Q1 2015 Earnings Call

Company Participants

- Roland Vogel
- Ulrich Wallin

Other Participants

- Anasuya Iyer
- Andrew J. Ritchie
- Frank Kopfinger
- In-Yong Hwang
- Kamran Hossain
- Thomas Fossard
- William Hawkins

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen, and welcome to today's Hannover Re International Conference Call on Interim Results 1/2015. 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. Good morning, ladies and gentlemen. I'd like to welcome you to our conference call presenting our results for the first quarter of 2015. As always, I'm joined by our CFO, Roland Vogel. Given that today is also the date of our annual general meeting of our shareholders, we are holding this call rather early.

I've also heard that one of our competitors is reporting today as well so we will try to be rather punctual and finish at around 10:15 to give you the opportunity, if you wish so, to do other things. With this in mind, Roland and I will try to keep our comments as brief as possible to make sure that we have sufficient time left over for the Q&A session.

I'm pleased to report that Hannover Re had an excellent start into the year 2015 with a group net income of €280 million, an increase of 20% and a gross written premium growth of 10% on a ForEx adjusted basis, the first quarter has seen a successful first step to achieving our full-year guidance. This is especially gratifying against the backdrop of continued difficult environment for the international reinsurers, in particular, due to the fierce competition mainly on the P&C side as well as the continued challenges that are presented to ourselves by the very low interest rate.

The very good profitability of the first quarter is based on excellent results of our Life & Health reinsurance business and continued good underwriting results of our Property & Casualty business. At 13.9%, we were, again, able to achieve an attractive return on equity despite the fact that the shareholders' equity is further grown by roughly €1 billion to now €8.5 billion.

This is the result of the retained high earnings as well as currency effect, as you know, with the change of the functional currency of our Bermuda subsidiary, we have increased the U.S. dollar component in our capital and that is, of course, felt in the OCI and is the decreasing interest rates in the first quarter we also had growing valuation reserves.

The book value per share reached a new all-time high of €70.68. Following three consecutive years of low (03:40) major losses, very good results in the industries, the property & casualty reinsurance market continues to see fierce competition with the capacity exceeding the demand from ceding companies by quite a margin.

However, the amount of quality business you've seen so far towards the end of 2014 and in 2015 has actually been a little bit better than we had expected. Although we continue to adhere systematically to our selective underwriting approach, our Property & Casualty business has grown on a gross premium basis, currency adjusted, by 13%. This is mainly driven by new business from emerging markets, particularly China, the U.S. and also quite significant growth on our agricultural business.

We also had a special effect with a more accurate estimating of premiums and our accounting of the facultative business, which led to a non-recurring additional premium of approximately €93 million for the first quarter. However, even eliminating the fact we were able to grow the gross premium of our P&C business currency adjusted by about 8%.

This figure shows that we have made a highly successful start into the year 2015. With a

healthy operating profit of €255 million and a combined ratio of 95.7%, our Property & Casualty business continues to be quite profitable. This is then particularly true as we were able to keep with our conservative loss reserving policy also in the first quarter of the current year.

We are thoroughly satisfied with the development of our Life & Health business. The currency adjusted premium growth of around 7% is at the upper range of our target. Opportunities presented themselves in the emerging markets in the Australian group business as well as the block assumption transactions of our longevity business in particular from the UK. The significant improved results show that the steps taken to improve the profitability of our Australian (60:40) disability portfolio throughout to some extent of our U.S. mortality business makes themselves felt.

On top of the good underlying profitability, we saw a significant additional profit of around €39 million from termination fee of a financial solution transaction which had been booked as a derivative and, therefore, will appear in the line of ordinary investment income. Altogether, the operating profit showed a remarkable increase to reach €173 million, an impressive increase of 165% compared with last year's figure.

We're also satisfied with the development of our investments. Also interest rates continued to move lower. Our ordinary income from the fixed income securities as well as our real estate portfolio had increased remarkably. This is on the back of large shareholdings because also the invested assets have again increased significantly, not least because of a continued very positive cash flow.

On that note, I will hand over to Roland, our CFO, who will explain to you these rather good figures in more detail.

