Ulrich Wallin {BIO 4863401 <GO>}

As far as the excess capital on the rating agency model is concerned, certainly we haven't got that concrete number, that's partly also to do that these models are not steady either. I mean, they keep changing. Normally when they change the - increase the capital requirements, but we should still comfortable - have a comfortable buffer in excess of a $1 billion.

A - Karl Steinle {BIO 1986424 <GO>}

Okay. We continue with Ivan (1:39:05)

Hi. Just following up on the Solvency II topic. So, you've added 10 points of solvency this year. Just wondering, looking forward, what type of ongoing generation do you see from the business? And secondly, the €400 million that you indicated might become - might reduce the SCR from 2018. Do you have any concrete plans on what to do with that?

A - Ulrich Wallin {BIO 4863401 <GO>}

Do you want to take that?

A - Roland Vogel {BIO 16342285 <GO>}

We have up to now not defined any strategic plan to increase numbers or what to do with the numbers. Strategically or politically, I must admit I've been a member of the European CFO Forum for quite some time, so we work on a lot of numbers and regulations and do a lobby. I was always a promoter of the view that as long as we have Solvency II defined by a regulator, we should view it as another hurdle to be jumped over. This is a number which - where we see political influence.

So, up to now, I've promoted the view that we have IFRS numbers, which we represent, which are not actually showing a real economic picture. This is why we add. This is why we have introduced our own internal IVC numbers. This is why we've published MCVs and other add-ons to show you economic values.

Now with an internal model being developed and economic numbers being developed, this might change. But we've also seen, as part of the Solvency II regulations, that Greek government bonds are risk free and other things. So these things are not free from any political influence. So, up to now, we've seen these numbers as - as you can see, AA minus rating from Standard & Poor's. That is something we want to make sure.

We will now, from now on, develop and will see in May the numbers and the long, long reports which will be presented. We will develop into economic balance of P&L's, so the analysis of the changes in the numbers and all that.

Up to now, it is more a hurdle to be jumped over, so we have not defined any strategic goal to do with it. We will find out in which direction that goes. In parallel, we are developing IFRS 2017, which is an additional burden which also is intended to present economic numbers.

So, again, I was also not too happy about all these strategic Solvency II goals. I felt that we are doing our own inflation in the industry a little bit. So, this regulation came in to make sure that we have 100%. All of a sudden, we then defined 150%, then you put 200% into your strategy, then the regulator comes in. If you have 200% in your strategy, then your (1:42:42) has to start at 220% and your (1:42:46) So we're adding our own inflation into the whole process. To cut that long story short, we don't have - we have until now, not defined a, to say, well, we wanted to increase our Solvency II ratio by XY percent and on that basis, we will do XYZ with that increase.

A - Ulrich Wallin {BIO 4863401 <GO>}

Yeah. I would say, I mean, we need some further experience with it in order to really steer the capital returns, things like that, based on that number. The form we have made in (1:43:24) SCR is, of course, we expect that from the operational risk model. Furthermore, we haven't got that as yet. And I'd have to make clear that the internal model number for the operational risk is not too different from the standard formula number. The saving only come from the fact that the standard formula number, I just have to add to the quantitative and modeling numbers. So, it's just an addition. If I have a full model, I can take the number from the SCR for operational risk and diversify it with the rest of the exposures. And that is the reason why on a diversified basis, the SCR reduces. But again, I mean, I think our regulator would be he is probably almost be concerned, meet (1:44:30) even talking about it because he has not yet approved it. But whilst we believe we could convince him to approve it. Once that's done, we will be able to do something with it.

Q - Karl Steinle {BIO 1986424 <GO>}

Just to summarize what you've been saying, the 200% threshold that you have, it only works on the way down. So you wouldn't go lower. But if you're materially higher, this does not affect your capital return decisions, for example.

A - Ulrich Wallin {BIO 4863401 <GO>}

Not as yet. I mean, we need to have a little bit more experience with it. And one has to say it is relatively, I mean, volatile number because, I mean, it moves around with the currencies and it moves around with the market yields. It moves around with the mortality assumptions on the Life & Health side. So it has many moving parts. And, therefore, for the time being, as long as we can achieve attractive ROEs, we think higher is better than lower. Let's put it that way.

A - Karl Steinle {BIO 1986424 <GO>}

Okay. Some more questions. One is from Olivia and two others here from In-Yong and Vinit.

Q - Olivia Brindle {BIO 17273762 <GO>}

Hi there. It's Olivia Brindle from Bank of America. Just to push a little bit on two things that you said already, so I'm sorry about that. On the point about capital and special dividends, there must have been some thinking behind €150 million so could you explain why that? Is it because that's what it was previously? Clearly, it's not relative to the threshold. So, how do we think about that number?

