Q3 2017 Earnings Call

Company Participants

- Roland Vogel, CFO and Member of the Executive Board
- Ulrich Wallin, Chairman of the Executive Board and CEO

Other Participants

- Andrew James Ritchie, Partner, Insurance
- Frank Kopfinger, Research Analyst
- Guilhem Horvath, Research Analyst
- James R Oram, Senior Associate
- Jochen Schmitt, Research Analyst
- Jonathan Peter Phillip Urwin, Director and Equity Research Insurance Analyst
- Kamran Hossain, Analyst
- Michael Hermann Haid, Analyst
- Roland PfÃ¤nder, Research Analyst
- Thomas Fossard, Co
- Vinit Malhotra, Banca di credito finanziario S.p.A., Research Division
- William Hawkins, MD, Head of European Insurance Research and Senior Analyst

Presentation

Ulrich Wallin {BIO 4863401 <GO>}

Good morning, ladies and gentlemen. I'd like to welcome you to our conference call presenting the results for the first nine months of 2017. As always, I'm joined by our CFO, Roland Vogel.

After years of moderate losses, we saw an accumulation of severe natural catastrophes in the Third Quarter, particularly in the U.S., Mexico and the Caribbean. Protecting against the consequences of such events is the central goal of reinsurance. For us as a reinsurer, our top priority is the efficiently settling of the incurred claims and the support of our clients. This way, reinsurance can also play a part in alleviating the humanitarian and economic impacts of natural disasters such as the ones of the Third Quarter of this year.

The national catastrophe losses in the Third Quarter resulted in a large loss burden for Hannover Re of EUR 766 million. Within this number, Hurricanes Harvey, Irma and Maria, together with the 2 Mexican quakes, amount to EUR 222 million of net losses. The largest of these losses is Hurricane Irma with EUR 330 million, followed by Hurricane Maria, it's

EUR 221 million; and Hurricane Harvey was EUR 100 million, all numbers are net of retrocession and before taxes.

Based on the currently industry loss figures reported by various sources as well as the figures published by the reinsurance industry, it would -- this would give us a market share in the losses falling on the reinsurance market of around 1.5% to 2.5%. Whilst these figures are subject to significant uncertainties and recognizing that the reported losses from the industry fall short of the industry losses estimated by the various cat modeling firms, this nevertheless would suggest that Hannover Re's market share in the losses is well below its market share in the reinsurance business overall, which is around 5%. This confirms our strategy we followed in recent years to have lower market share in the natural catastrophe exposed business as compared to the overall reinsurance business.

Despite the losses in the Third Quarter, we managed not to fall to a bottom line loss in that quarter. But maintained a small net profit of EUR 40 million. This, comparatively, positive result was achieved on the back of a very positive investment income, which, beside an increase in the ordinary investment income of more than 10%, was aided by the sale of our quoted expertise, which boosted the realized gains by EUR 226 million. So sales was not only motivated to absorb part of the negative effects of the natural catastrophe losses. But also to free up capital, which can be utilized in taking increased underwriting risks based on the expected improvements and the conditions of the property casualty reinsurance market.

On the Life & Health business, we saw a drop of the EBIT in the net income, which was largely due to a one-off impact from our in-force management of our legacy U.S. mortality business as a result of the recapture of some loss-making treaties. This one-off effect amounted to EUR 45 million. Otherwise, the very positive development of our financial solutions business as well as our business outside North America could not fully compensate for the continuously higher-than-expected claims from our U.S. legacy mortality business.

On this note, I would like to hand over to Roland, our CFO, who will explain the figures in more details.

Roland Vogel {BIO 16342285 <GO>}

Yes. Good morning. Thank you, Uli. After various quarters, which were rather in line also, we have to report some extraordinary items for the Third Quarter 2017. Still, I will try to keep my comments as brief as possible and usual because I'm sure you have a wide variety of questions.

The top line development for the first nine months of 2017 continues to be favorable and the bulk of our expectations from the beginning of the year. But very much in line with the first half year numbers. You will see later that this is entirely driven by our P&C business group whereas our Life & Health business showed a small declining gross premium.

Net premiums increased by 8.4% adjusted for currency effects with a difference compared to the gross premium development driven by additions to unearned premiums as the retention remaining fairly stable. Apart from the stable, net retention on the group level here, it might be worth mentioning that the stand-alone quarter, as Uli already on mentioned, ended with a small profit and the tax rate is down by quite some margin. Here, although the profit contribution from lower tax jurisdictions went down, this was overcompensated by the fact that the realized gains from the equity portfolio are only taxed at very reduced rates.

Moreover, in Essen, Germany showed a very strong result, which has increased the minority deductions as compared to the previous year.

On the next slide, the operating cash flow continues to be very positive, also slightly below last year's average. One should have in mind that the strong increase in our structured reinsurance business is not very cash flow accretive in contrast, for example, to nonproportional contracts. Nevertheless, assets under own management decreased to roughly EUR 40 billion, significantly driven by negative FX or currency effects of around EUR 2.5 billion due to the strengthening of the euro against most of the relevant currencies.

On top of this development, we paid out last year's dividend, which, overall, was only partially compensated by the positive operating cash flow of a good EUR 1.5 billion.

In order to understand the development of the IFRS capital position, one should start reading the next slide on the right-hand side. Shareholders' equity decreased by 8.9%, driven mainly by factors that we have already mentioned. There was a payment of a record dividend, including the special dividend that amounted to EUR 603 million. Additionally, the exchange rate movements as part of the OCI had a negative impact of EUR 650 million. This especially reflects the currency translation of the capital position of our subsidiaries. Moreover, the sale of the equities resulted in the realization of some valuation reserve, which was only partly mitigated by an increase of other asset classes.

