Q1 2019 Hannover Rueck SE Assets Under Management Call

Company Participants

- Sven Althoff, Member of the Executive Board
- Ulrich Wallin, Chairman of the Executive Board & CEO

Other Participants

- Andrew James Ritchie, Partner, Insurance
- Edward Morris, Equity Analyst
- Frank Kopfinger, Research Analyst
- James Austin Shuck, Director
- Michael Hermann Haid, Analyst
- Paris Hadjiantonis, Research Analyst
- Vinit Malhotra, Banca di credito finanziario S.p.A., Research Division

Presentation

Operator

Good morning, ladies and gentlemen. I welcome you to today's Hannover Re International Conference Call on 1st of January 2019 P&C Treaty Renewals. For your 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.

Ulrich Wallin {BIO 4863401 <GO>}

Thank you very much. And good morning to our -- today's renewals conference call. I'm joined by Sven Althoff, who is responsible for our P&C business, in particular, the speciality lines. And he will help me to give you the details of the renewal fees net 1/1. And I will also give you updated guidances for 2019. And also, one for 2018, which is, of course, a little bit more concrete because book closing activities have been going on for some while.

If we look at market situation and the market condition, the 1/1 renewal -- first, just to say, of course, that we have had significant cap losses in 2017, which resulted in slight rate increases for 2018. But certainly below expectations of many observers. Then in 2018, we had, actually, quite a lot more cap losses to, again, a year, which is above, say, the 10-year average on cap losses. In addition, we had a number of rather significant man-made losses.

So from a large-loss point of view, 2018 was better than 2017. But it was certainly a lot worse than the years 2012 to 2016. That had resulted in some further slight hardening of the market. But not a lot. I mean, it's, again, only a very slight drift up in the overall quality of the premiums of the reinsurance market.

The capacity in the market has remained very resilient to those losses, both on the traditional capacity as well as on the ILS capacity, the reductions were rather small. So there was still more capacity offered than there was a demand from the reinsurance buyer, which meant -- which means, that, largely, still continues to be a buyer's market rather than a seller's market.

The -- if I said -- I mean, there's a -- say, if the capital remains stable, however, I would also say that the demand for reinsurance had also increased a little bit, driven to quite some extent by primary insurance company involved in large commercial business had experienced quite a lot of volatility to their results in 2017 and 2018. And it has the ambition to manage those volatilities and reinsurance, of course, is a very good tool to manage such volatilities of the primary insurer, their result. And therefore, we have seen additional demand. We also had seen additional demand from capital-management point of view, they are particularly based on risk-based regulation like Solvency II, also like reinsurance can help ceding companies to reduce their cost of capital and, therefore, run their capital more efficiently. And we have also seen increased demand on that front.

Then, also, cyber insurance continued to see some growth and new kind of opportunity to grow the business by, derivatively, small at this time is reinsurance that is developed in collaboration with the newly arrived InsurTech market.

On the ILS market, the retro capacity that was available was reduced to some extent, just to be said that more than 60% of the retro capacity provided worldwide is actually provided by the ILS markets. And due to heavy losses, they were a little bit more cautious in providing that capacity, however, it did not have any effects on the pricing of the reinsurance business at the 1/1 renewal. So all in all, I mean, continued soft market, I would say.

If you look at our outcome for Hannover Re, overall, we were not too unhappy with the outcome of our renewals. We managed to improve the rating quality of our book a little bit, after having being able to improve it also a little bit in 2018. So from that point of view, if I look at the overall renewed book of business, the pricing should be sufficient to cover the cost of capital. We, also, managed to grow our book of business double digits -- premium grew by 15.4%. And Sven will elaborate on that in more detail. But it is driven, in particular, by relationship management with some of our larger clients. And territorial wise, China, North America and Germany have seen the most pronounced growth.

We have seen continued good showing on -- at the renewal season. So we could continue to underwrite our business selectively. And concentrate on the business that fulfills our margin requirement.

We, also, were able to place our retros pretty much in line with expectation. So we could keep the net risk on NatCat in line or inside our -- somewhat our slightly increased risk appetite for natural catastrophe risk. We still are underweight on cat. And we will continue to be underweight on cat because part of the cat renewals were still somewhat disappointing, on last 3 programs we still saw some decreases. And one thing that's for sure, if you believe that the trend of cat losses is increasing due to global warming, this is definitely not included in the current pricing of the natural catastrophe business.

This slide should be quite familiar for you, which shows you that there's a time lag on the financial year of development that you see on the rating quality on the underwriting year, meaning that half of the premium and earnings that you have in any given financial year stems from previous years. That means that in 2019, of course, we still have half of the business that stemmed from 2017 and '18. But the rating quality was even less than we have seen in 2019.

Therefore, if you look at it, I mean, '16, '17, '18 and '19 are only marginally different when it comes to the rating quality. This is probably of those for year '16, still most favorable, because it still benefited from the '15. And '14 year, which were a lot better. And I mean, '17 is the bottom of the cycle. And then, '18 and '19 slightly better. But all four years, pricing quality still significantly below, say, the five years, 2012 to 2016. So we are in a, kind of, a soft market, their margins being under pressure. So it's very important to have a competitive advantages to outperform the average market player and, of course, at Hannover Re, the point to our long-standing business relationship and our lower expense ratio.

With that, I would hand over to Sven on the details of the 1/1 renewals season.

Sven Althoff {BIO 19104724 <GO>}

Thank you, Ulrich. A very good morning, also, from my side. I apologize in advance, I do have a cold, just -- but I hope you can hear me well, nonetheless. We are reporting about our traditional 1/1 renewals today. As you can see, this is approximately 46% of our overall P&C business. And when we just deduct the structured reinsurance and facultative reinsurance, 66% of our traditional P&C business. There is no special report on the structured side this year. You will remember, we had a special report last year. But there was no special situation for the -- a '19 renewal and the portfolio is mostly stable on the structured side.

