Q3 2021 Earnings Call

Company Participants

- Clemens Jungsthofel, Chief Financial Officer
- Jean-Jacques Henchoz, Chairman of the Executive Board
- Klaus Miller, Member of the Executive Board - Life & Health
- Sven Althoff, Member of the Executive Board - Property & Casualty
- Unidentified Speaker

Other Participants

- Andrew Ritchie
- Darius Satkauskas
- Iain Pearce
- Thomas Fossard
- Vinit Malhotra
- William Hardcastle

Presentation

Operator

Good morning, ladies and gentlemen. I welcome you to today's Hannover Re International Conference Call on the Q3 2021 Financial Results. For your information, this conference is being recorded. At this time, I would like to hand the call over to your host today, Mr.Jean-Jacques Henchoz, Chief Executive Officer. Please go ahead, sir.

Jean-Jacques Henchoz {BIO 17457677 <GO>}

Well, good morning, everyone and welcome to our conference call presenting the results of Hannover Re for the first nine months of this year. As usual, I'll start with an overview before our CFO, Clemens Jungsthofel, goes over the financials in more detail. And then, I will comment on the outlook for this year and for 2022. For the Q&A, as always, I'm additionally joined by my Board colleagues, Klaus Miller and Sven Althoff.

In the first nine months of this year, Hannover Re has again proved its resilience in a challenging market environment in life and health reinsurance. The results continued to be impacted by the COVID-19 pandemic. And in P&C reinsurance, we had to deal with the elevated large losses from natural catastrophes, most prominently the European floods and Hurricane Ida in the third quarter.

The fact that we still achieved a double-digit return on equity, year-to-date highlights the strong underlying profitability of the group and our successful volatility management. Additionally, the group net income of EUR856 million is in line with our full year target range of EUR1.15 billion to EUR1.25 billion, and hence, we have kept our profit guidance unchanged.

Gross premium increased by 14.4% adjusted for currency effects. This is mainly driven by our P&C business group, where we recorded continued strong top line growth on the back of improving market conditions and increased demand from our clients, although growth in life and health reinsurance was also ahead of our expectations.

In P&C reinsurance, the large loss impact of more than EUR1 billion was clearly above our budget for the first nine months. Adjusted for this quarterly budget overrun, the technical profitability was, however, in line with our expectations.

Furthermore, this is supported by our unchanged net estimate of COVID-19 related losses, which has now been stable since the end of 2020 at EUR950 million. As mentioned, the ongoing global pandemic continues to have a significant impact in life and health reinsurance. Within our portfolio, the main markets affected by COVID-related excess mortality of the U.S., but also South Africa, where Hannover Re has a very strong market position.

All-in-all, losses connected to COVID-19 amounted to EUR404 million and most notably the third quarter losses of around EUR140 million, came ahead of our initial expectation. As already disclosed in Q1, the restructuring within our U.S. mortality portfolio led to a positive one-off effect of EUR129 million. Additionally, we recorded a positive effect of EUR99 million from reserve releases in the longevity in Q3, partly mitigating the COVID-19 impact.

At 2.9%, the return on investment is significantly ahead of our expectations, mainly driven by favorable ordinary income. Our capitalization according to Solvency II continued to be excellent confirmed by our strong solvency ratio of 239% at the end of the third quarter, well above our 200% threshold. The main reason for the decrease in the third quarter is the increase in required capital due to the attractive business growth, including the growth we expect to see in 2022. This leads to an increase in SCR, whereas the positive impact on own funds is less immediate due to our conservative assumptions for new business.

Furthermore, large losses in P&C and COVID losses in life and health, had a negative impact on the solvency ratio year-to-date.

The operating cash flow in the first nine months of 2021 reached a record high of EUR4.2 billion, mainly driven by attractive reinsurance growth as well as very favorable results on the investment side. The figure for the first quarter included a positive one-off from the restructuring within our U.S. mortality portfolio of EUR640 million.

Overall, the positive cash flow fueled the strong growth in assets under own management to an all-time high of about EUR55 billion. This growth was additionally supported by ForEx effects and the issuance of EUR750 million in hybrid capital, already known in March. This bond issuance is also visible on the next slide, bringing our total hybrid capital to EUR3 billion. Despite this issuance, we still have material flexibility in regard to our total hybrid capacity. On the right-hand side, you can see that our strong profitability is the main reason for the increase in shareholders' equity. And additionally, the change in OCI was slightly positive, because negative valuation effect were offset by positive currency translation.