Taking all these developments into account, I would circle our capital position is strong. And you probably are aware that the rating agencies take the same view. S&P just renewed our rating of AA; and a stable outlook here during Q3. Furthermore, in October, A.M. Best placed our rating under review with positive implications following the release of the updated rating methodology.

On the next slide, the P&C gross premium increased by a remarkable 16.1% on an FX adjusted basis. This is mainly based on the successful new business written by our structured reinsurance team. Additionally, as a result of our strong position in the industry, we could grow some selective markets like for instance, U.S. property, China and Australia. But also the first time consolidation of our Argenta acquisition has contributed for the first time. Although here in the P&C, the difference between the gross and the net development was caused by movements of the unearned premium reserve.

At 30.8% of net premium, major losses were about 4 combined ratio points above the budget for the first 3 quarters, mainly owing to Harvey, Irma and Maria and the 2 earthquakes in Mexico. The combined ratio of 104.4% is, therefore, of course, clearly above the full year target compared to last year with more than 1% of the increase. And combined ratio stems from the Advanced Solutions segment, which we, on the one hand, write with higher than 96% combined ratios plus some of the contracts were affected by hurricanes as well. Major parts of these losses will be compensated in the future based on the conditions of such longer-term agreements. But you should also bear in mind that the opt in reserving remained unchanged since the end of the Second Quarter. Please remember here, we had EUR 291 million additional reserves compensated by IBNR releases. We will reflect the potential positive changes envisaged from another change in the legal framework whenever we have more certainty about it.

Apart from such considerations, runoff profits have not been extraordinary. And we expect the level of redundancies to be at the Q2 level. The ordinary investment income was slightly ahead of expectations, mainly driven by a strong contribution from private equity and real estate. And on top of that, of course, the disposal of the listed equities boosted the good investment result even further in this segment.

We achieved EBIT margin of 8.9% as a little bit below our target. But given the frequency of the natural catastrophe losses, the number is a good one especially as compared with the industry.

Major losses may reach historic highs here in the next slide like the ones we saw in 2005 and 2011. Although 2011 and 2017 on this slide seem to have a very similar gross and net impact for us, one needs to bear in mind that 2017 also reflects more than EUR 350 million losses from our ILS segment and the collateralized reinsurance, which go in and out. And if we adjust for that, that means that, on the one hand, our retro cover were a little bit less effective as compared to 2011 as we had more losses from proportional treaties, which were not protected by the K-Cession. And on the Irma reached into the nonproportional whole account protection, on the other hand, it also means that the vast majority of our retro cover is still available and we could also already offer new coverage for clients who needed it for the rest of the year. One thing should -- we should really not forget is the remarkable level of uncertainty about all such rather new estimates.

The large loss here is an interesting one this quarter. As I said, the numbers look very precise. But they are all early estimates. Maria, for instance, occurred just about 3 weeks before we had to close our books for the Third Quarter. And that demonstrates the uncertainty. If you count the 3 major hurricanes together, we are estimating our loss currently at EUR 650 million. If you add the 2 earthquakes to the numbers, this would be in the region of EUR 720 million. Including the ILS contracts, we overall had a 50% or 45% relief from our retrocessions.

The next slide looks completely different if you -- we compare that with the Q2 conference call as the natural catastrophe losses have impacted various markets. Overall, the total combined ratio came in clearly above the MtCR. Just as a reminder, the combined ratio for the U.K., London market in direct business line stands out and that is, to some extent or to a large extent, the result of the reserves strengthening for the change in the Ogden tables over the course of the first half year.

In Life & Health, gross written premium increased slightly by 0.7% on an FX adjusted basis. That is in the ballpark of our expectations for the full year as well. We have seen growth in a number of regions as it's China, Australia and the U.S. This was, however, offset by reduced premium income due to the discontinuation of larger volume contracts in our U.K. annuity segment.

As reported in previous quarters, the result of our legacy U.S. mortality business had not lived up to our expectations. This was the case for the reported results on an ongoing basis. But also in addition, as Uli mentioned already, the preannounced recapture of our mortality treaty materialized as expected and led to an average result of minus EUR 45 million. From an economic point of view, the recapture was still very beneficial as it will improve the future results by quite some margin.

In contrast to the mortality, the profitability of our financial solutions business continued to be excellent. These developments are also reflected in their respective EBIT margins.

Income from funds withheld declined by EUR 64 million due to the discontinuation of 2 large financing treaties. As indicated on previous occasions, the profit from the deposit accounted business, mainly the U.S. financial solution, has grown remarkably. It reached a level of EUR 139 million, which is reflected in the other income and expenses lines. Currency effects, on the other hand, had a slightly negative impact.

Looking at the investments, the development in the first 3 quarters 2017 was very pleasing. The ordinary return of 3.1% is well above the expectation for the full year. And in light of the strong contribution from private equity and real estate, the ordinary result increased by an impressive 11.5%. The income from private equity did, however, include some extraordinary elements, which we cannot expect to reoccur in the Fourth Quarter. Uli had already indicated the background of our decision to sell our portfolio of listed equities short after Maria had hit Puerto Rico and a major loss for the industry was foreseeable. We had realized a bit more than EUR 220 million in gains. According to IFRS, such profits are really ROE accretive as they increase the profits and they decrease the IFRS capital as the variation reserves go down. On the Solvency II, the decrease in capital is not reflected in the owned funds. But the decrease of the high capital requirements for the equity is reflected so that solvency ratio should be impacted positively. And according to German GAAP, the dividend-paying German holding company, had a re as he receives any tax-free profits. In light of such advantages, it was -- the decision was easy to make. Moreover, of course, we took into consideration the strong performance and the valuation of the private -- of the listed equities especially in this year. We will further use equities as a technical instrument and may enter again if opportunities arise.