And secondly, thinking about earnings and the trajectory there, you talked about your auditors giving you a yellow card rather than a red card on the reserves. So it sounds like you didn't have to release quite as much as you actually released. What was the motivation there? Because you could have still more then exceeded your earnings guidance without that 10 percentage points. So, to play devil's advocate, why not hold back a little bit more than you did?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, I mean it has number of reasons. One, of course, is when you set up the reserves, I mean they are then audited by the auditor. And, of course, at that time we didn't know that they will increase the threshold. And we wouldn't know what – how their calculations would end up. So, from that point of view, we did not want to have a red card again. So, we were a little bit more cautious there, which meant more aggressive reserving.

Also, of course, 2016 was – is the 50th anniversary of Hannover. So, we had a little bit of an interest to show our record result if we could. And as we were so close, we said, okay, fine, we do it. There was a little bit the thinking behind that. Special dividend, well, I mean we wanted to increase the dividend because I mean the capital had actually grown quite substantially, I would say. But we didn't want to increase too much. Then we put the increase on the ordinary dividend because we didn't want to fall below 35% there, and because we feel that, I mean, the €350 million also in the future, we will be able to contain that – this in 35% to 40% of the IFRS group profits.

So we're a little bit more optimistic than we were a year ago on the long-term profitability, on medium-term profitability of the company, and therefore we decided to put the ordinary up. And then we just kept the extraordinary stable because I think keeping a growing line to the extent we can, we will try to do that.

Q - Olivia Brindle {BIO 17273762 <GO>}

Thank you.

A - Karl Steinle {BIO 1986424 <GO>}

So finally, we got also a question from the conference call, one from Michael Haid. So if we conclude (1:49:14) that before.

Q - Michael Haid {BIO 1971310 <GO>}

Thank you very much. Good afternoon, everyone. Only one question. On attritional losses, I calculate that excluding prior year reserve releases and also excluding the effects (1:49:27) from the unused large loss budget. When I go back to 2016, then in the second quarter, we had seen an extraordinarily high attritional or a basic loss ratio. In the first and in third quarter, the attritional loss ratio came down to what I thought was more a normal level. And now in the fourth quarter, it is even above the level of the second quarter. So I wonder, was there more activity in frequency and any drivers behind that? And is it fair to assume that the higher attritional losses in the second and in the fourth quarter reflect now the new reality of the soft market?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, I think it's not entirely logical to think that the attritional losses on the business, I mean, on the accident here are actually increasing because what you see as underlying losses or loss ratios certainly, I mean, the reserves for the current year, I mean our IBNR reserves are based on underwriting year basis, so the accident year of 2016 is largely based on, IBNR reserve based on premiums written in 2015 and premiums written in 2016.

And here, even for the short-term lines, the loss ratios are determined by the loss ratio picks to quite some extent. And that is not actually fully in line with the underlying, I mean attritional loss ratio because if you look at that, you would have to look at the actual advised losses and the paid losses. And I can tell you that the advised and the paid losses did actually not move. Actually, the paid losses are down from last year. And the advised losses outside large losses are pretty stable. So what you really see underlying is reserve developments on the older years. And, I mean, if – for example, if you have large losses –

I mean, the large loss budget not fully utilized in the fourth quarter, we would then, I mean, reduce the loss ratio picks for those segments where the large loss budget is included in the loss reserves.

And therefore, if you take that out, then you can say, well, this is just coming from the large loss budget. Therefore, if that should basically be counted as increasing the underlying frequency, I think that's not necessarily a correct picture of the accident year and underlying ratio.

Therefore, I'm afraid without distinguishing between the actual accounted number and the reserve numbers including IBNR, it's not that easy to make a precise – I mean, to get a precise number on the underlying attritional.

I mean, our feeling is that the underlying attritional in 2016 from a loss point of view has been a little bit higher than 2015, but still below the long-term average. The question, of course, is how much premium we get to cover those? And that's, of course, a little bit less, maybe 1 or 2 percentage points less than the year before.

Q - Michael Haid {BIO 1971310 <GO>}

The volatility in the average is the – and we should probably look more at the yearly figures rather than the quarterly figures here.

A - Ulrich Wallin {BIO 4863401 <GO>}

Yeah. If you look at the quarter, I mean the second quarter looks high because we released and we mentioned that we specifically released some, I mean, IBNR reserves that were not coming from the large loss budget. I mean that is, in particular, in our Bermuda company where we had – and in particular, the Canadian wildfires had a large loss. We could of course, in theory, I mean, released loss reserves in our Bermuda company in the second quarter which we didn't do because the Bermuda company is very conservatively reserved already. And so we didn't – I mean, the actuaries had difficulties to defend their loss reserve position at year-end 2015. And therefore they were very hesitant to already, after the second quarter, release loss reserves. Of course at the year-end, that then happened. And therefore the loss ratio of the Bermuda company then in the end matched the expected value, but there was a little bit of a skew in the second quarter.