On that note, I'd like to hand over to Clemens, who will explain the figures in more detail.

Clemens Jungsthofel {BIO 22251357 <GO>}

Yes. Thank you, Jean-Jacques and good morning, everyone. I would dive straight into the reporting for our business groups and start with P&C. We now look back at all important renewal dates in 2021. And you can see gross and net premium in P&C reinsurance grew by a remarkable 18% adjusted for currency effect.

The growth is highly diversified with particularly strong momentum in North America, in Germany, and in Southeast Asia. On top of this, we successfully expanded our structured reinsurance book, and we also were able to increase the volume of our facultative reinsurance book. As in previous years, we would expect the growth in gross premium to slow down somewhat; however, the net premium growth should remain more stable.

As you all know, the impact from large losses was significant in the third quarter of 2021. For Hannover Re, this resulted in net large losses of EUR1.07 billion for the first nine months, clearly above our budget of EUR849 million for the first nine months. The net loss estimate for COVID-19 related losses, however, remained unchanged at EUR950 million.

All together, the combined ratio of 97.9% for the first nine months is very solid, in light of the observed loss activity and the underlying figures are in line with our targets.

Net investment income in P&C increased based on strong ordinary income, higher realized gains, and lower impairments. Other income and expenses include negative currency effects of EUR105 million. In the previous year, we had almost the same amount as a positive contribution, and I alluded to that already in the second quarter, that it is mainly an accounting mismatch as we have a similar movement in our equity. All together, the EBIT increased strongly to EUR161 million, thanks to the improved investment results and the favorable underwriting result, which had been heavily impacted by COVID losses in the previous year. Finally, the tax ratio is at normal level.

On the next slide, as mentioned, total net large losses accounted for EUR1.07 billion, that's EUR221 million above budget. This means that we have already almost reached the level of EUR1.1 billion budgeted for the full year after the first nine months. Of course, the year-to-date budget overall is absorbed in the Q3 result, and hence the EUR251 million budgeted for Q3 -- for Q4, are still available.

On the next slide, looking at our large losses, the two largest events were unsurprisingly the European floods with a net loss of EUR214 million and Hurricane Ida with EUR306 million net for our account. On top of this, we have seen further increases in the loss estimates for storm Volker and the Texas freeze on the NatCat side. However, man-made losses also increased by slightly more than EUR100 million in Q3, almost entirely due to the riots in South Africa, which are included in the property losses with an amount of EUR94 million. Altogether, the impact from both NatCat and man-made losses was significant in Q3, pushing the actual loss experience above the budget for the first nine months.

The next slide, as usual shows the technical profitability of our P&C portfolio by reporting line. The picture I'd say very much reflects the large loss situation. I've just explained, combined ratios for EMEA, affected by the European floods and by the riots in South Africa, while the Americas include significant losses from Hurricane Ida and the Texas freeze.

The worldwide markets show a rather mixed picture. Facultative and agricultural business are mainly impacted by large losses in the technical profitability and credit and surety, as well as in aviation and marine, is really excellent driven by favorable underlying loss development and positive reserve runoff.

Let's move on to life and health, then on the next slide. The pleasing business growth is reflected in both the premium and in value of new business. And really, I'd say, comes from all our four important categories. Growth is actually quite diversified by region as well. As Jean-Jacques mentioned, the technical result was still affected by losses in connection with COVID-19. Around 85% of the losses stemmed from two markets, EUR197 million from the U.S. and EUR149 million from South Africa. The losses in South Africa were particularly significant in the third quarter, whereas the losses from the U.S. were lower than in previous quarters.

On the positive side, we recorded a positive effect of EUR99 million from reserve releases for our longevity portfolio. In part to really avoid misunderstandings, I think this needs some additional explanation. You might be wondering how we can have further reserve releases when we have locked in assumptions according to address for accounting and usually, we do not even have to set up reserves for this kind of treaties. The reason is that we have so-called provisions for adverse developments and as Claude already explained at our Investors Day, not long ago in recent months, we have received updated mortality data from our clients, showing that the mortality within our enforce portfolio has been higher than expected.

Hence, we could release those provisions for adverse developments those had, because more people in our portfolio have actually died than initially assumed, not because we assume any different mortality trends for the future.

In other words, the impact does not reflect any general change in assumptions for our longevity business, which would be uncertain, but only higher mortality in the enforce book, which of course is completely certain.