Before that background, the overall return of the investments was very strong at 3.9% while valuation reserves were slightly reduced. But the remaining portfolio remains strong and on a high level.

You're on the next slide that is very familiar to you. It shows the overview of how the different asset classes contributed to the ordinary investment income as compared to where we are invested. Nothing extraordinary here.

And I think that should conclude my remarks. And as usual, I'll leave the target matrix and the outlook to Uli.

Ulrich Wallin {BIO 4863401 <GO>}

Thank you, Roland. Talking about the target matrix, you can see that we have 3 ticks, or I might say only 3 ticks. I think the return on investment, as Roland explained, the growth of the P&C premium as well as the EBIT margin on our very successful financial solution and longevity business. The remainder of the target, particular regarding the profits, were impacted naturally by the high (losses) of natural catastrophes in the Third Quarter. In order to avoid any confusion, let me emphasize that this target matrix is still the one from the strategy cycle 2015 to 2017. And therefore, it's slightly different from the new one, which we presented on our Investor Day in October.

Coming to the outlook and here in particular to our new guidance for 2017. You will recall that we gave a profit warning in 21st of September 2017, following the significant losses in the Third Quarter. Because of these losses, it became evident that one of the providers of our profit guidance was no longer fulfilled being that the large losses remained this in the large loss budget.

Regarding the premium volume, we left our guidance unchanged because the guidance for growth of more than 5% is well supported by the 9-month figures.

Return on investment, we increased to more than 3% from more than 2.7% and that, of course, reflects the very positive development of the investment income in the first nine months, not least due to the sale of the listed equity portfolio.

Group net income, we now estimate at around EUR 800 million. And that, of course, reflects that we are missing the profits from the Third Quarter, which largely was, as you call in Germany, the black zero. And therefore, we have to do the three quarter profits for this year. This, of course, is still subject to the proviso that the large losses for the Fourth Quarter remain this in the budget for the Fourth Quarter being EUR 202 million and that we see no dislocation in the capital market. I should also caution, I guess, at this point in time that the loss estimates for the Third Quarter losses are still subject to significant uncertainties, which would -- which may go either way. I mean, we will see a little bit clearer at the end of the year. But also then, uncertainties will remain significant.

The dividend payout should not be affected by the reduced profits. But we expect, provided that the Fourth Quarter is in line with expectation, that we will still be in the position to pay out the same dividend as last year being the ordinary as well as the special dividend.

Coming to the profitability of the P&C business for 2017 as well as the development of the volumes, you can see that due to the cat losses above the large loss budget, we are not expecting to earn the cost of capital on our property casualty reinsurance for this year. The affected areas, of course, North America as well as the natural catastrophe excess of loss business. However, also the U.K. and the London market is affected. This, of course, by the Ogden tables.

On the other hand, our very diversified book mitigates the impact of those cat losses. And you can see that in the lines of Continental Europe where we have very good profitability as well as Marine, credit and surety and in particular, the facultative book. So you can see that a very diversified book of business with below-market average share in catastrophe-exposed business allow us even at heavy catastrophe losses to still show somewhat acceptable results.

Coming to the Life & Health business. You can see that our financial solution business, we expect to continue to be very, very profitable with longevity and morbidity business. We expect to earn the cost of capital. As far as the mortality business is concerned is the negative effect, including the one-off effect from our U.S. legacy business will push the entire segment or subsegment into profitability levels, which are not sufficient to fulfill as a cost of capital.

On the premium side, we expect a rather stable premium development for the entire year. There might actually be a slight increase because we already have seen some increases in the Third Quarter. And we expect that to continue into the Fourth Quarter. However, it will be largely stable.

Coming now to the guidance of 2018. And I should emphasize that this guidance does not include the effects of the hardening market, which is expected following the Third Quarter losses and the reported results of the reinsurance industry for the first nine months of the year. Therefore, the premium growth, we expect single-digit growth. We haven't specified low or high single digits that will really remain to be seen based on the actual effects of the hardening market.

Return on investment, we expect at 2.7%, which is stable ordinary investment income compared to the average of the last five years. I would say, in absolute terms but also in relative terms, we see a stabilization here. I think Roland explained that in detail at the Investor Day in October.

Net income, we estimate back more than EUR 1 billion. Again, that also does not include a hardening market. At the same time, of course, it's also subject to the possibility of further recaptures within our legacy U.S. mortality business that might take a negative IFRS impact. But will have a positive long-term impact on the profitability. In addition, I should caution that there might also be an unforeseen further acceleration in the actual losses from that business, which, of course, could have a negative impact as well. Overall, however, we feel well positioned to achieve again a profitability above EUR 1 billion in 2018.

Our dividend policy remains unchanged as the basic dividend will be 35% to 40% of the IFRS profitability. And depending on business opportunities and capital development, there's a good possibility that we also will again pay a special dividend.

This now brings me to the last slide, I guess, which is the prospects, the midterm prospects. Here on the property/casualty side, we feel that things are a little bit more positive than they have been in previous years because we already see for us find of a more or less than across-the-board trimming of the reinsurance market on the P&C side. Of course, more pronounced on the loss affected business. But also we expect firming of some market on loss business and have already witnessed first evidence of that. Therefore, we feel that our combined ratio target of 96% or below is achievable in 2018 and beyond without resorting to reduce -- to reduction in the confidence level of our loss reserves.