But let me talk a little about the traditional business. You can see that the 1st of January renewals is the time of year when we are renewing most of our European business, well, approximately 50% of our U.S. business and 2/3s of our Asian business. When we will report on our Q1 and Q2 figures, we will also give you an update on the later renewals in the year. 8% is going to renew until the 1st of April, another 16% then until 1st of July. And when it comes to the April renewals, of course, we are observing or we will report on the price increases after the various losses we had in Japan, most notably the Typhoon Jebi. And in July, we will able to report the impact of the California wildfires, because wildfires happen relatively late of the year. So the impact on the 1/1 renewals was still relatively limited. Some programs were already placed, when the full extent of the wildfires became clear. So the 1st of July renewals will be a better indicator how the market is repricing the market after those effects.

As Ulrich already said, we were able to show a significant growth with our traditional business at 1/1. But let me walk you through the slides here in more detail. I mean, as a start it's worthwhile noting that already in the existing business. So the renewals business, due to price increase or us increasing our shares a little bit and ceding companies having more underlying growth themselves, we were able to renew a little more than we have actually lost through the cancellation and restructuring of treaties, where we had lost EUR 639 million. But the renewal book alone, leads to a renewal of EUR 665 million. And in addition to that, we were able to produce additional new business, which were at the bulk of the underlying growth of 15.4% at this year's renewal and at constant exchange rates.

From a pricing environment point of view, Ulrich already mentioned that, overall, the market was relatively flat to slightly up. The rate increases we have seen were mostly coming from the areas that actually had losses in the calendar year 2018. You could also observe that the trend from the previous years, the higher demand for proportional reinsurance certainly continued. Very often this additional demand is still driven out of the internal solvency models, our clients are using for their risk management. And due to our strong position in the market, i.e., the long-standing and stable client relationships and, also, our strong financial strength rating, we were very well positioned to take advantage and write business out of this additional demands from our clients.

Also very notable is the increased volume on the non-proportional business, where we have managed to write 8.4% more than in the previous years, here the supports through the rates' change is a little higher than on the proportional side. So here, we can report 1.1%, as a rate change on our renewal book of business. But also, here as you can see, we have found additional areas of new business. And I will report on that in a little more detail when we go through the February's portfolios of our P&C business.

So Slide 14 is summarizing the renewal by line of business. You can see that we, overall, have an improved pricing environment of positive 0.9%. And also, see that we had particularly strong growth in North America, Europe and in Asia.

And the worldwide treaty line, where we could grow by 29%, a significant part of that actually is resulting from China. And while there was pressure on the rating environment for the entire region was minus 0.4%, on the business where we actually did grow, the underlying rate development was slightly more positive. The rates development here was a positive 0.1%. So more or less stable. And this meant that we could write this additional business taking into account our minimum margin requirements in order to earn our cost of capital.

The next slide, you can see that those areas where we did see losses in the calendar year 2019 (sic) (2018), reacted the most when it comes to the price changes. So for example, you see strong rates development in marine and in credit, surety and political risks, much more meaningful than in the more benign areas. And I already mentioned that for the rest of the year, we can expect other areas to also show a little stronger rate development, notably, Japan and part of the U.S. American portfolio, which is impacted, as I already mentioned, by the California wildfires. So overall, a relatively flat picture. But was good reactions in those areas, where we did see more than the average loss situation.

Ulrich already commented on the rate quality for the financial year 2019. On this slide, we are talking about the price level development from an underwriting-year perspective. Here, you can see that after the 2019 renewal, we are approaching a pricing level which is relatively close to the years 2011 and 2015, which were underwriting years, that's from a rate quality point of view were rather acceptable. So the trend is certainly is showing on a -- in a positive direction. But with some overspill from a financial-year perspective from the previous and softer underwriting years into 2019.

Now let me go into the individual portfolios, where I will start with North America. For North America, we could observe a growth of almost 22%. And this is supported by a -- at least slightly improved rating environment there's a positive 0.3%. The growth is mainly coming from existing client relationships on the property side, where there was additional demand and we could utilize our very strong position with those clients, in order to take advantage on this side. But we could also broaden our client base, which we have been able to do over the last couple of years, already. So this is certainly, also, a very pleasing development.

On the casualty side, we still only see limited growth opportunities. Some did actually exist. So we grew our casualty portfolio a little bit. But we are still deemphasizing our large -- the large commercial excess casualty exposure in our writings on the reinsurance side.

Last but not least, we continue to see a strong demand on the cyber side. And like already in the last couple of years, we were able to add some new business into our portfolio, also from a cyber perspective.

Continental Europe was another strong area of growth. Here we can report 15% growth, the main contributor was our subsidiary E+ S Re, which as you know, is writing our German business. So E+ S Re could maintain and build its leading position in the German reinsurance market. There were particular growth opportunities in Germany coming from the property side. Here, we can certainly observe that after the last couple of difficult years for the German commercial fire business, the market is starting to re-underwrite and in part significant re-underwrite their portfolios. So we would be able to take advantage of this under -- re-underwriting activity with some selected clients.

Another driver for the growth in Continental Europe was, again, Solvency II driven. And most notably, we could see this development in Italy, where Italy standalone we could grow our portfolio by 50%. But we also had other spots in Europe, like, for example, Netherlands, where we did see some additional demand. So overall, a strong picture in Continental Europe, with certainly the bulk of the growth coming from Germany. And overall, a 15% growth year-on-year.

The Marine renewals was very mixed. On the Marine side, we had a couple of significant losses, most notably, a major fire in a German shipyard. And also a Marine loss is coming out of Japan, following Typhoon Jebi. And -- so the market was repricing the business after those losses. But it did not so in a very consistent manner. This led us to deemphasize some programs and grow with other clients, where the price increases were a little more meaningful. And in addition, we have to report a slightly shrinking client base. You may have followed that particularly in the loan market, there were quite a number of Marine portfolios, either on the (haul) or on the cargo side were closed down or significantly re-underwritten by our ceding companies. This is, of course, leading to a lesser demand for reinsurance and at times, even no demand for reinsurance any longer because those clients do no longer write Marine portfolios. And what we could also see was, clients that have come through merger and acquisition activity had an increased risk appetite for their Marine exposure so, therefore, also slightly reduced demand for Marine reinsurance, particularly, from an appetite of loss point of view. So overall, a very mixed renewal with strong rate increase but at the same time, a slightly falling volume with minus 7.7%.