Q - Michael Haid {BIO 1971310 <GO>}

Okay. Fantastic. Thank you very much.

A - Karl Steinle {BIO 1986424 <GO>}

Okay. Please, In-Yong, continue.

Q - In-Yong Hwang {BIO 18784369 <GO>}

In-Yong Hwang from Goldman Sachs. Just hopefully two quick ones from me. On the Solvency II, appreciate the 10 percentage points of accretion over the year from 220 to 230, but the ratio is pretty much flat versus the half year to be disclosed, and (01:56:22) high given the market movements and the retained earnings you had in the second half. So maybe you could explain some of the components of the movement there. And the second question, just a quick one on the Life fourth quarter results. You mentioned the frequency of large losses. Just whether you could quantify that for us, please. Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, I mean the movement from the – I mean, there's a movement I think in the second quarter where the solvency ratio was even higher than year-end. That was due to the interest rate reductions following Brexit which have caused the valuation reserve shot up by €1 billion actually, but in the fourth quarter, of course then, we had the U.S. dollar interest rate increases. So quickly, €800 million of that €1 billion was lost again. And in the Solvency II measurements, you see all of those movements in the owned funds, and therefore on the capital adequacy ratio. That's why I say it's rather volatile despite the fact that over the last fourth quarter, it looked quite stable, but this is a volatility why we are I mean happy that we have a little bit of a distance to our threshold, because I mean say, if there's 100 basis points increase in interest rates. I mean that will have an negative impact on the solvency ratio clearly.

If it goes the other way, then it has a positive effect. So it is a very volatile number because it hasn't got any buffers in it. And therefore, one might even argue that it not fully depicts the economic situation of the company because for large part, we are held to maturity investors. So I mean this big enough €800 million down, economically for us, is not that relevant but in the Solvency II ratio, it's very relevant. I mean, on the first quarter I would say – I mean, I think we had an EBIT just over €50 million. In a normal quarter, we would have expected that to be more, I would say, like €80 million. So the difference, in this case, we can't even blame it on the U.S. mortality business. The difference is just the increase in medium to larger claims frequency which can happen any quarter.

That is not a problem if it goes both ways because, I mean, second and first quarter were actually quite favorable in that respect. It's not unusual to see this volatile on a quarterly basis. The only thing when you get concerned if you see the volatility only going in the same direction all the time because rather than it's being volatility, it's a trend. I mean, such a trend would not be good. But we have no evidence that this, if anything else, in random volatility, we don't think it's such – we cannot see that it's a trend.

A - Roland Vogel {BIO 16342285 <GO>}

Maybe to add to the development of the Solvency II number, on the flight over I had a look at various reports and I was also trying to prepare my comment on the development. As you do in your P&L, when you go down, this comes from here and this comes from there. We will have to learn a little bit how to cope with these numbers.

So, for instance, if you compare the two years, the beginning and the end of the year, the difference is not that big. And a lot of that development comes from also the currency exchange rate. So I was trying to follow the developments through the various points. So you see that in the market risk because our U.S. dollar investments got higher values than you find it in the aggregate numbers of our net cat exposures. You also find it in the capital position when our valuation reserves go up. And then, overall, you would have to look at the diversification effect of all these developments in one diversification line.

So in that regard, it was really difficult to identify one single source of this has happened and this is why it's gone up and down. It's a total mixture of things which then also meet the diversification line where, in a lot of cases, we had positive movement with all the single numbers. The positive numbers – the numbers on the asset side were a little bit higher. Plus, there was an additional diversification, which then if we compare the beginning of the year and the end of the year, ended up additional with the increase in the owned funds driven by the profitability in those 10%, but it would be very difficult for me to now actually identify to say, that 1% stems from that one development.

A - Karl Steinle {BIO 1986424 <GO>}

Go ahead, Vinit.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yeah. Thanks for the opportunity. Vinit from Mediobanca again. Just following up a few things. Just on the financial solutions in the P&L, that topic, I understood that is more in the other income line and the other income line was a big number in fourth quarter. Could you just guide us a bit about how much was that? So that's the first question even roughly.