With our strong market position, we also feel that we could benefit from the growth of the market more than the average market player and thus are expecting to slightly increase our market share. And as a result of that, we expect a positive impact both on the bottom and the top line of our P&C business.

In Life & Health, we expect a continuous attractive earnings from our U.S. financial solutions business and the majority of our non-U. S. business.

For the overall profitability, the main importance would be the success of our in-force management of our legacy U.S. mortality business, where we are confident that we could achieve the necessary adjustments on the rate, in particular on the YRT business.

That said, for 2018, there is some uncertainty on the EBIT contribution due to the possibility of recaptures, which may result in a negative impact on the IFRS earnings in 2018. But of course, it would be positive for the future earnings of our Life & Health group.

With that, we expect an EBIT between EUR 200 million and EUR 300 million in 2018. And that, of course, would largely depend on to the extent of the recaptures that we are seeing.

A favorable development of new business and the already mentioned in-force management give us a positive outlook for the IFRS profitability for 2019 and onwards.

On our investment, I think Roland explained in detail the stabilization of the ROI as a percentage of the ordinary investment income from 2018 onwards. Then, of course, this expected increased volumes in the medium term would suggest that we would be able to increase our returns in absolute figures.

That concludes our presentations. And I look forward together with Roland to your questions. Thank you very much for listening.

Questions And Answers

Operator

(Operator Instructions) The first question is from Kamran Hossain of RBC.

Q - Kamran Hossain {BIO 17666412 <GO>}

Two questions. The first one is just trying to understand that the context of having the (XT) portfolio and then what that means for growth. So I look at your 2018 guidance and you said kind of single-digit growth for the group. But at the same time, you've kind of freed up this cash, which in my mind should allow you to grow more, especially in P&C in the coming year. What should we think about there? I mean, is that single-digit growth really, really conservative? Just kind of any thoughts on that will be really helpful. And second, in the life EBIT guidance for 2018, what level of recapture is included in that assumption? And what kind of level of confidence do you have that this will be sufficient?

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes. Thanks for those questions, Kamran. Firstly, on the guidance, the growth guidance for 2018, this was done really before because it's a plan, which was concluded before we actually saw the effects of the Third Quarter losses and the effects on the market and it was also before we were selling our listed equities. Therefore, I think on the P&C side, this is a rather conservative estimate. I mean, we think there may be opportunities for good growth on the P&C side in 2018. On the EBIT for the Life & Health, I mean, the EUR 300 million upper end of the range would include of recap -- negative impact from recapture, I would say, of up to EUR 100 million and of course, I mean, the lower end and then slightly more.

Operator

The next question is from Vinit Malhotra of Mediobanca.

Q - Vinit Malhotra {BIO 16184491 <GO>}

I just wanted to follow up on the retrocession comment that Roland was making, suggesting that retro cover was less effective. I mean, relative to the budget, obviously, 2017 has been far better managed in terms of net lease. Could you just clarify what that comment meant, Roland? And just in that same context, I've noticed that on your line-by-line combined ratios, the structured reinsurance and ILS was much worse in 3Q than 1H. Is it just the same effect? So just as a clarification needed. And secondly, just on the motivation for the equity sale. If -- you said this several times, I apologize. But just a clarification, it was done primarily to have more capital to participate in the market hardening. Will that be a correct understanding? Or was it done also for tactical reason? But which one was the more important way, is what I'm trying to understand.

A - Roland Vogel {BIO 16342285 <GO>}

Well it was both, I mean, because -- I mean, of course, it was the rather neat way of mitigating the impact because, I mean, the development of the equity markets have been very favorable. So we had much of significantly large portions of unrealized gains on them, which, of course, are clearly subject to change. And therefore, we thought -- I mean, not only for the capital base. But also from a result point of view, it would be an opportune time to utilize those gains. I mean, our expertise strategy remains unchanged. I mean, we have certain triggers for investment and we have certain triggers for divestment. We were pretty close to our divestment trigger. But not quite there. But so we just accelerated that because it became quite handy. I mean, this is basically the motivation. And of course, the positive effects on the capital adequacy ratio gives us the room to pay and see on the one hand, of course, to write more business in 2018. But also, I mean, to pay an extra dividend for the current year, which we deem to be in the interest of shareholders at least in the interest of our majority shareholder. And therefore, overall, it seemed to be a plausible thing to do. I mean, on the effectiveness of our retro program, it has to be said that the growth loss includes a significant amount, as Roland already mentioned, that we are directly ceding to the capital markets. So this is business, which we accepted and then just, I mean, make it suitable for the capital markets. So it's really a pass-through. And that is the majority of the difference between gross and net. Our overall retrocession program was not that heavily impacted outside an aggregate excess of loss that we bought, which, of course, was a total to the tune of a little bit more than EUR 100 million recovery. But look at the whole account, I mean that has attachment point of EUR 350 million for peak zones and EUR 250 million for nonpeak zones. That was only partly hit by Irma, not hit by the other losses. And also K, a lot of the losses that are not subject K. So the K result is still relatively benign for our investors there. Therefore, I mean, the collection was less pronounced as in 2017. It would have been for us, in theory a lot better for all the losses would have been -- I mean, accumulated into one loss because -- and then outside the aggregate is several loss, of course. Our program could be -- would have been suited better. Needless to say, I mean, the overall net amount of losses that we have from those events are well within the expected parameters for return periods, say, around seven years.