On the aviation side, we are seeing strong signals that the market on the original side is stabilizing. In parts, we even see significant rate increases, particularly, in the field of general aviation. And -- but we all have to remember that the rates are coming from a relatively low level with the years falling for many, many years. And even decades coming from the high in 2002 after World Trade Center. So whilst, we are positive that now with the rates improvement of 1.8%, the market is slightly stronger from a technical point of view. We do still not see as an opportunity to start building our aviation portfolio in a meaningful manner again. And that is the reason why the volume is more or less stable with only EUR 1 million of additional premium yet to report.

Credit, surety and political risk, another area where, in 2018, we have seen a frequency of loss activity. As you can see here, this was taken into account when pricing the renewals. So the price development with a positive 3.5% was stronger than on average. This certainly helped us to renew our existing portfolio, which we have done very successfully, sometimes even with increased shares with some of our clients. And we have also been able to develop a few new opportunities so, overall, good repricing and solid underlying growth with almost 7% to now almost EUR 800 million of premium in this basket.

On the U.K. loan market and direct portfolio, we had a more stable renewal, most lines of business renewed basically flat or only slight improvements in case of clients having losses. We saw a little bit of pricing pressure on individual Motor XL of lost programs. You will remember that this part of our portfolio was significantly repriced at last year's renewal, following the sharp reduction in the ogden rate in 2017. So therefore, the pressure on some of the programs was coming from a strong base, from a rate-environment point of view. Nonetheless, we managed to renew most of the portfolio on an as before basis, also on the motor side and the pressure created a little bit from the anticipation that there will be, at least, a limited swing back in the ogden rate table in the calendar year 2019, where the current assumption is that we will see the ogden rates table move again, either in Q2 or Q3 in the calendar year 2019. The extent of that, certainly, is not known by us. But the market consensus is that the ogden rate will be at least 0% rather than the minus 0.75%. And maybe even swinging a little bit into the positive territory, which, of course, will mean that we would have a significant reevaluation of our motor XL of loss claims reserves. And we have not taken that into account at year-end because this was only an anticipation, this is not a done deal yet.

Otherwise, there was no particular opportunities in the U.K., in loan market portfolio. So we, basically, renewed our existing book of business. And as you can see, the growth in the volume is more or less in parallel in the -- with the growth in the pricing of 1.5%. So this is one of the more stable portfolio.

Worldwide treaty, on the other hand, saw a very significant growth almost 29%. Here, we have a variety of factors supporting this growth. First and foremost, we see a lot of positive underlying growth trends in almost all countries in our clients' portfolios, which, of course, means that even if we only keep our existing shares, our portfolio is growing organically with our clients. But the bulk of the growth actually came from individual opportunities we had in a few territories. The most prominent for China, where we could, again, see more Solvency-driven demand coming out of China. But we've also managed to improve our positioning with a limited number of selected clients so they were willing to offer us more significant shares on their existing programs, which by far was the most prominent driver behind our growth in China.

We could, also, see some positive rate increases in some of the territories. For example, in Australia and New Zealand, despite the fact that the bulk of the renewal in Australia will -- only happen at 1st of July, some businesses already renewing at 1st of January. And we had -- certainly had support from rate increases on that side.

We also had selected opportunities in countries like Japan and in Korea, all on the non-cat driven side. So from that perspective, there was no Jebi effect in the Japanese opportunities. I'm talking about, they were more coming from the non-cat property or from the motor side.

And last but not least, I also wanted to mention that our Caribbean business has been flat, which certainly was a good development following the significant repricing of the Caribbean business in the 2018 renewals. And the lack of losses in the Caribbean in 2018. There certainly was pressure from clients to reduce rates. But the market on the reinsurance side, overall, resisted that pressure and was able to renew the business flat.

Overall, a very pleasing development in our worldwide portfolio. Strong additional demand and 29%, despite a more or less flat rating environment.

Last but not least, I will talk about our catastrophe XL of loss portfolio. Here, you can see another area of significant growth with 32%. The price developments was positive with 3% increases. We have seen growth both in the U.S. but also outside of the U.S.. And the main driver really was our support with those clients where we have seen growth on the non-catastrophe business over the last couple of years. And with our slightly increased NatCat risk appetite, some of those non-cat growth opportunities we have realized over time, now needed support from the catastrophe side as well. As Ulrich said, we are still significantly underweight on the cat side but, of course, many clients are also in a position where they want to balance their cat and non-cat sessions with the reinsurer. So we saw opportunities on that side and in combination with our slightly increased risk appetite, this lead to a significant growth of 32%.

Ulrich Wallin {BIO 4863401 <GO>}

Yes. Thank you, Sven. And I will continue with the overview, basically summing up what Sven just said, You can see that on the premium side, most arrows are upwards, none of them is downwards, there are few sideways. So that calls for an increased premium income. Also, the profitability overall acceptable. So we expect to generate sufficient profitability to cover the cost of capital. And maybe even a little bit more, that's of course, on the basis as the large losses remain in the budget.

You can also see that the areas that we are nonreporting on like facultative and structured reinsurance and ILS, are rather flat, that's particularly, also true from ILS. But of course, there's always the opportunity to write some more business throughout the year. Certainly, all major renewals net 1/1 have been renewed. And there's not really a loss in income from that point of view. Actually ILS is, of course, much smaller than the structured reinsurance from a premium point of view. But that has actually grown quite significantly in -- at 1/1. So overall, I mean, rather acceptable picture, I would say.

That leads me to the 2019 guidance. We're expecting single-digit premium growth. I think, the renewal season at 1/1 is a good basis for that. We also expect some growth on the life and health side. But that would also be single digit rather than double digit. Of course, we will lose some of premium income due to the recaptures of some of our U.S. mortality business. But there's also new business opportunities that will make up for that and a little bit more.

Return on investment from asset under management, we expect at least 2.8%. Here it has to be said that due to the increased interest rates in the U.S. dollar territories as well as some increased spreads on the corporate bonds, certainly on the fixed income sides, the valuation reserve have decreased. Therefore, realized gains from fixed income are somewhat less slightly. And therefore, the 2.8% is a little bit less than what I will report to you on 2018.

But still, I mean, it is in line with the absolute return that we have seen in the last five years. And is fully supportive of our group net income guidance of -- in the region of EUR 1.1 billion. Here, on the P&C side, we assume rather flat development of the profitability compared to last year. This higher profit-- significantly higher profitability on the life and health side that, overall, should allow us to, hopefully, comfortably achieve the EUR 1.1 billion, of course, on the basis that the large losses are not significantly above the large loss budget and the -- there's no dislocation in the capital market.