Roland Vogel {BIO 16342285 <GO>}

Okay. Good morning and thank, Uli. In the interest of time, I sort of immediately start with Page 2. And as already mentioned, top line growth was notably ahead of our expectations in the first quarter with regard to the very impressive currency exchange rate impact, one has to bear in mind that premiums are translated on the basis of monthly rates and 2014 started into the year with a much stronger euro.

Net premium earned increased by 6.9% at unchanged FX rates that is slightly less than the top line mainly due to our ILS activities and some fronting arrangements in the P&C reinsurance segment.

Investment income, very satisfying benefiting from the positive one off in Life & Health which Uli has already mentioned and which we will hear about at different occasions. Here, the fee of around €40 million became payable, owing a customer-initiated withdrawal from a financial solutions contract and due to the limited risk to the insurer as already mentioned. This contract was booked in accordance with derivative accounting and, thereby, is recognized within the investment income of the Life & Health division.

Other income and expenses benefited again from positive currency exchange rate effect, this time mainly in the Life & Health reinsurance segment. Storm Niklas has hit Germany and hereby especially E+S Rück, our German subsidiary. And on that basis, some of these losses are borne by the minority shareholders, which is the reason for the positive swing in the minority interest line.

The tax ratio is slightly above our expected level due to a rather conservative approach in recognizing deferred tax liabilities, however, those who have already read our quarterly report in detail might have found in the notes that we do expect a refund of past tax payments in Q2, which should lead to a rather low tax rate in Q2, and, overall, the full year tax rate should be in line or even a little bit below our expectations, and those were usually around 25%.

If we look at the capital side, we have just recently announced the early redemption of a €500 million perpetual bond on the 1 June 2015. Just as a reminder, we had already refinanced this bond in September last year. So, therefore, the green part of this column on the slide should be reduced in Q2 to a level that will likely be sustainable, and with that also the interest claimants will of course be reduced in the future.

When it comes to shareholders' equity, last year's trend continued with an increase of around 13% in the first quarter of 2015. Here, especially the OCI changes driven by the asset valuations make our life more difficult when it comes to ROE achievements. Before - the background, the actual achievement of 13.9% is, from my own point of view, even more remarkable.

Cash flow continues to be very positive, mainly fueled by the premium growth of our reinsurance business. And it also, of course, includes currency exchange rate effects. But also, the investment income has contributed.

Assets under own management further increased by 9.5% to a level of close to €40 billion, in the meantime. The impact of currency exchange rates here, in particular, the USD was around €2.5 billion within that numbers. Rising valuations reserves had a positive impact of around €260 million in the first quarter of 2015.

On the P&C side of life, the gross premium increased by a remarkable 13% on an FX-adjusted basis. Uli already mentioned the special effects of the changed recognition of pipeline premium in the facultative business. Here, we have enhanced our accounting system to calculate more accurately what we call the pipeline premium, which is the premium already earned, but for which we have not yet received cedant accounts. This effect accounts for 5 percentage points of the reported growth for the first quarter and this is expected to normalize over the next quarters.

At 3.3% of the net premium earned major losses, again very well below the budget in the first quarter. The underwriting result is again on a very good level. The combined ratio of 95.7% is below the full year maximum target of 96%. With the very positive overall result in mind and in line with our practice employed in the past, we did not release the unused large loss budget, but capped (14:37) it for the remainder of the year.

We did also not benefit from other positive run-off results in the first quarter of 2015, plus we have kept our reserving methodology unchanged. All in all, this means that we should have kept our confidence level at minimum stable, and the absolute amounts of redundant reserves should have been increased one more time.

The very low inflation level has had a negative impact on the investment income, but other than that, the ordinary investment income and also realized gains were in line with expectations. Other income and expenses in this segment are on a similar level compared to last year. All together, net income from our P&C business stands at €171 million, very satisfying even if a little bit below a very good previous quarter or Q1 2014.

On the next slide, you can see that most lines of business showed good underwriting profitability. Continental Europe was mainly affected by Storm Niklas at the very end of this quarter, while aviation was impacted by the Germanwings loss, plus a few single losses which did not make it over the large loss threshold, but still added to the negative combined ratio effect. Marine is only slightly above the MtCR. This can be explained by the increased basic losses in the first quarter and a cargo ship carrying rather expensive cars that went aground in January, but didn't really make it to a single large loss. Not surprisingly, the profitability of our global cat business was very good due to the absence of the cat losses.