Operator

The next question is from Guilhem Horvath of Exane BNP Paribas.

Q - Guilhem Horvath {BIO 18460437 <GO>}

Two questions from my side. The first one is I would like to have your view on this exercise that's everyone is trying to contribute today in sending out all the reported losses and trying to reach the USD 95 billion or USD 100 billion total loss for the industry. What is your view on the fact that part of this is missing? And maybe in line with this, you said that your -- particularly your Maria estimate was computed very shortly before you closed your quarter. This estimate materially moved since you closed the quarter? And if yes, in which direction? And the second question would be on the negotiations. Can you update us a little bit on what you see in the market today regarding your own business negotiations. But also the retro, you mentioned that the retro was only slightly affected by the recent events? And you also said at Investor Day that you expected the retro prices for you not to increase too much or at least you not accepting higher prices on retro. Is this still the case?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well on -- I mean, yes, you're absolutely right that the loss estimates are of, I mean, early estimates and that they have not reached the modeled numbers of, say, I would say, people say it's anywhere between EUR 75 billion to EUR 225 billion. I must say, I mean. So far, our estimate tracked pretty well with the advised losses that we have seen so far, which, of course, are only a fraction of the losses that we have booked. On Maria in particular, I mean, I would say there are some positives and some negatives. Overall, I would say that at this point in time, the loss estimate that we have given on or that we have booked on Maria still looks pretty solid. Overall, I think we will have to watch the development of these losses in the next couple of years because if you look at the U.S. domestic losses, which are the least of concern to us due to our low market shares in the affected areas, I mean, there is such a vast number of individual small and large losses that it just takes a long time to check -- to adjust all of them. On the Caribbean, I mean, if you look at Puerto Rico, it's still not fully accessible. It's still largely out of power and while the structure has not been hit as hard as expected, I mean, BI losses and later development of losses is, of course, still very possible. So it's early days. But so far, I mean, our loss estimates compared to what we have seen in loss advices and, of course, talking to our clients at this point in time looks quite solid, I would say.

A - Roland Vogel {BIO 16342285 <GO>}

Maybe I can add here. We should, of course, bear in mind the comments we had made about our retrocession being available. So if we just assume there would be negative development there and the capacity would still be available, at least on the whole account. As Uli mentioned, only Irma is slightly in it. So there would be a natural ceiling for developments in our case.

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes. That's absolutely true. I mean, if we then look at the question of our own retrocession, well, I mean, it's a difficult one for me to comment because we are actually in the negotiations -- starting the negotiations for 2018 on our own retrocession. So I'm not too sure if I should be too open here because you want to play your cards closer to the chest when you go into these kind of negotiations. But on a more broader note, I mean, I would still expect that retrocession of prices will increase. How far that will affect our own retrocessions, of course, remains to be seen and that, of course, depends how well the negotiators (inaudible) retrocession, who I have to say are still there over the last five years. So it's still in a rather positive position, I would say. Market overall, I mean, it's still early days. But we have seen, particularly in the London market, particularly on the facultative business, I mean, clearly points to increases. In loss-affected areas, clearly, I mean, significant double-digit increases. But even having been recently been on a conference in Asia or to the Asian clients that I have talked to, of course, point out that they not live in the Caribbean nor in the U.S. nor Mexico. But they have some sympathy if you tell them, well, look in 2011, you had the losses and the rest of the world market increased in pricing as well. And I think they expect a similar movement for their markets for the current year.

Operator

The next question is from William Hawkins of KBW.

Q - William Hawkins {BIO 1822411 <GO>}

Just one question really. You've been very clear on what you said about the recapture for U.S. mortality next year. I mean, I'm just wondering if we look beyond that, the EUR 200 million to EUR 300 million, is that a new range that you're also thinking about for 2019 and 2020 because this is an ongoing issue. Or to pick up on what Kamran asked you, I mean, are we having 1 down year and then hopefully everything sorted out and we're back to normal, the EUR 300 million or even EUR 400 million that you referred to is the starting point for 2018?

A - Ulrich Wallin {BIO 4863401 <GO>}

If things go according to plan, I mean, we have 1 down year because, I mean, the rating actions that we are planning are really confined to 2018. So from that point of view, 2018 should be the most exposed year. If things go according to plan, of course, then from 2019 onwards, results should be significantly better. And while, of course, I mean, with the uncertainties that we have seen on the loss development on the legacy U.S. mortality business in the last couple of years, of course, the confidence with which I'm seeing that is a little bit less than my predictions normally are. But as I said, if things go according to plan, 2019 and '20, we should see significantly higher and higher EBIT.

Q - William Hawkins {BIO 1822411 <GO>}

Got you. And given the -- I understand what you just said about wanting to be conservative. I get that. But I think the first time I heard you mention in answer to Kamran's question a EUR 400 million figure for underlying profits in 2019. The best I'd heard in the past is EUR 350 million. Is that higher figure just reflecting the fact that the portfolio is growing, you've got great financial solutions business? Presumably, that's what it is.

A - Ulrich Wallin {BIO 4863401 <GO>}

It's largely growing financial solutions business. It's also a growing international business. And of course, it takes into account that the burden of the U.S. mortality business would gradually come down.

Operator

The next question is from Frank Kopfinger of Deutsche Bank.