Dividend policy will be rather stable. I mean, the solvency ratio is still well above our limited threshold. Therefore, I mean, all things being equal and, I mean, if the result actually transpire as guided, we will probably be able to pay a special dividend again. And I -- that mean that we will be able to support our growth even with dividend somewhat higher than 45% of the net profit of the group.

We also changed a little bit, the target metrics. I mean, of course, return on investment is pretty much housekeeping because that's based on a bottom-up plan and, therefore, it really depends on the capital market environment. I mean, we have reduced our exposure to credit a little bit. And have gone to better qualities because to some extent, we could because of high interest rates in the U.S.

The remainder is largely unchanged. We have also changed, which is probably quite remarkable on the combined ratio, we increased that from equal or better than 96% to equal or better than 97%. The reason is twofold, certainly, the proportion of the structured reinsurance, which have higher combined ratios will be more notable, particularly, on an earned-premium basis in 2019. It takes that into account, also what we call the maximum tolerable combined ratio, which is a combined ratio where we earn our cost of capital. And have also increased a bit due to, I mean, increased interest-rates' risk. So-called risk for interest rates in the U.S. dollars and some other territories. And therefore, also, we increased the target combined ratio in line with that. I mean, this target combined ratio, all things being equal, should still allow us to generate, for the entire group, a return on equity well above our minimum target, say, in the region, say, 11% to 13%.

That's for the target metrics. And then I would come to the 2018 year, in line with the previous two years, we give you some update on the 2018 guidance as well. And that's based on the current book closing activities, which of course, are still ongoing, particularly with regards to our auditors that are still looking at the books. And of course, the supervisory board has not been involved as yet. But nonetheless, these figures are, I mean, have certainly a higher stability than the figures mentioned, say, at the end of 2017.

So we expect the premium to grow by 11% currency adjusted, 7.7% in real figures due to currency movements. And that is in line with our previous guidance and even slightly better than our previous guidance to EUR 19 billion.

Asset under management rather satisfying 3.2%., in particular ordinary investment income as compared to last year, partly to do with, I mean, continued a very positive returns from our real estate book as well as our book of alternative investments.

Group net income, we expect around EUR 1.050 billion, which is above EUR 1 billion as you can, see. And I will also be giving you the split: 38% -- sorry, 83%, property, casualty; 17%, Life &; Health reinsurance. Of course, if you add the business group numbers, they will be a little bit higher than EUR 1.050 billion. But then you have a negative number from the column of consolidation. And that has been distributed to the business groups in the split.

Overall, I mean, a little bit better on the life and health side, maybe, than expected. Yes. We have the significant burden of recaptures in excess of $300 million. Otherwise, we had good underlying performance of our life and health business. And we also had some relief of some expense reserves, which we could no longer hold, they were in respect of collateral costs for our U.S. XXX business. But following the restructuring and the aftermath of the U.S. tax reforms, there are simply no collateral cost on the business in question. And therefore, the reserve on future collateral cost had to be released, which means that the overall extraordinary burden on the life and health side was just over USD 200 million.

P&C, we had pretty heavy large loss burden in the Fourth Quarter. So overall, the large losses came in just slightly above the large loss budget of EUR 825 million. And taking that into account, we are not that unhappy with the overall performance of our large -- of our property, casualty business.

I mean, large losses, the 2 largest single losses that we have was the typhoon Jibe with about EUR 135 million. And the campfire is around EUR 130 million, that's all net after a concession. If you take all the wildfires together in the U.S., that includes then the Woolsey fire. And we also have the car fire earlier in the year, if you put it all together, it's around EUR 200 million from wildfires. So quite significant burden from those events.

Dividend payout, at least EUR 5, we will report more in detail, I think on the 7th of March, where we will give you all the insights and all the figures. This is just the first update of the guidance for 2018.

With that, we look forward to your questions, ending the presentation. Thank you.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from the line of James Shuck from Citigroup.

Q - James Austin Shuck {BIO 3680082 <GO>}

I had 3 questions from my side, please. Firstly, just on the raised guidance for the combined ratio from 96% to 97 %, I think you mentioned that the max tolerable combined ratio is -- has increased due to higher interest rates. There's also a negative impact from structured and tailored transactions. So I guess, if I look at the guidance you gave last year that was 96% that was stable year-on-year, I would've thought that both of the -- those influencing factors would have be much bigger last year. You grew 53% in structured products and interest rates were actually higher at year-end, year-on-year. And yet you're able to keep it stable. If you can just shed a bit more light on why you're not able to keep that stable, despite the 1-point-or-so increase in pricing? Why is it this year that you're seeing that upward pressure earned through?

Secondly, could you just spent a little bit more time on the retro point, I think you mentioned that there's reduced availability of retro, had none impact on your pricing, not too sure why that would be, where in the -- retro pricing is up 20% to 40% or so. So just keen to know why that has no impact on for you?

Then, finally, the 2018 profit number EUR 1.0 billion, obviously is a number of moving parts and that, you mentioned the release of the collateralized cost is also the recaptured charges, large losses, et cetera, what's the normalized level of that EUR 1.0 billion for 2018, please? It's just interesting to see that in a context of what you're expecting for the EUR 1.1 billion for 2019?

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes. Thank you for those questions. I mean, on the combined ratio, of course, I mean, the interest rates were increasing throughout 2018. So I mean, there were a little bit lower at the end of 2017. But I mean, we just tried to align the combined ratio targets really with the CRE target. And as we could tolerate a higher combined ratio, coupled with the fact that there's some pressure from the structured reinsurance, we thought we should increase it. Also, I mean, to give us some flexibility regarding our loss reserving, considering that even with 97%, we would expect to have a very acceptable -- I mean, a very acceptable ROE. Of course, I mean, if this business develops more favorable, we would not hesitate to also show an improved combined ratio to the target of 97%.