I think we can go through the next slides rather quickly, because as already mentioned, major losses well below the average in the budget. Still, the year has only just begun. Three losses made it on to our large loss list, apart from the already mentioned events, the winter storm in the U.S. just crossed the €10 million threshold and, overall, the bulk of our €95 million in unused budget as already mentioned has been carried forward for the remainder of the year as IBNR.

With currency adjusted growth of 6.5%, the premium development as well as the growing business segments in our Life & Health business lines us very much in line with our targets. The important message here is that the underlying profitability has improved as we had expected.

On top of this improvement, the result benefited from the already mentioned one-off effect in the ordinary investment income as well as the occurrence of positive currency exchange rate effects in other income and expenses. Overall, this results in a remarkable operating profit of €173 million for the first quarter.

This excellent result is also reflected in the EBIT margins for our reporting currencies, which all outperformed their respective targets with the financial solutions segment, of course, benefiting also from the run-off. But even without these non-recurring items profitability, it was very, very positive. As a sideline, the effect from our ModCo derivatives was around zero in the first quarter.

Looking at the investments, I'm quite satisfied with the results of the first quarter 2015 despite the low-yield environment or even lower-yield environment. And excluding the special effect in the Life & Health segment, the ordinary investment in turn is still above the last year's level based on the increased asset volume. Of course, this development is also supported by the strengthening of the U.S. dollar.

Mainly as a result of regular portfolio maintenance realized gains were on a lower, but still remarkable level. Depreciations were again only on a very, very low level, consisting for the most part of regular depreciation from our increasing real estate portfolio.

Excluding the effects of the technical derivatives, meaning ModCo and inflation swaps, the ROI from assets under own management was 3.5%, clearly above the expectation and leaving us well placed to achieve our target for the full year. If we adjust that for the one-off, the ROI would have been 3.2%, still clearly above the target of exactly 3%.

Moreover, we have switched our targeted inflation protection from swaps to inflation-linked bonds. And our last tranche of the swaps is maturing in the second quarter. So in the future, this should mitigate the artificial volatility we have seen from these instruments in the past.

Our asset allocation is almost unchanged and for this reason, you can find the respective slide in the appendix to these presentations. And again, in the interest of time, I would conclude my remarks here and leave the rest to Uli.

Ulrich Wallin {BIO 4863401 <GO>}

Thank you, Roland. It's a pleasure for me this quarter to present the target matrix because, for a change, all targets have been achieved, which is evident of a very good first quarter 2015. This also suggests that we have laid a good foundation for achieving our full-year targets.

Therefore, I will move directly to the outlook on the next slide. We have actually been quite satisfied with the renewals at 1st of April on the P&C side where business in Japan is traditionally renewed, and alongside with that, some business from Australia and New Zealand, as well as part of the U.S. property catastrophe and some other U.S. business. In addition, also some of our agricultural business was up for renewal. Overall, we recorded a premium growth of 5%, which, of course, as always is on a currency-adjusted basis. And we achieved that without making concessions to our underwriting discipline.

This increase is actually largely driven by some new business that we wrote in the U.S. where we actually managed to write some quite attractive new short-tail treaty. Also in Japan, we managed to increase our volume to some extent, and that is despite the fact that on the property catastrophe business, we saw continued pressure on the rates.

In personal accident and property per risk, the price declines were for the most part actually quite small, and based of some losses in the past, on the casualty business, we indeed actually saw some increases. Overall, we managed to improve our provision, particularly some of our core clients and this is the reason that the opportunities that we at Hannover Re saw in the Japanese market have actually been quite positive at this renewal.

On the property catastrophe in the U.S., we saw the – it's too difficult for me to say expected decrease, but nonetheless, it's a decrease of 5% to 10%. We saw another increasing showing of that business to Hannover Re and, therefore, due to some business reason, the premium volume actually increased slightly at 5% that actually rates have come down. But we continue to underwrite rates which meet our requirement for being well excess the expected loss plus expenses plus cost of capital.

Given the result of the first quarter, largely supporting our guidance, we have left the guidance more or less unchanged. This, however, is no entirely true for the expected growth because the successful start in the year, which will, of course, have continued effects on the premiums booked in the later quarters, we are now more confident that actually we will achieve an increase of our volume, both in Property & Casualty as well as in Life & Health.