Furthermore, it is also important to note that the updated mortality data is largely for pre-COVID period and not affected by the pandemic.

Finally, as explained in our Q1 conference call, the restructuring of parts of the ING portfolio in U.S. mortality led to a positive one-off effect affecting various lines items in the P&L. In total, the positive impact was EUR129 million. The ordinary investment income was in line with expectations. The fair value of financial instruments decreased materially. The negative impact was driven by the valuation of derivative embedded in a life reinsurance contract in the UK. And additionally, the previous year had benefited from positive valuation gains from an equity participation.

Other income and expenses mainly driven by a further increase in the contribution from our Financial Solutions business, a large portion of which is recognized according to the deposit accounting method. Currency effect here in line and has had a rather minor impact. Altogether, the EBIT of EUR220 million is satisfactory, reflecting the aforementioned positive and negative extraordinary effects.

On the next slide, as usual, a quick look at the non-IFRS metric for business growth in life and health, the value of new business according to Solvency II. In Q3, we again took advantage of the attractive opportunities for financial solutions in the U.S., but also in China and we further expanded our longevity book in the UK. The total value of new business for the first nine months supports our full year minimum target of EUR250 million. Furthermore, the pipeline currently looks very promising, and I would say we are well on track in terms of new business production.

On the next slide, the development of our investments. I think it's fair to say that the development in the first quarter and in the first nine months of the year was very satisfactory. The ordinary investment income is particularly strong. The main drivers for this development are the excellent returns from our alternative investment portfolio. Then the overall asset growth fueled by our very positive cash flow as well as the impact from increased actual inflation numbers and the associated positive impact on the amortization of our inflation linked bond.

Realized gains have also increased compared to last year and are mainly the result of routine portfolio management as well as some strategic -- let's say, as we mentioned the sale of listed equities in the first quarter, which have contributed EUR50 million to the realized gains. Impairments and depreciations decreased compared to the previous year, where we had recorded some impairments in the more volatile market environment. So, this year's number is more or less at expected low levels to a large extent comprising regular depreciation on our real estate portfolio.

As explained in my comments on life and health, derivative valuation was negative. So, the overall return on investment was 2.9% and we expect to achieve a higher return than our initial full year expectation of roughly 2.4%.

Unrealized gains, as you can see here, decreased by around EUR500 million, mainly due to the increase in interest rates that are compared to year-end 2020.

On the next slide, well known, I think the asset allocation developed in line with our strategy. The most notable change is the reallocation from government bonds into corporate bonds. The focus here is on large and small corporates in developed markets. The contributions to ordinary investments income is diversified as usual. The highlight as mentioned is probably the recovery in the contribution from private equity to the strong levels we had seen before the market volatility, caused by the pandemic.

To conclude my remarks, the first nine months and in particularly, the third quarter proved to be a challenging period for the reinsurance industry, and therefore, the overall result and the fact that we have confirmed our full year profit guidance for 2021 highlights Hannover Re's strong ability to manage and absorb volatility.

On that note, I'd hand back to you Jean-Jacques for the comments on the outlook.

Jean-Jacques Henchoz {BIO 17457677 <GO>}

Thank you very much, Clemens. On the next slide, the target metrics confirms Clemens' summary. Most notably, our main profitability target for the group, the return on equity is well above our minimum target, even though the underwriting results in both P&C and life and health are impacted by extraordinary losses. This also means that the EBIT growth targets in P&C and life and health are somewhat distorted by COVID claims. These targets being more oriented towards normalized growth over the course of the strategic cycle.

More importantly, growth is significantly ahead of the strategic target, providing a strong basis for a successful business development in 2022.

So, before we move on to the outlook for next year, let's have a brief look at our guidance for the year 2021. As mentioned, the profit guidance remains unchanged. Thinking about the individual components contributing to this number, the premium growth is stronger than initially expected, and together with a higher return on investment, this should be sufficient to compensate for higher-than-expected large losses in P&C and higher-than-expected COVID losses in life and health, which were also partly offset by positive one-off effect as we've seen.

For the fourth quarter, further impacts from COVID claims is likely in life and health. Even though the development of the pandemic remains uncertain, the accelerating vaccination progress in South Africa in particular provides the basis for decreasing excess mortality in this country. The targeted ordinary dividend according to our new definition as communicated at our Investors Day is at least the EUR4.5 paid out this year. As before, we will consider paying a special dividend on top of this if the capitalization exceeds our capital requirements for future growth and profit targets are achieved. And as of today, I'd say that both sides of trend are being met.