Retro pricing, yes, you -- lastly, if you -- our main retro vehicles is our K transactions, which we renewed, already, in October for the most part. So that was really prior to most of the Fourth Quarter losses. Our vertical hold account still shows a very positive credit balance to our retrocessionaires. And that means that we could keep the price quite stable. And of course, I mean, we are not quite as heavily oversubscribed as a year ago, I would say. But we were able to just to bring it home at more or less the same prices. Then, we have an aggregate excess of loss that, yes, admittedly, we paid a little bit more for that. But that had 2 total losses in a row. And of course, I mean, there is a reaction to losses on that. So that situation on the retro side overall, I mean, it allowed us to manage our cat losses just in -- our cat exposure within the risk appetite.

I mean, normalized 2018, if you take out the special effect from the life and health, to the tune of a little bit more than $200 million. Also, take into account that we, definitely, did not increase the confidence level of our loss reserves in 2018, which we normally like to do a little bit. I would say, the normalized figure would be, probably, a little bit more than EUR 1.050 billion, probably, a little bit closer to the EUR 1.1 billion. But not much more than that so in line with our policy of book closing, I mean, I would say, around EUR 1.1 billion, it would be something without special effects, we would comfortably expect to achieve and, hence, that's also the basis for the guidance into 2019.

Q - James Austin Shuck {BIO 3680082 <GO>}

That's very helpful. Just a quick one on the retro side of things, again. So you mentioned you renewed in October so, I mean, when it comes to thinking about the outlook for the combined ratio, 97%, in 2019, if we were to think about pressures on that going into 2020, then presumably, your retro costs will be much higher and there'll be a negative margin impact on 2020, is that right?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well we wouldn't mind if our retro costs are increasing because we would assume that we would, then, also see increases in our reinsurance business. And that would, of course, then allow us to keep a larger part of our cat writings on a net basis. So the only thing that would be a difficulty for us, if you see a dislocation or -- I mean, these retro costs are not moving in turn with this reinsurance cost. But I mean, we haven't seen it really at 1/1 this year. And of course, we have sufficient warning, I guess, on the 2020 developments. So that we can react accordingly.

But we always, of course, can either scale back our writings a bit, or alternatively give a higher net on the cap should be rate warrant that. So that does not mean that we will not yet give enough of our continuity to our retro partners, we will always do that.

A - Sven Althoff {BIO 19104724 <GO>}

But if I may add on the early October renewal Ulrich was talking about. There is no price pressure going into 2020 because there's collateralized quarter share. So the pricing of this is following our pricing. And we see it on a quarter-share basis, there's no time delay in our retrocessionaires as repricing that transaction.

Operator

Our next question comes from the line of about Vinit Malhotra from Mediobanca.

Q - Vinit Malhotra {BIO 16184491 <GO>}

So my main question was on the 97%. But just if can follow-up. So the -- I mean, the fact that the structure business is growing -- is not new. And we've discussed about the 60 bps to 1 point of effect on the combined ratio. So how should we interpret this 97%? Should we interpret that the structured book is going to stay longer in your portfolio? And keep growing more than you imagined in the past? Or how would you -- how should we interpret this guidance in the light of that? And I ask because the premium guidance, sort of, for 2019 is not really changed on that basis. So that is really my main question. I mean, also, I would like to understand this guidance being conservative also on combined ratio. Is it that we are building in a lot of conservatism now in that 2019? Because it was -- EUR 1.1 billion already could have had some upside, consensus as looking EUR 1.2 billion. But now even the 97%, you said, you wouldn't hesitate to deliver better than that. So if you could just comment a bit more about the conservative nature of the guidance, it will be very helpful for us.

A - Ulrich Wallin {BIO 4863401 <GO>}

You -- thank you, Vinat, for that. Of course, I mean, the 97% on the overall book including structures means still below 96% on the traditional P&C reinsurance. And of course, we could have already increased the combined ratio guidance last year when structured was actually growing quite remarkable. But we only did it this year. We looked at it really. And really were asking ourselves, do we really need 96% in order to achieve our other profit targets? And the answer to that was, not really. I mean, 97% would be more than sufficient to do that. Also, takes into account that we are expecting, of course, a more -- significantly, improved results from our life and health business, which we said, of course, then would mean that there was a pressure on the technical result on the P&C business would, of course, be not quite as high. And taking all that into account, we thought that we should do the adjustment on the combined ratio now, that is not saying that we are compromising on our Re target. So I mean, we are little bit -- I would say, overall situation for 2019 is a little bit more comfortable, I would say, than 2018 because 2018 we had, of course, all the recaptured charges. We were quite fortunate that we had a better-than-expected loss experience from our U.S. life and health business, which alleviated the problem. And for the future years, we are of course, quite fortunate that the problem is a lot smaller anyhow because of all the recapture. So there's less pressure in 2019 than there is in 2017. But the guidance basically takes into account that we would like to deliver the message that 2019 may be better than 2018. And that we expect for 2019 to achieve our targets particularly when it comes to the Re.

Operator

Our next question comes from the line of Paris Hadjiantonis from CrÃ©dit Suisse.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Two questions. The first one would be on the reserve buffers. I think, earlier you have alluded to the fact that you have not really increased the redundant reserves this year or the past year in 2018. Did you actually reduce them? So given the level of large losses, given the recaptures that you've seen on the Life Re side, where you required to, actually, release some of the EUR 1.8 billion of reserves that you had?

Then, on the specialty lines, since Sven's on the call, pricing seems to be quite good, probably better than the rest of your portfolio. But volume doesn't seem to follow through. You have explained the loyalty impact. But is there anything more than that? Is -- I think you were discussing M&A as well. So if you could actually give us some better guidance of what exactly you are seeing in the specialty market? It would be, certainly, very useful.

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes. I'll leave the second question to Sven because he knows much better than me. On the reserve buffers, I mean, I would say the calculations haven't been finished as yet. We will, of course, advise that on our Investor Day again. But the way it looks now, I would say that the redundancies would have gone down to some extent in 2018. They are from the basis of the recapture that's also on the basis of the large losses just slightly above the large-loss budget. That's also why I said, I mean, the underlying, kind of, normalized result, I mean, is more like EUR 1.1 billion in 2018. And not, say, EUR 1.25 billion, which you would end up if you just add, I mean, the one-off effect from the life and health side to the current results or maybe EUR 1.2 billion you run there. So a difference, you would probably have to say. But most likely have come out of the reserves buffers. They, however, continue to be quite comfortable, I would say. But also that it's a little bit of the basis for giving a guidance for next year, which some of you might think is a little bit conservative. On specialities, Sven, I will hand over to you.