We left the target of 875% (sic) [€875 million] (25:30) for the profits for the entire year unchanged despite the fact that we have made quite a way in the first quarter, but the year is long and lots of things can happen. So, we felt it will be prudent to keep that guidance unchanged for the time being.

Well the dividend, you can see is our normal 35% to 40%. This allows us, of course, to finance our inspired growth internally. However, if the market remains unchanged and the capital develops as we have seen in 2014 and the first quarter of 2015, of course, higher dividends are actually quite likely.

Looking at the individual areas of our Property & Casualty business, we are quite confident that we will still be able to achieve margins above the cost of capital and this is despite the intensive competition. However, we have seen that our Property & Casualty practice is positioned to be successful even in this rather competitive phase of the market.

We see potential for further growth, in particular, in North America and Asia-Pacific, but also in our facultative business and, in particular, our structured reinsurance business and we, it's already certain, we'll see quite remarkable growth of our agricultural business. While the volume, the arrows you see here is a little bit more positive because they are not on a currency adjusted basis. So, a large part of those arrows are actually currency.

On the Life & Health business, similarly, we expect 2015 will be better than 2014 and overall, can see a very good result. You can see that we expect negative premium growth on our financial solutions business, however, premium on financial solutions is not that decisive because a lot of the transactions are actually booked on a deposit basis. And even as we have observed to some extent as a derivative therefore are not shown up in the premium line at all. On the financial solution business, of course, it's the most important development of the bottom line. And here, we are very confident that we will see a very impressive growth in 2015.

The areas of longevity business we expect to grow. I mean, there's a continued demand of tailor-made solutions which actually allow us to grow that business. Mortality business, despite the continued negative repercussion from our ING portfolio, overall actually, it's quite profitable. And for the morbidity business, we see improvements in Australia particularly in the group business due to the significant rate increase.

Therefore, all in all, we are quite positive on our Life & Health business for the current year. This slide looks familiar to you because it really shows where we see the strength of Hannover Re and the current competitive business that reinsurance presents for us in challenging investment environment. And this is actually quite continuous for the last couple of years.

For the Life & Health business, I think, a lot has been said. Needless to say that it is quite gratifying that we see increased profits from our Life & Health business at a time when we see a lot of pressure on the P&C business from competition as the diversification works well here. As for as the Property & Casualty business is consumed, our franchise is intact. We, in our position as one of the large multinational, multi-line (30:47) reinsurers see good opportunities on that business, and we can also that way safeguard the quality of our business.

So far, we also could keep the very conservative loss reserving policy as the result overall has been good. And that gives us quite a reassuring buffer also into the coming year. Investment income, cash flow continues to be positive. We continue to keep the absolute return on a stable level as the relative returns there on investments, 3%. We actually are a little bit better than that. So, overall, the story is intact.

On that note ladies and gentlemen, we come to the end of our presentation covering the start, which was actually quite good into 2015 and we will be more than happy to answer your questions.

Q&A

Operator

The first question comes from Mr. In-Yong Hwang from Goldman Sachs. Please go ahead, sir.

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

Hello. Hi. In-Yong from Goldman Sachs. Two questions from me. The first one is on the very strong non-life growth, you mentioned some of the segment spectrum and also if you could give us a bit more detail around that and in particular what kind of strength that Hannover you think is allowing you to grow so much in such a challenging environment?

And the second question is on kind of capital management. We're seeing continuous high level of unrealized gains that is still going up. But I think that's where you will consider capital money (33:10) always starts to go towards the 13% if that's kind of (33:15) the same or does the high level of unrealized gains change that somewhat here?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, for the non-life growth, I mean, it's always a case that there are a lot of projects where we are working on new business. So far, this year, the hit ratio where we actually came to a conclusion has been relatively high. I mean we have particularly written some new business, which we feel is actually quite attractive in China. This is largely on a proportional basis, and it's kind of on a whole account basis of our Chinese cedants.

We also, last year, had underwritten a model of quota share which was actually premium-heavy. And, originally, we expected that to vanish because these things come and go, but we managed to renew it for another year. So that is the reason for that.

Growth, I mean, I was just talking about the Japanese renewal where we managed actually to improve our market position, and, therefore, on attractive business, which we were looking to write larger shares, so we actually were able to do so. Then there are continued flow of business there. The specific needs of our clients may be in conjunction with acquisitions who are entering new lines where support of reinsurance can be helpful and if you have a rather broad client base, we are contacted on these opportunities quite regularly.