Q - Frank Kopfinger {BIO 16342277 <GO>}

I have two questions. My first question is coming back to the disposal of your equities. Can you roughly at least quantify into how much additional volume growth this would translate, given that you release capital, which you could then deploy into the -- I would assume into the P&C business? Then secondly, also on the P&C business, there must be some sort of underlying negative track from U.S. property per risk business in 2017 so far. Can you quantify this? And also, say, whether this will be only a 2017 event or whether this is something ongoing?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well on the property per risk, yes, I mean, the combined ratio sits on that business normally in the 70s. We are now looking more in the 90s there, which is a significant high effect. I mean, there will be -- I mean, as this business is reacting to losses on an individual basis because, I mean, it's largely, I would say, midmarket term product -- property per risk business. I mean, we expect that to move back to the profitability that we have seen over so many years in 2018, partly on the back of rate increases, which have nothing to do with cat losses. But this business is just reactive to losses. In addition, it will also react to the cat losses. So that -- we see that quite positive. I mean, on the amount of new business that we can write based on the freed-up capital, that of course depends what kind of business that is. I mean, of course, it's quite likely that we will increase our net risk appetite for cat because there are a number of opportunities we are working at on the cat side. That, of course, in volume terms will not be that significant. But it will be significant in bottom line terms when you look at bottom lines based on the expected losses. I think it's difficult to be more precise because there's different capital requirements on different businesses.

Q - Frank Kopfinger {BIO 16342277 <GO>}

And I think one should bear in mind that, yes, the disposal of the equities had different reasons. That is one of which also without that disposals, we would not have held impaired in our opportunities or potentials to take up market opportunities that is definitely not the case. Of course, it increases flexibility a little bit more. So this is not a prerequisite. It just helps. And it was also driven by variation considerations.

Operator

The next question is from Andrew Ritchie of Autonomous.

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

I have 2 quick questions. Curious, why you said earlier the K vehicle didn't pick up a lot of the losses, a lot of losses were not subject to the K-Cession. I mean, given the K-Cession has 40% quota share of your property exposed -- I'm sorry, cat-exposed business, why was that? I'm just curious as to why that was the case. Secondly, I want more clarification. I mean, you're implying that you will revisit the guidance -- 2018 guidance after 1/1 renewals. But again, just to clarify, to the extent there is any harder pricing, currently, you wouldn't really be earning materially improved margins until 2019. Isn't that the case?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well on the first question, I mean, the K on the cat-exposed business, the K only takes the property catastrophe business. So the property catastrophe excess of loss business, that's only what it takes. And as on the property catastrophe excess of loss, we are largely writing the higher layer. They have, based on the current loss estimates, not been affected. So should the losses grow. So will be the impact on the K transaction. But on the current loss picture, which is more a picture of frequency of major losses very large major losses, the K is not taking up that many losses. It, of course, works as a very efficient shield when it comes to further loss development in the future on these losses. And the second question on how the possible, I mean, margins from increased pricing will flow through. Yes, partly, they will, of course, not flow through immediately into 2018. But partly into 2019. But if you look at excess-of-loss treaties that are renewed at 1/1 at better prices, of course, there you have an immediate effect because you get just more premium for the same exposure. So I would say on the hardening market, as we said in previous years about half of that -- 40% of that you see in first year and then the rest comes in the second and the third year.

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

I guess also there is going to be a bias to norm -- to harder prices in the later renewals rather than the 1/1, which is why I was also thinking there could be more of a delay in the (un) through?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well of course. I mean, 65% of our treaty business renew at 1/1. And of course, we will definitely strive to increase the prices also at 1/1 because that's the majority of the treaty business they have to renew.

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

How much of that is loss exposed do you think or has been exposed to losses?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well I mean, at this rate, difficult to say. But I think it's a smaller part of that. But I mean, as we have seen in 2011, we expect pretty much also the loss-free business will be subject to firming in terms and conditions.

Operator

The next question is from Michael Haid of Commerzbank.

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

Just 2 questions relating to retro. First, on the K-Cession, is it then fair to assume that, therefore, your K-Cession investors this Q3 was still only an earnings event and not a capital event? And second question, regarding your expectations for your retro protection for the renewal, what conclusions do you draw from the Q3 events? And how much your retro was hit? I mean, I'm not asking in terms of what price expectations you have for the renewal. But how do you want to change, if at all, your retro protection?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well I mean, as far as K is concerned, it's probably still a bit early to say if it was the capital or an earnings event. But if it's in capital event on K, definitely not a significant one. K is, by the way, largely renewed at this point in time already. The overall, I mean, structure of our retrocessions that if you buy, I mean, depending, of course, on pricing, stay pretty much unchanged. I mean, we will, of course, try to continue this buying aggregate excess of loss maybe even a little bit more. And on the whole account, we expect that to be largely unchanged, of course. There is no unlimited acceptability for us of rate increases because, I mean, with our capital base, we can, of course, also increase our retentions. But at the same time, I mean, this a reason we will, of course, of all our retrocession and partners' renewal.

Operator

The next question is from Jochen Schmitt of Metzler.

Q - Jochen Schmitt {BIO 4227302 <GO>}

I have one question on your investment book. What should we think about your strategic exposure to listed equities going forward? Or will you run this position predominantly on an opportunistic basis? That's my question.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well I think it's exactly how you described. You may remember that we entered into listed equity in 2010. Once we went out of it because also the reinsurance opportunities were remarkably higher. We always said that we are open and willing to invest again if opportunities arise, then we did that up to an amount of 2% of the overall portfolio. That is still -- or developed into nearly EUR 1 billion. But we should bear in mind, it was never more than 2%. So the -- we could run our investment portfolio and we have run it also with -- in good terms also without the equities. So in that regard, nothing has really changed. If you invest in equity -- listed equities and you assume that there will be evaluation increases in the future, then sometimes there is a time to harvest those. And this is what we did in conjunction with all the other good reasons to do that. And moreover, we are -- we have not changed our appetite in our strategy. So we will use opportunities to go in. And if that develops exactly as it did before, there will be a time to harvest gains again.