A - Sven Althoff {BIO 19104724 <GO>}

Yes, I mean, I tried to explain on the marine side that this was a very mixed renewal. We were relatively pleased with the increase in the pricing that we could achieve overall. And this is the area where, at the same time, we have reduced our volumes. This -- the reduction in volume really is to do with the lesser demand, either from existing clients because they had to re-underwrite their own portfolios. And at times, they are very significantly re-underwriting those portfolios and at least one significant M&A transaction, where after the restructuring of the combined entity from that development alone, we lost a low 2 double-digit premium figure from this M&A situation.

So I would not be negative about the medium to long-term trend on the marine side. I think after the re-underwriting efforts, the client portfolio would turn into stronger portfolios again. And they will eventually grow again. So maybe, we only talk about the time lag when our volume is responding positively again on the marine side. And so from that point of view, I wouldn't read too much into the dip at 1/1.

And there is positive development already on the horizon. You may have read in the trade press that we were able to continue or even increase our private placement on the reinsurance for the International Group of P&I Associations. That is in the public domain so that I can talk about that. This is not included into the numbers here because we're talking about 1/1 business. And that development will happen a little later in the year because the renewal date is later than 1st of January.

I think on the aviation side, I talk about, yes, positive rate development but from a very, very low base. So this would be a line of business where, with a little more positive rate development, we can certainly grow our portfolio again. I mean, some of you may remember that at its peak, we almost had EUR 1 billion of aviation income. This is now down to a much, much lower number. I'm not saying it will ever be EUR 1 billion again. But there's certainly significant scope to continue or to rebuild our aviation portfolio. But we need a certain level of technical pricing for that.

And last but not least, the credit and surety and political risk portfolio, I mean, this is one area, which has a, I guess, reacted like you could expect, good underlying rate development but also good underlying growth. This portfolio has grown consistently in the medium to high single-digit figures for the last 7 or eight years. So from that perspective, I think you were more interested in the mixed message on the marine side then this more stable development on the credit and surety side.

Operator

Our next question comes from the line of Edward Morris from JPMorgan.

Q - Edward Morris {BIO 16274236 <GO>}

Three questions from me, please. Firstly, just coming back to this premium guidance for FY '19, single digit. Just trying to understand if there's one area where you're expecting slower growth. Because obviously, the P&C premium growth appears pretty strong so far this year. You seem to be talking about further growth in structured and also on life and health. Can you just help us as to why we get back to single-digit growth overall? The second is on your comments on pricing as we go through the year. Obviously, we have 1/4 and 1/6, 1/7 renewals to come, which probably have a higher proportion of loss-affected contracts. Can you just tell us what your assumptions are for pricing going forward? Then lastly on the cat budget, you made an interesting comment about, there appears to be --

have been no change in the market for changes relating to global warming, whether the exposure has changed. Now I'm just wondering if your own increase in the NatCat budget takes into account that. You seem to be suggesting it's actually just due to business growth. So I wonder if you can just comment whether you think the exposure is changing.

A - Ulrich Wallin {BIO 4863401 <GO>}

If I start with the last question, of course, with after two years of alleviated NatCat losses, there's a tendency that you think, well, that might be a trend and you will see more in future of that. We were in a similar situation at the beginning of 2006, then we had the hurricanes in 2004 and 2005. And certainly talking about the near-term probability as opposed to the long-term probability. I mean, I think, there is certainly clear possibility that you would see a continued gradual growth of the cat losses due to global warming, particularly when it comes to flood losses and there may be drought losses. That has not taken into account -- that has only taken into account our increased large loss budget to the extent it's included in the NatCat model. Because I mean, the budget on the NatCat side is really the result of the expected losses calculated in accordance with this model that we use. And so to the extent that we have take into account higher potential for losses then than, let's say, in otherwise, it's not I would say -- overall, it's based on the status quo. And so it's really driven by more business.

I mean, that's one of the reasons why we are still reasonably cautious on our cat writings because we think it has suited us fine to be underweight on cat loss 10 years because it reduce the volatility of our results. And we're currently not really enthusiastic on the cat business to increase our net exposure significantly.

Premium guidance, single digit, well, I mean, we probably, as I said, expect some slower growth on our life and health business as a major part of our business. It has to do with the premium that we will not be having as a result of the recaptures. Then the life and health growth will also depend on a few of the larger transactions that we're currently working on that are coming to fruition or not. Overall, I would say, we have nice growth on the U.S. financial solutions business on the life and health side. But that will not be visible in the top line, only in the bottom line. And to grow in China on life and health. But if you take it all together, we think life and health will probably be lower single digits. Then if you put it all together, we think we will be in the single-digit bracket. If it ends up to be double digit, I mean, we will not stop writing in order to keep it in the single-digit range. And on the midterm pricing, would hand over to Sven, again.

A - Sven Althoff {BIO 19104724 <GO>}

Well our base assumption on the midterm pricing was that we have to expect a stable market environment. So basically flat on the business that has not seen any losses. On the business with losses. And I mentioned a few of the territories, we certainly expect that things will be different. And that we will see strong rate increase, depending on the individual client, depending on the individual size of the loss. At times, we will talk on those programs, with those losses at high single-digit rate increases or meaningful double-digit rate increases if programs were more or less totaled or at least significantly impacted. But the base assumption for the remainder of underwriting year 2019 is very much like we have shown you today, that it's going to stay a flat environment for those territories that have not seen any losses, which of course, is the bulk of the business.

Operator

Our next question comes from the line of Andrew Ritchie from Autonomous Research.

Q - Andrew James Ritchie {BIO 18731996 <GO>}

Just a few quick questions. First of all, could you just clarify how you talk -- when you think about price on quota share as a proportional business, how are you calculating the price? Is that purely a movement in ceding commission? Or is that also reflecting the original underlying market? And is there any risk there on the -- an offset between the original underlying market pricing and some claims trends? Just clarify how you calculate the price effect on proportional business. Second question, just on the retro -- your retro arrangements. I think the implication is that you renewed them with the same structure as in the K-quota share on the cat exposure business, the whole account protection in the aggregate. Is that true? Or is there any slight change in terms of your own retentions? And I guess, finally, I suppose -- I'm not sure, maybe you sort thought you have answered this already. What is the risk we get disappointed again with the renewals over the rest of the year? I suppose on driving that, do you see scope for the ILS market in particular to get its act back together once you've got over the trauma of ILS losses we suffered in the '17 and '18 underwriting years? Do you see some risk as that gets back together, particularly by the midyear?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well I mean, as far as the last question on the ILS market, it of course, will depend on the loss development this year. But I think midyear is probably a bit early. I mean, I think if you suddenly are talking, say, 20% to 30% cat price rise at midyear, then it's very likely that you will see the ILS market coming back in order to make sure that the rate increases are not quite so high. But outside that, I think for remainder of the year, I would assume that the ILS market will be relatively stable and will probably be looking for some higher prices.