Of course, the hit ratio is sometimes not very large because of our margin requirement. But so far, this year, we have been reasonably successful. Of course, there are few others in the pipeline, but again, I mean, the ink needs to be dry before you can really say something more definitive.

On the agriculture business, we also brought significant new business both – I mean, into developed North America as well as in Asia, notably India. There is a reason for that remarkable growth. I mean, but it's also growth that you probably can gather which to some extent is the result of a more bulky transaction that we write.

As far as the capital management is concerned, of course, we have our AGM today and we will I mean, propose to the AGM to pay a dividend of €4.25 which, of course, reduces the capital in the second quarter. That is still on the agenda, despite the unrealized gains on – as part of the capital. Therefore, I said, I mean, that it's not yet unlikely that we may also pay a special dividend for 2015 should results allow, and capital markets be unchanged in their trend. So, I mean, on the subject of share buybacks with our majority of shareholder, it's a little bit more challenging. Does that answer the question?

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

Yes. Yes. That's very clear. Thank you very much.

Operator

Thank you. The next question comes from Mr. Frank Kopfinger from Commerzbank. Please go ahead, sir.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Yes. Good morning, everybody. I have two questions. My first question is on your FX effects. Could you please explain why they only hit your Life Re segment in the other income and not the Non-Life segment as well?

And my second question is also, could you update us on your current reinvestment yields and also whether you'll change your strategy going forward? And also given your strong capitalization, whether there is some intention to put some more capital into risk or to re-risk your investments?

A - Ulrich Wallin {BIO 4863401 <GO>}

I think, Roland, this one's for you.

A - Roland Vogel {BIO 16342285 <GO>}

Yes. With regards to the FX, you know that our policy would be to always be matched and avoid positive, as well as negative effects, although positive effects are still more welcome than negatives. Still, the overall approach would be a matched approach.

That is not always possible because and I think I've explained that before, you have to decide which balance sheet you match, either the economic or the IFRS for the group, for the single company, or the German GAAP so you have to compromise here.

And in that regard, it is very often – you could see unmanageable to be matched to 100%. Here, the likelihood that we are a little bit long in the U.S. dollar was a little bit higher in the life subsidiaries and the segments. So this is more or less by chance that these effects have occurred on the Life side.

A - Ulrich Wallin {BIO 4863401 <GO>}

And if I may add, of course, in the first quarter the softening of the euro was actually quite dramatic I would say, due to the quantitative easing of CZB (39:48).

A - Roland Vogel {BIO 16342285 <GO>}

So the leverage of any even not very high mismatch which might be unavoidable has been rather high within that one quarter.

So with regards to the reinvestment yields, I think I present them twice a year. The math, it should be around 1.6% I would assume. I haven't seen an update this year – this week. We have not really dramatically changed. We're still looking for more investments on the real estate side. We are looking at opportunities here or there.

You know that 60% of our assets are outside the euro, which helps at least to a certain extent. Other than that, we have not changed our investment strategy. And we still expect if the yields stay where they are, that we lose around 15 basis points per year as ROI for the portfolio. Up to now, our expectations that this should be mitigated by higher volumes have – but still realized so there is not a real new story here.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Okay. Thanks.

Operator

Thank you. The next question comes from Mr. William Hawkins from Keefe, Bruyette & Woods. Please go ahead, sir.

Q - William Hawkins {BIO 1822411 <GO>}

Hello. Thank you very much. Could you just give a bit more detail about the life margins, the remarkable figures you mentioned? Because I'm just trying to understand, when we've got a material beat in longevity and mortality and morbidity as well versus your budget, is that all kind of FX or are there other common things that are worth commenting on or is this normal quarterly volatility?

Again, I'm just a bit confused about whether to say that this is a great beat and it's sustainable and I should annualize it or if you just had a lucky quarter and in future quarters, I should be back to your targets, so the strength outside of the one-off that you've clearly flagged.