Operator

The next question is from Jonny Urwin of UBS.

Q - Jonathan Peter Phillip Urwin {BIO 6126952 <GO>}

Just one from me please. Just thinking back to your retro program. I mean, I guess, you're going to want to get that all nailed down, sorted, renewed before you think about how much you want to write at 1/1. And what do you want to do to your cap appetites and what I have been hearing in the market is that in this phase that it's going to be quite late renewal given the uncertainty around losses. The question is how quickly do you think you'll be able to get certainty around your retro program and get it renewed. Will you be ahead of the pack perhaps, given it's been less impacted than elsewhere?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well I would say on our main facility, the K transaction, we already have certainty. So I mean that's done. And the rest, I mean, of course, we haven't as yet went to the market for quotation. But there is a centerpiece already in place. I mean, we are less concerned with that.

Operator

The next question is from Thomas Fossard of HSBC.

Q - Thomas Fossard {BIO 1941215 <GO>}

Two questions left on my side. First one will be on the S&P rating. So Ulrich, in your preliminary statement, you indicated that S&P has recently updated your rating. Have you also closed the discussion with them on how much excess capital you're holding on your AA rating level? And the second question will be on the life U.S. mortality recapture for the EUR 45 million negative impact on an IFRS basis. Could you disclose whether these in reverse or quantify how much was the positive impact on an economic basis so EUR 72 million or EUR 72 million like?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well I mean, on -- if I may take the later one, I mean, we would have to say that, I mean, this recapture was fully in line with our plan of the rate increases that we proposed there. Therefore, a part of that has already been taken into account on the future management actions at the end of 2016. So that the movement in the economic balance sheet for 2017 on this particular one will not be all that large. But it shows that the future management actions that we contemplate are actually very reliable and we are able to execute pretty much in accordance to this plan. I mean, the overall future losses that we avoided that way were actually quite significant.

A - Roland Vogel {BIO 16342285 <GO>}

If I may take the Standard & Poor's question. I think what we have to bear in mind that the Standard & Poor's has changed their treatment in the models, especially of the reinsurance industry to some extent. So the world how we view excess capital has changed in two respects. First of all, we are still in communication with Standard & Poor's about some of the changes, which have cost us excess capital. And on the other hand, we were living in a world where we assumed that, of course, for a AA; rating, we do need as reinsurers based on the volatility and the industry risk, we would have to always have a AAA capitalization. So the relationship between the two. So what we have and what we really need to stay there has changed. And we are still in discussions with Standard & Poor's how this will look like. So you could argue from a pure technical standpoint, this has decreased to some extent, the excess capital. On the other hand, the hurdle we have to jump over to stay at a AA; rating seems to have decreased also. So that was a little bit of long-winded answer to your question. But as far as we see and with the confirmation of the rating where we are, we feel comfortable where we are with our capital position with Standard & Poor's today. To quote a number as we did before, I wouldn't be brave enough today.

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes. And there are still some moving parts in. Maybe I would say mid next year, we should -- the fog should have lifted, let's put it that way.

Q - Thomas Fossard {BIO 1941215 <GO>}

Okay, sure. And just one additional point around where is the part of the changing model, which is potentially the most costly or expensive for you? Is that on the P&C side or is that on the mortality side of things?

A - Ulrich Wallin {BIO 4863401 <GO>}

No. It's not on the mortality. It's more on the longevity side. It's also a concept that S&P runs it by, I mean, category of risks. They look at your internal model and always takes the higher number of their own assessment and your assessment within the internal model, of course, without using the same correlation metrics in respect of the diversification benefit.

Q - Thomas Fossard {BIO 1941215 <GO>}

Okay. So more on the life than on the P&C for the time being.

Operator

The next question is from Roland PfÃ¤nder of ODDO BHF.

Q - Roland PfÃ¤nder

Two questions from my side, please. Did you see business opportunities in the shorter frame following these net cat losses? Did you see, for example, backup covers already? And secondly, you spoke about positive spillover effect to loss-free lines. So which lines do you think will be most exposed to maybe price increases going forward?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well I mean, we have, of course, already written some backup covers. I mean, this is not huge. I mean, this is just individual backup covers that have been in the market, that some of them we wrote, some of them we didn't write. As far as the spillover effect, I mean, I pretty much view the situation a little bit similar to what we have seen in 2011. And if you remember in 2012 following the 2011 losses, that the impact was not too dissimilar from what we see this year. We saw basically an overall price increase somewhere of 7%, I would say. And if you look at the overall business, that should be achievable this time around as well. That, of course, means that loss-affected businesses have significantly higher rate increases. And the rest of the businesses would really be dependent on profit prospects and, of course, also I mean the experience of that business, you will have differential, I mean, methods of rate increases of those. Of course, I mean, if business is marginable at current rate, that will get higher rate increases if loss free compared to business that is extremely profitable where the rate increases may actually be not as pronounced, if at all. But it really depends on the individual experience and the profitability of the business. But needless to say, it would mean overall also on the loss-free business, we will see rate increases.

Operator

The next question is a follow-up of Vinit Malhotra of Mediobanca.