Price on the pro rata business is calculated from our rating models. Out of the rating models, we calculate -- we expect the profitability based on commissions, profit commissions, original price movement, market movement relative to the cost of capital. And that's the basis for calculating the price changes there. You can see the precision of our statement there as good as our pricing model. It's not worse. It's not better. It's the best that we have. So that's where we go about. Changes on the retro structure, again, I would like to put that to Sven.

A - Sven Althoff {BIO 19104724 <GO>}

Yes, Andrew, I mean, there were a few changes, no significant changes when it comes to the structure of those placements. So on the K side, we placed a little more capacity. On the whole account retro, we also placed a little more capacity compared to previous years. Where we have placed a little less was on the large loss -- excess of loss was always -- already highlighted. This is the area where we have seen price increase so, therefore, in order to keep that under control, we placed a little less and then changed the structure a little bit. And in order to stay in line with our risk appetite, we placed more of those protections where there was no movement in pricing. I hope this answers your question.

Q - Andrew James Ritchie {BIO 18731996 <GO>}

So I'm just trying to work out that in a sort of -- I mean, I appreciate you're targeting your overall cat budget. But I suppose you've got a little less protection in a frequency year than you would have had?

A - Ulrich Wallin {BIO 4863401 <GO>}

That's, I mean, in years, there were -- of course, the K transaction covers frequency quite well. Of course, I mean, in years like in 2018, where the losses are not sufficient to hit the load account. Of course, the aggregate cover is extremely helpful. And there we place a little bit less. So I mean, if you weigh it all up in a year like 2018, probably we would have collected slightly less than we actually collected in 2018.

Q - Andrew James Ritchie {BIO 18731996 <GO>}

Okay. And just to clarify, how -- what's the capacity of the K vehicle for 2019?

A - Sven Althoff {BIO 19104724 <GO>}

Well on the K portfolio in question, we are placing 44% into the -- with our collateralized reinsurance. So just under 50%.

Q - Andrew James Ritchie {BIO 18731996 <GO>}

Sorry, what was the total risk-bearing capacity of K this year? How much capital did you raise? What's the K vehicle capitalized at? Then, I can -- obviously, I'd put in the premium as well.

A - Sven Althoff {BIO 19104724 <GO>}

Andrew, I have not memorized that. It was slightly up. But we would have to come back to you.

Q - Andrew James Ritchie {BIO 18731996 <GO>}

No worries. I will follow up. Cool.

Operator

(Operator Instructions) And our next session comes from the line of Frank Kopfinger from Deutsche Bank.

Q - Frank Kopfinger {BIO 16342277 <GO>}

I have also 2 questions. One is a follow-up to Ed's question on the top line growth. I think you pointed in life and -- or you gave the explanation for life. However, I would also like to have your view on how we should bridge your 15% volume growth now on the treaty business with your 3% to 5% premium growth from the P&C overall. Then secondly, can you give some indications on what we should expect in respect to remaining charges or negative effects from your Life Re business in 2019? And I think there is still some arbitration going on.

A - Sven Althoff {BIO 19104724 <GO>}

Well I mean, if you look at the premium, of course, the 15% is on just under 50% of our P&C business overall. So I mean, the 15% at 1/1 really accounts for 7.5% for the entire year. Of course, I mean, there will be some further growth, most likely on the midterm renewals. But as I pointed out, the structured reinsurance and facultative for the time being is assumed broadly flattish. So that makes it probably, if you put it all together, maybe reaching on the P&C side 10% or just a little bit above that. Then if you take, say, 3% to 5% on the life and health side, that creates a double-digit overall growth.

Then further charges on the Life Re, we would still assume that the majority of those are really done. Of course. So I mean, if we have charges next year, they will certainly be not be higher than mid-single-digit millions in U.S. dollars. So our overall U.S. life and health business is expected to be very profitable because we expect very good profitability from our financial solution business that should be at or even more than $300 million. And we also expect, I mean, continued solid profitability from our health and special risk business in the U.S. Non-U. S., we expect an EBIT of north of EUR 200 million.

Operator

Our next question comes from the line of Michael Haid from Commerzbank.

Q - Michael Hermann Haid {BIO 1971310 <GO>}

Michael Haid, Commerzbank. Two questions. Also, when you look at the renewals, you grew strongly North America, you grew strongly in Continental Europe. And you also grew in Asia. Can you give us some idea how -- where are you particularly happy growing? What was -- where were more aggressive? Or what made you particularly happy there? Second question, you mentioned that the InsurTech market newly arrived into reinsurance. Can you say what role it played, I assume, from the client side?

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes, okay, if I start with the first question on the growth. I mean, the growth is really with individual clients. And I would say it's the -- with the largest premium volume, it's really kind of -- I mean, I hate that word. But you might call it private, private placement, where we have secured lines at our terms. And that's why we like the business. And I mean, it happened to be pretty much around the world, I would say. Sven, you want to add something to that.

A - Sven Althoff {BIO 19104724 <GO>}

Well it's just -- I mean, it's really a selected amount of clients. It's very much driven out of additional demand from those clients. The pricing is acceptable. So we have not changed our pricing assumptions in that respect. We do make our cost of capital on those transactions. And the bulk of the growth areas is coming from the short-tail classes. So mainly property, which certainly we also like because there was a lesser chance mispricing on the shorter-tail classes. But the main driver was really additional demand from a selected number of clients. It was certainly not a growth across the entire portfolio in those territories.

Q - Michael Hermann Haid {BIO 1971310 <GO>}

So is it -- go ahead.