And then secondly, how do you want me to interpret the increase in the non-life combined ratio year-on-year? To what extent is that business mix and to what extent is that occurring because of pricing? I thought what you said about the reserving and the rest of it. I'm just trying to get a feel what I should conclude by that visible increase year-on-year. Thanks.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, if I come to the life margins, I mean, I would say that you will continue to see higher life margins on our financial solution business because it's an area which is actually quite high margins because really it's a lot of financing of statutory reserves. I mean, if you call it, out of the money stop losses where you would, of course, expect low premium for the most part or premium equal to the profits. And that business, there is a little bit of a first-mover advantage particularly in the U.S we have seen grown quite nicely.

Also in the segment of financial solutions, we have the large morbidity treaty which had a lot of premium, but very slim margin, if any, and as we discontinue that, you will see premiums come down. But, of course, the margins increase.

On the longevity business, that is not really currency because – I mean, from the currency – the claims and the premiums really are quite well aligned when they are booked. I would say on the margins, on the longevity business will – a little bit high in this quarter, which has to do with the enhanced annuity, but they will probably for the entire year will be more like a 2% to 3%.

On the morbidity business, I mean, margins sustainable will be higher than in previous years mainly due to the rate increases on the Australian group business that a lot of that premium comes from and that on the DII business in Australia, which was the other source of losses in 2013 we strengthened the reserves quite remarkable, and that seems to hold.

Therefore, I mean, we are relatively positive on the development of the profitability of our Life & Health business even though, I mean, you cannot multiply the break fee by four because it is quite unlikely that we will have similar break fees in the coming quarters.

As well as – as far as the non-life combined ratio is referred to, well, I mean, I don't think that's a major mix in the business. I mean, of course, it's determined by the loss ratio pick for the more recent underwriting years the fact that we keep the unused large loss budget in reserve, and the fact that is what kind of development from previous years you have. As there has been no release of loss reserves from previous years you can see a rather pure figure here. Rather pure figure taking into account the – actually the large losses at the expected level.

With that, I would say we are relatively satisfied if it comes in below 96%. I mean in theory, the reserve releases, that number can improve, if necessary, but then we had a very good result in the first quarter. I mean, one thing which is of course a question we ask ourselves all the time, when will we reduce rates, and we've seen reduced rates at least twice, sometimes three times in a row. Make itself out in the underlying loss ratio. That actually has not been the case as yet in the first quarter as far as we can see.

Q - William Hawkins {BIO 1822411 <GO>}

Thank you.

Operator

The next question comes from Mr. Thomas Fossard from HSBC. Please go ahead, sir.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes, good morning. One question. Going back to the (47:28) on growth actually in Q1 in the P&C Re segment. I just wanted, Ulrich, you to comment a bit more on these short-tail opportunities you're seeing in the U.S. markets. So, it seems to be pretty much under pressure for the time being due to capacity. So, I'm quite interesting to better understand where these short-tail opportunities are coming from.

And also, if you can comment a bit more on the agro business, because it seems to be that for a lot of guys like you, not only Hannover Re, but in general, agro business is a significant source of business opportunities. So, could you comment about on that if there is any potential (48:11) regulation or anything like that? And more generally speaking, could you update us now on how much is the agro business for the total group and what are the main geographical exposures? Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

Okay. When we come to the short-tail business we were mentioning. I mean, these are business opportunities mostly actually on not industrial lines, but personal lines of small to medium commercial. And, I mean, they are surrounding accumulation management of catastrophe exposure with our client. And they are partly also, I mean, capital management resultant. So, I mean, to that extent, there are opportunities that come and go really. It just depends on the regions, necessities of our clients and beginning of the year was just a few of those arose that we could achieve our margins and after significant negotiations on the terms and conditions we finally came to a landing.

I mean, another big block of our property business is, of course, our property per risk account. Prices are on a pressure there, but the rate reductions are, I would say, single digit to the lower end rather than the high end. We have - I mean, particularly in the U.S., we are the lead market on that and we have - historically had very god margins because again on that for the most part it's a very well diversified book, which is not that much based on the heavy industrial business. And that business actually, we feel that at the current rates, we still have sufficient margins, so we are looking for new business still and also, of course, defending what we've got and we have been quite successful with that.

On the agricultural business, I mean, there is increased demand, particularly in China and India, which we are benefiting from. Historically, we were heavily underweight in North America and heavily overweight in Latin America. We still have very attractive portfolio in Latin America, but we have accretively large market share. But we have increased our involvement in the - particularly in the U.S., following the drop that we had a couple of years ago. We felt that margins got a little bit better and so we got a little bit more active there and that's where particularly in 2015, we have seen, I mean, significant growth. But this is really, I mean, one or two new transactions which are quite large and makes themselves felt.