Then on this slide 13, on the new business value jump up, will it be very naïve to just take a tax rate and assume the growth was sort of 20%-odd or could you guide us a bit about what really the growth was in the new business value? On the asset side, one question on the re-risking please. I have noticed a duration in the euro portfolio is lower this quarter versus the previous quarter. Is it a deliberate attempt to prepare for some interest rate moves, or is it just coincidence? And then just last on the outlook, the retrocession you mentioned, Uli. Will that be reflected in the famous slide of the cost of capital for nat cat going forward or will it not really change that cost of capital slight basis for nat, because this was a big topic last year, one year ago?

A - Ulrich Wallin {BIO 4863401 <GO>}

Yeah. That would reduce the net aggregate and therefore would also reduce the cost of capital. So it will be reflected in that slide. On the other income line, on the P&L account, that will become much more prominent this year because the – I mean you have treaties that do not have sufficient risk transfer from IFRS insurance accounting. And therefore, I think it's not overly transparent, but that IFRS accounting they're only shown as one number in the other income and expenses. So that's all where you see them and we would probably, when we present the 2017 numbers, give you a little bit more color on that line because there're so many things in this as income and expenses.

And of course, we have it all broken down internally to know where it comes from, because also when we show you a currency result, it's a balance between currency gains and then currency losses. And the result, as you look at it I mean (02:04:54) presumably, maybe 20% of the gains and the losses if you look at them individually.

So, I think the other income, if you look at S1 (02:05:07) number, it's not overly transparent, but as I said, on the deposit accounted treaties, both Life & Health and P&C but we will see them on the Life & Health much more. You will see them in the other income and expenses, but that's before the EBIT line. So they will also show up in the EBIT.

They will not show up in the technical results, where the – I guess my personal view is that (02:05:33) they should be, because – I mean we have the one treaty in China, which was deposit accounted. So what we saw that was in the 2015 P&L account, all we saw was a – one number in the other income and net expenses of a positive €2.85 million, but the German GAAP premium we booked on as treaty was €1.6 billion. So you can see that, yeah the €1.6 billion might be relatively high, but this is the underlying in this case, saving premiums that were underlying that treaty.

And of course, the treaties make economic sense for the buyer only when you consider those big numbers. And so, we have to see how we report it, but one thing is that we'll be sure that the other income and expenses in 2070 (sic) [2017] (02:06:36) will be a more positive number than in 2016. Then the other question was value of new business. Well, the value of new business of course, what it calculates is the actually expected future cash flows based on the expected mortality, expected lapse, and if you have living benefits because the expected payout of the living benefits.

That then gets discounted. And then you have further discount factor of 6% which is a capital margin because of the uncertainty. I would say, in 2016, if you calculate 2015 on a like-for-like basis, it's more than doubled. And this is really from a relatively small number of large transactions in the U.S. I must admit that outside the U.S. and outside the UK longevity business, we calculate the value of new business lot more conservative than we do it on the U.S. business, but this year on the financial solutions because one of the transaction has actually pre-launched. So we took extra prudence and reduced the value of new business. And hence, the Solvency II capital as well which is the interesting other dynamic just because we had – I mean, it was just a very large number and result. Let's see how the treaty actually performs.

We also had a negative not on the value of new business, but based on the in-force value. And that is that we increased the technical provisions on the old underwriting years of the U.S. mortality business. That part will become a little bit more transparent when we have IFRS 2017, but that will not be before 2021. You will also see it when, in next year, we do the variation analysis on the economic balance sheet which we have to do from 2017 onwards.

A - Roland Vogel {BIO 16342285 <GO>}

Maybe to add to that Uli, you mentioned the other income line. I should also mention that some of these contracts are to be counted as investments as we had seen with last year's recapture rate. That was part of the ordinary investment income. So we might take that up and be a little bit more transparent as the profits from the financial solutions business get bigger and bigger in that respect. The high number of the Q4 other income line in Life & Health was also driven a little bit by the currency exchange rate because that was when the U.S. dollar got stronger. I know that by chance because I did look at it as well. So there was also a little bit an impact from the currency exchange rate.

With regards – you mentioned real estate and duration – not real estate that was – okay not real estate. The duration in the euro I must admit, I don't exactly know where you've read that. Right now, we still pursue our rather strict duration matching in all the currencies. We define around the numbers we get from our actuaries about the duration total liabilities. Some flexibility for the asset managers, but there was definitely no tactical decision. This was just following the durations of the liability side. So tactical bets on durations.

A - Karl Steinle {BIO 1986424 <GO>}

Okay. I don't see any further questions at least at the moment and there are no further questions from the conference call. So that being the case, I would like to thank you for participating in our analyst conference and also for your interest.

This call has been concluded. You may now disconnect. For all the others here, we would like to invite you to join us for a snack and a drink outside of this room. Thanks again for coming.