A - Ulrich Wallin {BIO 4863401 <GO>}

Sorry, I was said, if you have another question on the growth, then I would come the InsurTech after that.

Q - Michael Hermann Haid {BIO 1971310 <GO>}

Yes. Is it fair to assume that price differentiation becomes even more important nowadays than, say, 1 or two years ago?

A - Sven Althoff {BIO 19104724 <GO>}

Well it certainly helps if you have, across your entire portfolio, the capability to price the risk and be a lead market. Do we see more price differentiation? It's still only in isolated circumstances. I mean, the bulk of the business is still placed with the same terms and conditions with all the participating reinsurers. We see it a little more often than in the past. But it's still the exception. It is certainly nowhere near the norm yet.

A - Ulrich Wallin {BIO 4863401 <GO>}

And of course, if you write the business 100%, you're not quite sure what the price of the rest of the market would have been. If it would have been a composite placement. Therefore, we're always a little bit cautious when we talk about pricing on private deals. I mean, we get the price that we need -- that we think we need to earn the cost of capital. But of course, if you have at all, I mean, it might have been more expensive than it would have been in the -- on a core reinsurance basis. You just don't know.

On the InsurTech, I mean, here we have a partner model. I mean, we're not developing a lot of InsurTech capabilities ourselves. But we work with partners that have an interest to partner with us. And that has resulted in reinsurance business to some extent where the InsurTech has a license to be an insurance company. So then we provide them with this reinsurance capacity and some support regarding products and original pricing. Sometimes they are just tools providers, like on the life side. I mean, on our Vitality business. But we also have other areas where, I mean, we have InsurTech that provide medical, I mean, screening based on wearable devices where they have the technique. And we help them to create an insurance revenue stream that they, of course, are reinsuring it. That's pretty much what we have.

We have as I said, created an underwriting department so that, I mean, brokers but also the InsurTech themselves, have somewhere that takes care of them within Hannover Re. And as I said that has been quite -- I mean, they were more successful than we expected it, I must say. I mean, we have more opportunities and created more business than we actually thought. At the same time, it's still, I mean, it's more a minority of our overall business, I would say.

Operator

Our next question is a follow-up question from the line of Paris Hadjiantonis from CrÃ©dit Suisse.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Couple of follow-ups from me. Firstly, on the cost of capital, I was just wondering if you could give us an idea of where, for the overall P&C portfolio, this now stands. And how it has changed year-on-year? Then a clarification on what you've done on the life reinsurance side with the release of the collateral. Why did you have to do it in the Fourth Quarter, given that the restructuring of your U.S. business actually happened earlier in the year? Was it related to close of books at the year-end? Or was it something else?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well the cost of capital that we take into account is, of course, the cost of capital on the economic capital. But we then also look at the ROE target. And so the cost of capital definitely has to fulfill the ROE target based on interest -- on risk-free interest rate. So this is the 900 basis points over and above risk free. That's the basis for the calculation.

Then on the cost, I mean, what that really is, I mean, on the XXX and AXXX business that you write from the U.S., historically, you have to put up a collateral for the so-called noneconomic reserves, which was the reserves over and above the calculation of the actuaries. And that's normally done in -- by letter of credit. And that means that, of course, when you calculate the future expected cash flows, these collateral costs are taken into account. Through various measures, we have reduced these collateral costs through captive structure and other things to virtually 0. However, we still kept the reserve for collateral cost because some of these structures are subject to change. For example, I mean, the reduced collateral following the convent order that we have for the some of the U.S. authorities, are subject to our -- for our credit ratings. So if our credit rating would deteriorate, we would have to put up higher collateral again. Then we would also, of course, have to take care of that in reserving.

Now with the change in the business, some of the business is now structured through a captive that we have set up by the name of Sand Lake Re. And with that, there is no need to put up collateral under any reasonable circumstances. And therefore, we reduced the reserves that are in relation to that. I mean, why -- I mean, we would have probably done it early on. But of course, I mean, this was work in progress. I mean, there was a significant restructure. And of course, there was then a lot of discussions with our auditors as well. And that was just finalized in time for year-end. And therefore, this release came at year-end. But it's only a smaller part of the overall cost reserves that we are having obviously. I mean, it's not the entire cost reserve.

Operator

Our next question is another follow-up question from the line of Vinit Malhotra from Mediobanca.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Just very quickly, please. You mentioned a comment of the -- some business being brought forward in some of the later renewals to January. And I understand that this is not the NatCat-exposed business. Could you just comment on why that could be happening? Or is that -- is that you have been expected? Or -- and did that affect your pricing data as well? And just one very, very quick follow-up, please. When you said that the loss reserve flexibility is one of the reasons why you -- that combined ratio went to 97% target. Can we interpret that to mean that you want the option not to release -- not to have to release too many reserves in '19?

A - Ulrich Wallin {BIO 4863401 <GO>}

The answer to the last question is yes. The answer to the first question is, well, it happens quite often that you either have treaty periods that are prolonged, say, for 18 months or where you have to cancel and rewrite earlier on for many reasons. It just happened that on some of the business that we have, that had an effect on the 1/1 renewal. If you look at the renewal for the entire year, that will not be visible. We just thought we mentioned it because it had an effect particular on our property catastrophe. That 32% increase is not what we're expecting for the entire year.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Sure. But does this mean that some of the pricing uptick that we had in April or July is already coming in January, is what I am trying to get at?

A - Sven Althoff {BIO 19104724 <GO>}

No. That's not what we are seeing. I mean, it was on not loss-impacted programs. Unfortunately, most clients do not volunteer loss-impacted programs to renew those early. They rather wait a little.

And if I may add, I mean, Andrew, if you are still in the line, we now have your answer on the K. We have increased -- and I'm talking dollars now. The capital placed on K by just shy of $40 million to now an overall capital placement of a little higher than $640 million.

A - Ulrich Wallin {BIO 4863401 <GO>}

Then, of course, in addition, you have the net premium to cover the losses yourself.

Operator

And as there are no more questions registered. And I hand back to our speakers for any closing comments.

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes. Thank you very much. Thank you, all for listening in to our call. Thanks for all your questions. Hopefully, we could clarify most of them in a reasonable manner. And with that, I wish you all a very nice day. And all the best. And goodbye.

Operator

This now concludes our conference call. Thank you, all for attending, you may now disconnect your lines.