I think, if you look at our overall volume on the agricultural business this year, we could reach, I would say close to $500 million. So, it becomes an important part of our P&C business. A little bit gratifying that we had also good profitability last year because that is the big challenge on the agricultural business. It is a challenge for that business to be profitable. So, we have to be very diligent when we underwrite it.

Does that answer the question?

Q - Thomas Fossard {BIO 1941215 <GO>}

Thank you very much.

A - Ulrich Wallin {BIO 4863401 <GO>}

Thank you.

Operator

Thank you. The next question comes from Mr. Kamran Hossain from RBC. Please go ahead, sir.

Q - Kamran Hossain {BIO 17666412 <GO>}

Good Morning. Two questions. The first one is on capital. You sound - I mean, earlier in the Q&A, you sound very - highly confident that you should be in a surplus capital position at the year-end. Could you - I mean, unless we've got a massive (52:51) in between now and then, which is Solvency III. Could you just give us a quick update on where you stand on Solvency II and whether you see any kind of other potential major impacts on your capital position between now and then?

And the second question is just on M&A. I know you talking about this in the past valuations were a bit right. But is it happening at the moment given kind of a renewed focus on maybe growing the top line where the business is attractive that this is something that you might consider? Thanks.

A - Ulrich Wallin {BIO 4863401 <GO>}

As far as the surplus capital goals and Solvency II, I mean we have hired our internal capital model for Hannover Re subgroup with our regulator in Germany and that looks to the extent you can be sure when you talk with regulators quite positive, I would say. So, I mean, from that point of view, in 2016 as the, I mean, legal capital adequacy should be very comfortable, I would say, well in access of 200%.

So from that point of view, I mean excess capital is not a question. We still have the constraints of the rating agencies, which – I mean we have got our capital model is a little bit more precise for our business than theirs. That is still a slightly higher challenge. However, also as their situation looks quite comfortable. So from that point of view, even taking into account the necessary buffer, we are relatively confident, actually very confident that we will have sufficient and even more than sufficient capital by year-end.

M&A activities, yes, I mean, we have constantly looking for M&A activities. We also have a few targets in lines that could be very attractive for us. Unfortunately for the most part, they are not for sale at this point in time or very expensive. Therefore, on large M&A activities, there currently no hot topic or hot project that we are working at, I would say.

But, I mean, of course, we would always be interested in – if we find targets that can improve our overall business profile, that would most likely go into the direction of a specialty reinsurer or a combined insurance and reinsurance operation with a very strong practice in this lines of specialty insurance.

A - Roland Vogel {BIO 16342285 <GO>}

If I may add to that comment, you mentioned that there might be a higher focus on top line growth again. I don't see that. Even if we have been growing in the first quarter more than expected, we have not comprised our margin requirements or whatever, and we are still prepared to not grow in case the business is not profitable. So there is no readjusted focus on top line.

Q - Kamran Hossain {BIO 17666412 <GO>}

That's very clear. Thanks very much.

Operator

Thank you. The next question comes from Mr. Andrew Ritchie from Autonomous Research. Please go ahead.

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

Hi there. I've actually – just two sort of clarifications from William's questions earlier. I'm not sure when you talked about the margin in mortality and morbidity business, which is 8.1% in Q1 versus the target of 6% you were suggesting that part of that is because of the repricing that occurred in Australia. Are you saying then that the 6% target is sort of out of date now? And given the repricing, should we be accustomed to a higher target? I mean, within the target of 6%, this can (57:32) with your ROE targets. So, maybe just to clarify, is there an – was it really just quite a benign experience in Q1 or is there a structural reexamination of that margin we need to think about?

And the second question, again clarifying, you said you were looking all the time to see if there would be a margin erosion coming through in non-life because of the (57:57) of weaker pricing. You said that you haven't seen it yet. So the underlying margin deterioration in non-life when we allow for the fact that you've got to fully (58:08) a normal budget (58:10) losses this year and last year is what then? It's just mix effects? And when do you think you will start to see some underlying margin and erosion through?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, I mean, firstly, the margin from the morbidity business. Of course, for the morbidity business, they have historically been for the most part below 6% while mortality was about 6%. I mean, on the Australian group business, the current margins are we above 6%. However, I mean, there is already reoccurring competition for that business arriving in that market because, I mean, as the overall reinsurance market is soft and people see signs of improvement in that business, of course, there is immediately a renewed interest in that class.