As usual, at this time of the year, we publish our guidance for the expectations for next year, as mentioned, growth opportunities are attractive, and we therefore, expect gross return premium to increase by at least 5%. As in previous years, the growth is likely to be more pronounced in P&C reinsurance. The return on investment should be at least 2.3%, the 10 basis points being -- decrease being -- versus our initial guidance for this year, reflecting the low interest rate environment with reinvestment deals below our portfolio yield.

The group net income is expected to be within the range of EUR1.4 billion to EUR1.5 billion, an underlying improvement of around EUR250 million compared to our guidance for this year. The main driver for the improvement is the profitable growth in this and previous years, in particular in P&C reinsurance. And this growth is not only leading to an improved underwriting result, it has additionally led to a very positive cash flow, which in turn forms the basis for the favorable growth in assets under own management. And the increased asset base is expected to more than compensate for the slight reduction in relative returns.

In life and health, growth is similarly helpful, but the profitability is also expected to improve. The uncertainty in life and health is somewhat higher due to the future development of the COVID-19 pandemic. And with this in mind, we have added a disclaimer to the effect that no material COVID lost is -- are included in the guidance.

In addition, we have not included any potential relief from our mortality rate for cover, which is likely to payout in 2022. So, there is some allowance for COVID claims embedded in our guidance, but no significant numbers.

Apart from this, the guidance is under the usual provisor the large losses stayed within the budget in P&C. And the budget has increased to EUR1.3 billion. And of course, also that there are no major distortions in the capital market. The increased large loss budget is mainly a reflection of business growth. Last but not least, the dividend policy is the same as -- for this year. The ordinary dividend announced in March 2022 will be our floor for the ordinary dividend and we have a potential special dividend on top. Altogether, our guidance reflects the positive development and successful cycle management of the group and we're quite positive about the outlook for next year.

This concludes my remarks. And as always, we would be happy to answer your questions.

Questions And Answers

Operator

(Question And Answer)

Ladies and gentlemen, we will now begin our question-and-answer session. (Operator Instructions) And the first question is from Andrew Ritchie, Autonomous. Your line is now open. Please go ahead.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Hi. Good morning, everyone. Could I just dig in a little bit more to the increased cat budget for 2022, the EUR1.3 billion. Because you split that between man-made and NatCat, because I noticed you give that split now, you gave us split for '21. I guess I'm just curious that the budget is growing 18%, is that a proxy then for your expected NEP growth or is it growing just funding ahead of NEP growth? I'm just trying to frame when you talk about it growing in line with business, to what degree it really is just the business volume versus anything else going on?

My only other question was, on the longevity release, thanks for the additional color. I'm just trying to judge, would there be like another possibly two years or something, before we'd have mortality, before you got more information again from cedents to update again unreleased further PADs. If there's something, it could be that much of a gap between when you look at it again, because of the nature of the slow information flow from cedents. Thanks.

A - Jean-Jacques Henchoz {BIO 17457677 <GO>}

Thank you. So, first question, Sven on the NatCat budgeting, and Klaus will address the longevity release.

A - Sven Althoff {BIO 19104724 <GO>}

Yes. With regard to the major loss budget, happy to give you the split man-made versus NatCat. So, we kept the relative percentage just close to the distribution we had in 2021. So, it's roughly 80-20 and to be precise, EUR250 million out of the EUR1.3 billion is man-made and EUR1.050 billion is the natural catastrophe. The growth is not a proxy for our premium growth ambitions for next year. As always, it is the mix between the growth we have seen already this year and there is a natural time lag translating this into our major loss budget and the development of the major loss budget, and some of the anticipated growth we expect for next year.

The bulk of the increase on the NatCat side is growth related. There's only a smaller portion going to model changes, which we are doing on an annual basis, where we are validating our current modeling assumptions and given the losses over the last three to four years, of course, there are always some minor changes even there and some of that is flowing through into the major loss budget increase for 2022.

A - Klaus Miller {BIO 16886879 <GO>}

Okay. Now, I'm happy to take the question on the longevity side. The way how it works as we -- our counterparties are either pension funds or in some cases life and pension insurer. And especially, the pension funds, how do I say that tactfully, I'm not at the forefront of modern admin systems and they are not used to do reinsurance accounting. So, when they take out this reinsurance, it's probably the first and only time they do that and they have to change their systems to administer that. And that takes usually at least a year, sometimes two, sometimes even more.