Q - Vinit Malhotra {BIO 16184491 <GO>}

The follow-up question is on the retro again. If K series and whole account both have not been severely -- I mean, not been hit too much. There is still around EUR 700 million of retro, which is -- or some kind of offset, which has come in. And I'm a bit confused as to what could have driven that because in the past, you have provided some scenarios, maybe 3 or four years ago at your Investor Day, which also included premiums in and out? Is there some such calculation behind these numbers? Or is it really that there is some retro. But we don't know or you're not disclosing where it is today?

A - Ulrich Wallin {BIO 4863401 <GO>}

No. These numbers are not heavily affected by -- I mean, it's not taking into account the cat premium and deducting it from the losses as you do if you look at the capital impact. This includes to some extent reinstatement premiums. But I have to say that reinstatement premiums in and out are quite similar. If at all, in is a little bit higher than out because the majority of the recoveries from the retrocession is either K, where we are not, of course, paying retrocession or the aggregate excess of loss, where we are not paying reinstatement premiums as well. Reinstatement premiums are only being paid on the partly affected whole account. I mean, of course, the remainder of the coverage is still in place. It's very comforting for us because, I mean, should there be a movement in reported loss numbers that would have us to adjust our figure's output on a gross basis. As Roland already alluded to, we would be pretty well protected on a net basis for quite a bit of development there. I mean, the reason that the retro program wasn't that effective was really, the -- I mean, the significant frequency of losses. So I mean the whole account, of course, it's really geared to larger -- for the most part, to larger individual losses, let's say, comes in the Mexican earthquake or even the Harvey. So that's the reason why it's only hit by Irma.

Operator

(Operator Instructions) The next question is again a follow-up of Michael Haid of Commerzbank.

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

Two additional questions. Maybe I missed it. But can you say a word on how the solvency ratio could have developed in the Third Quarter? I assume that with a profit and with the release of risk capital from the liquidation of the equity portfolio, it should have increased. Second question, also relating to the liquidation of the equity portfolio, I saw that you reinvested some of the money in government bonds. Can you say in what government bonds you invested in and what the reinvestment rate of this would be?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well if I take the first one. Well it looks at this point in time as if the solvency ratio on the Third Quarter for the group would actually increase rather than decrease. I mean, there are lots of, I mean, moving parts in a Solvency II solvency ratio. But it's also related to currencies and interest rates and stuff. But at this point in time, it looks as if there's an increase in the solvency ratio. That also, of course, has to do with the fact that we have our operational risk model being approved now. So from that point of view on a group basis, we would expect that the probability of an increased solvency ratio is higher than the probability of a decreased solvency ratio.

A - Roland Vogel {BIO 16342285 <GO>}

But let me comment on the reinvestment yields and the govies. So Mike, I don't think that you had the opportunity to be at the Investor's Day, where I showed a little bit the reinvestment yields also in respect of maturities and currencies and the dependencies. So we will, of course, invest currency-wise. I think also the equity portfolio did follow the over -- at least, in overall terms the currency composition. So the largest reinvestment will be in the U.S. dollars. We will also take longer-term maturities to see the maturity is a little bit on the govies side to avoid very low interest rates. The same would be true for the euro investment as well. We should also bear in mind. And I said that before that we will stay or we will keep the powder dry over the course of the renewal season. After that, we will have to decide and one should assume today that the reinvestment of these monies follows the overall reinvestments on average as well.

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

Okay. Can you remind us again what the operational risk could imply on your -- how much of percentage points in the solvency ratio?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well I think it's just shy of 20% if I remember that correctly.

Operator

The next question is from James Oram of Citigroup.

Q - James R Oram {BIO 19736003 <GO>}

This is James Oram from Citi. And I've got 2 questions, please. In your report, you mentioned U.K. motors is one of the areas where you expect to see price increases next year. It seems there's still quite a lot of debate over the extent to this increases that we might see and I just wonder how renewal discussions had progressed so far and what you're seeing there. And the second question was at the Investor Day, you suggested it was still too early to comment on potential developments in equalization reserve. I just wondered if you had a clearer picture now. You've got more precise loss estimates for your exposures.

A - Ulrich Wallin {BIO 4863401 <GO>}

Okay. As your second question is a difficult one, I would leave that to Roland, of course. The first one on the U.K. motors is a slightly easier one. So I take that. Yes, I mean, we see significant increases on the U.K. motor excess of losses, where we play with just an excess of EUR 5 million, which in a launch have been pretty much doubling in pricing in reinsurance rate, coupled with the increases in the primary business. So we have more than twice the price on those. However, I have to say that there is -- on most of them, we have adjustment clause that in case the Ogden rate changed again, the pricing will be reviewed. Because, I mean, the exposure on the upper layers, which we are playing is, of course, very much dependent on the Ogden rate. So I mean, if you have a layer excess of EUR 10 million and the rate changes back, say, from minus 0.75 to 0.5 positive, it has a major effect on the expected losses. It will also, of course, has a major effect on our reserves we have quoted there. But it will then also be reviewed. The pricing rates will then be reviewed again.

A - Roland Vogel {BIO 16342285 <GO>}

So with the more difficult question, the very quick answer could be, no we have not reviewed or made an additional estimate of the development of the equalization reserve. 6 weeks or 7 weeks before the end of the year, that exercise wouldn't make too much sense. I would still say that you should bear in mind that the addition and the releases from the equalization reserve to some extent can be managed and steered. They, of course, have an impact on the German GAAP accounting of the Hannover Re SE. But with the retained earnings and the profits carried forward, which we have and the opportunities to steer that, I would assume this really does not drive our management decisions to such a large extent.

Operator

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

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes. Thank you very much. Thanks for listening to our conference call. And I wish you all a very nice day.