So for us, it's obviously a little bit important that we are, I mean, not waiting until the improvement is actually seen, but are already involved in the improvement happening into the Australian group business. That looks well for us, of course, only if there's higher margins that we think we have now actually materialize itself in the longer time.

So I wouldn't say that – and I think that the 6% is still a good guidance for mortality and morbidity combined and it's still a hurdle which is not that easy to constantly develop that far. Despite the fact, again, also that the new business that we write, the margins that we calculate are above that figure. But of course, I mean, actually to expect that also we have to take them into account. But as I said, I mean, this, getting the problem areas continuously better under control, we expect that the margins on our Life & Health business will increase.

On the non-life...

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

And the 6% is consistent with the ROE target generally, is it right?

A - Ulrich Wallin {BIO 4863401 <GO>}

Absolutely. Absolutely.

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

Yes. Okay.

A - Ulrich Wallin {BIO 4863401 <GO>}

I mean, if you go to the non-life business, I'm absolutely certain that the reduced rate eventually will make it felt in the underlying loss ratios. I mean, it's a little bit maybe prolonged because of the continued very, very low inflation rate, but that is no way that you can reduce the rates three years in a row and still hope that will not be shown, it will not be seen in your combined ratios and loss ratios in, fact.

That's why we are so protective of our buffers on the loss reserves, because we expect that we will actually need I mean part of that in the coming years. And, therefore, every year like 2014 or the first quarter of 2015, we can continue to reserve very conservative in the current market environment on the P&C side it's bonus for us.

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

Okay. So, what you are saying is obviously the deterioration we saw on an underlying basis year-on-year is kind of partly prior year noise, partly mix noise, really, not margin yet?

A - Roland Vogel {BIO 16342285 <GO>}

No, this is not margin. It's really based on nurturing our reserve buffer.

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

Okay. Okay. Great. Thank you.

Operator

The next question comes from Anasuya Iyer from Jefferies. Please go ahead.

Q - Anasuya Iyer {BIO 18981555 <GO>}

Oh hi. My question is just coming back to capital. At the Investor Day last year, you gave us €1 billion number for your excess capital allowing for rating agency. Do you have an update on that given how the capital has moved since then?

And also how should I think about the usage of that capital especially given the growth opportunities that you're saying are now in Australia and large volume treaties? Thanks.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, we haven't got an update on the excess capital because we haven't yet calculated it on the Q1 figures which, of course, I mean the capital clearly has increased, but with the increased volume, also the capital requirement would have increased. So, we have to see there that we come out there. I mean, use of that capital is still a challenge, I would say.

Yes, we have seen a good opportunity at the beginning of the year, but still the market overall is relatively soft. So, I mean, that will be a little bit back and forth.

So, I mean we are still not in a position where we could use the capital without significantly changing the volatility of the earnings. We, of course, could use the capital by – I mean, significantly increasing our natural catastrophe risk appetite because we seem to be in the position to write more natural catastrophe business if we want, or we could increase this risk on our investment portfolio, for example, by, I mean, investing in equities.

However, we still see higher value to keep the volatility of our earnings to a lower level in the current phase because we are still relatively satisfied with the absolute level of our earnings, and therefore, from that volatility perspective, we could use the capital while increasing the volatility. We still more like to keep our powder dry to times and the opportunities are better.

A - Roland Vogel {BIO 16342285 <GO>}

And maybe from my side to the capital models of the rating agencies, I think I would endorse what Uli indicated here. We have seen an increase in the capital position. So the adjusted capital is higher. But also we have seen the drivers, the currency exchange rate plus also the increase in the premiums which do get additional capital charge. So I would assume and the first calculations would confirm that the position has not changed drastically when it comes to the excess position.

Q - Anasuya Iyer {BIO 18981555 <GO>}

Okay. Thank you.

Operator

Thank you. Thank you. There are no further questions. I hand over to the speakers.

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes. Thank you very much for listening in to this rather early call for us this quarter. And I wish you all a very nice day, and thank you very much.

Operator

Ladies and gentlemen, this conference is being concluded. You may now disconnect.