We have grown a lot in the last couple of years and got an awful lot of these (inaudible) and we did the pricing and when the treaty was concluded, it was also agreed that we get at least annual update. Sometimes we get these, sometimes we didn't, sometimes we have to ask for it. So, a delay of two years is probably the norm.

And when we get these updates, of course, we get accounts, but we only see the fixed lag, which is fixed from the outset. We know exactly these numbers. They don't even have to send it to us. And we see the variable lag, the monthly, quarterly pensions we have to pay. And as long as we see that, the fixed lag is higher than the variable lag. We know that the treaty is basically going according to plan. And then, we just book these numbers.

What we get as additional information from the (inaudible) is, are there people who died, if they are younger in terms of the annual monthly pension, it might be the same as somebody of aged 60 gets GBP1,000, or of aged 90 gets GBP1,000. So, in the monthly accounts, you don't see a difference. But if somebody who is 60 dies, and we had a lot of these claims more than expected, then the impact on the profitability is much higher than if somebody at the age of 90 dies, because the remaining pension time would be much, much shorter.

And we try to be assured with these (inaudible) but due to some other work, especially writing new business or people were not completely up to date with the analysis of the (inaudible) we received and then we took a major asset last year to start getting this up to date and again this year. And you can expect this for the future. If we don't update the (inaudible) and release the PADs as Clemens mentioned earlier, you should expect our profits are improving from year-to-year in small -- very small set. And then only as soon as we take the (inaudible) and clean up for the people who have died more than expected. And obviously, we can release all the provisions for adverse deviations for these dead people because we definitely don't need it. Then you will see a big profit like you see this year. This should happen regularly every two or three years.

A - Jean-Jacques Henchoz {BIO 17457677 <GO>}

Yes. Andrew, if I may add, you shouldn't see that as a recurring result (inaudible)

Q - Andrew Ritchie {BIO 18731996 <GO>}

Sure.

A - Jean-Jacques Henchoz {BIO 17457677 <GO>}

-- this year, so it's really, as Klaus mentioned, it's a bit of the cleanup to be honest. So, there will be an effect in every year going forward, but certainly not to that amount that we've seen this year.

A - Klaus Miller {BIO 16886879 <GO>}

But just to make one point clear, this is not a new assumption setting for mortality in the future. This is cleaning up the portfolio for people who have died. And therefore, clearly, we don't need to pass any long term.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Great. Thanks very much. Thank you.

A - Jean-Jacques Henchoz {BIO 17457677 <GO>}

Thank you.

Operator

The next question is from Vinit Malhotra, Mediobanca. Your line is now open. Please go ahead.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Hey, good morning. Thank you very much. So, a few questions please if I can. First is that, I'm noticing, I mean, you're talking about Solvency FTR growth, but I can't seem to recollect that, it was there, for example, similar period last year, might have been, but we didn't really mention it. The growth was similar. So, I just wanted to know, is there anything more remarkable in that number? And this is more a quick check really.

Second question is on the combined ratios in credit. I think I can back calculate 3Q is about 73%. Now, remember that we keep talking about how the economic recovery and insolvency in state schemes going away. Is there any reserve movement here or anything more notable please?

Just one more question on retro please. The bond recovery is very, very high. I mean 240 net growth, 643, I think is one of the very strong recoveries for a single loss. Could you comment on that? With also some comments please on Texas freeze?

And just lastly, please, the cash flow of EUR1.5 billion is very, very high, very high as far as me. You mentioned investment income, the roads and the business, but is there anything more remarkable, for instance, I mean, there would also be payouts to be made on these EUR1 billion plus of losses. Would that be affecting cash flows in the future as well? So, I just wanted to understand the cash flow well? Thank you very much.

A - Jean-Jacques Henchoz {BIO 17457677 <GO>}

Thank you, Vinit. So (Technical Difficulty) and cash flow, Clemens will give you status and credit (Technical Difficulty) and large losses, Sven will comment on this.

A - Clemens Jungsthofel {BIO 22251357 <GO>}

Yes, Vinit. Good morning. Let's start with the Solvency I. So, it's really as Jean-Jacques mentioned, the SCR increase, our own funds have largely not moved at all. So, if we would be looking at, let's say, as stable as the Solvency II ratio would mainly be on the basis of Q2 of 250 roughly. So, it's really the SCR that increased heavily. It's the usual exercise that we do in Q3.

First of all, it's a reflection as Jean-Jacques mentioned on the current business growth that we've seen in this year. But also, regularly in Q3, when we do our planning cycle for the next year, we include in our SCR model, in our internal model, the expected new business both in P&C and in life and health, in our SCR calculation, and that's the reason why the -- that's the main driver of the decrease in the Solvency II ratio. Again, it's the usual exercise, I'm just looking at the Q3 numbers for the last couple of years as we speak, Vinit, and it's always been the case that we have seen a dip in Q3 actually.

And I would expect with their own funds and looking at our reserving position, et cetera, in Q4, I would expect that, that number to increase again in Q4. What is probably also worth mentioning is the slight reallocation in our assets portfolio and our investment more to a bit more alternative investments, et cetera. I think that has also contributed to an SCR increase. But again, I think that will -- when we look at our reserving, when we look at our new business from an own funds perspective, we will be reflecting that in Q4, and then in the next quarter.

A - Unidentified Speaker

On the cash flow, nothing really significant. I mean, Jean-Jacques mentioned, for example, the Q1 effects from Voya and, of course, the bond issuance, et cetera, but in Q3, it's really the business in flow. And I think what is probably worth mentioning here, when it is the fact that we have seen very low payout ratios when it comes to our plane. I think that's probably the main driver, that the cash outflows for large losses has been lower than I would have expected. I hope that answers the questions, Vinit.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yeah. Thank you.

A - Sven Althoff {BIO 19104724 <GO>}

The credit and surety combined ratio, what you are seeing here is the impact of positive runoff from old underwriting years. We are still reserving the underwriting years at higher-than-average combined ratios due to the uncertainty, that what will happen to the level of insolvencies once the various economic stimulus packages are phasing out, but the runoff for the older underwriting years is positive, more positive than expected, given that we now had a period of one-and-a-half to two years of economic stimulus. So, the short-term level of insolvencies were below our original assumptions.

And there's a tail on trade credit is not particularly long. So, three to five years, we could now release some ultimate loss ratios from those prior underwriting years.

When it comes to the burnt loss, you're right, the difference between the gross and the net is relatively high. This means that we could collect the burnt losses from both our transactions, but also particularly from other -- our whole account protections, which explains the difference between the two numbers, Hurricane Ida on the other hand, the bulk of the difference between gross and net, which you are seeing is actually the difference coming from the ILS business, which we are fronting. So, EUR180 million out of that gap is coming from our fronting activities. So, on Ida, we had -- we have booked K recoveries, but no further excess of lost recoveries to walk our net position. And on the winter storm in the United States, we unfortunately had another round of negative runoff in the third quarter, which is due to the very late reporting from ceding companies on that freeze loss. So, this was a little unexpected, but given the situation with lot adjusting and capacity for construction in the U.S., the reporting is slower compared to the usual reporting periods. We are used to, but we are under the assumption now that we should have seen the full impact of winter storm Uri with this third quarter figures.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay. Thanks, Sven.

Operator

The next question is from William Hardcastle, UBS. Your line is now open. Please go ahead.

Q - William Hardcastle {BIO 16346311 <GO>}

Hi, morning, everyone. Just a quick follow-up on that. So, essentially on the fronting business, is what you're saying the difference between the gross and net, obviously on the floods is bigger versus Ida. Is that because of the greater fronting on European business? Is that what you're saying?

A - Klaus Miller {BIO 16886879 <GO>}

No. Not at all. That's not what I was saying or trying to say at least. When it comes to the German business, we hardly do any fronting. So, the difference on burnt between gross and net, is really our own retro sessions. So, the gross number you are seeing is also almost exclusively our own writing. that situation is different on an Ida. The U.S. portfolio is the peak portfolio in our fronting activities. So, therefore out of the EUR527 million of gross, approximately EUR180 million is fronted business, where -- while on burnt, it is almost zero.

Q - William Hardcastle {BIO 16346311 <GO>}

Sure. It's quite the opposite of what I was saying. So, effectively your retro is kicking far stronger in your own account from the floods than has on Ida. Is there anything why that's happened? Is there a specific reason?

A - Jean-Jacques Henchoz {BIO 17457677 <GO>}

Well, it's a question of market share. Given that our subsidiary for the German business, the ENS, from a market share perspective, the market leader in the German business. Our market share in Germany is just much, much higher on the business in general, but also the NatCat component within the business compared to where we are in the United States, where our market share on cat-related business is underweight.

Q - William Hardcastle {BIO 16346311 <GO>}

Okay. Moving to (inaudible) I'll go to my actual questions now. What benefit did the reinstatement premium have in Q3 for P&C? And is this already factored in when you provide the 2022 outlook, to say greater than 5%? And perhaps any quantification of what that impact is?

And the second one is, you've touched on there on the 2022 guidance, no material COVID-19 impact in life and health. Just for clarity, it sounds like you're not assuming zero, but certainly less than something like EUR100 million. Is that a very fair assumption?

A - Jean-Jacques Henchoz {BIO 17457677 <GO>}

Yes. On the reinstatement premium, we be -- our immediately booking those reinstatement premiums when we are booking the losses, so there is no spillover effect into 2022 from reinstatement premiums. I don't have any precise numbers for you on how high exactly those reinstatement premiums which we have booked in Q3 were. So, rather than speculating, I guess we will have to come back to you on that.

A - Unidentified Speaker

On COVID, life and health, William, I think your assumption is right. We have built in some expectation in our 2022 guidance for COVID related claims. It's not going to be a triple-digit number. It's somewhere a double-digit number I think that we've baked in. On top of that though, we still have the potential coverage from our retro pandemic cover in life and health, that will be most likely paid out in 2022. So, that will give us an additional buffer for the year. But as Jean-Jacques mentioned, it shouldn't -- should not significantly deviate from those numbers.

Q - William Hardcastle {BIO 16346311 <GO>}

And just on that pandemic retro cover, it sounds like you feel very confident that will pay out now, is that because Q3 losses for excess mortality came in ahead of your expectation, that it's effectively giving greater certainty that it will kick in. Is that how we should read that?

A - Jean-Jacques Henchoz {BIO 17457677 <GO>}

Yes. That's absolutely correct. Currently, the ratio stands at about 113% according to our own calculation. From a formal point of view, there will be a calculation agent who will do the calculation, as soon as he gets the official statistics for the years 2020 and 2021. So that will take some time in 2022 before this information is available. But according to our own calculation, we are getting close to 113% now.

A - Unidentified Speaker

Just for clarity, when the coverage is, it's a parametric trigger and the coverage is U.S., Australia, and U.K. So, it's not South Africa.

Q - William Hardcastle {BIO 16346311 <GO>}

Brilliant. Thank you.

Operator

The next question is from Thomas Fossard, HSBC. Your line is now open. Please go ahead.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes. Good morning. Couple of questions. The first one would be related to the walk from the '22 guidance versus 2021. If you could add maybe a bit of color on the underlying assumptions you have taken? The second quick question will be, regarding COVID scenario for 2022, I guess that you built something in into your 239% Solvency II ratio already, given it's forward-looking in terms of calculation. So, would you mind saying maybe a range of what you're already expecting for 2022?

And so, the last question would be, just to come back on the 2.3% return on investment guidance for 2022, and especially knowing that you reported 2.9% or 2.8% ordinary investment income in 2021. I mean, you've got the support from private equity from inflation linkers, but I'm wondering either 2.3% should be -- if nothing exceptionally is in the reported nine months 2021, I'm wondering, is the 2.3% should be compared to the 2.4% 2020 guidance or to the 2.8% 2021, and 2.3% seems to be super, super cautious, given what you achieved this year. Thank you.

A - Clemens Jungsthofel {BIO 22251357 <GO>}

Yes. Thomas, let's probably start with the guidance for 2022. So, overall, I think without going too much into the details, the core question is, where does the increase in net income mainly stem from. It's clearly a mix of effect. In the bottom line, first of all, of course, the significant business growth that we've seen both in P&C -- in life and health and in P&C, the quality of the book should have increased over the last couple of years.

So, we will certainly increase -- we'll see an increase of profitability and in P&C here and there. And of course, the overall amount of the growth will be reflected in higher EBIT numbers in P&C. On the life and health book, as mentioned earlier, the expectation is that we will see significant less COVID-19 claims in the life and health segment. So, the underlying profitability of the business should come through in 2022. That will be another large contributor.

On the investment side, I think, yes, when you look at the numbers, they do seem very cautious for 2022. We are optimistic that we will at least reach that number, the 2.3%, but I'm just conscious of the fact, of course, that we've seen sort of a rebound in the contribution from alternative investment, that amount has been significant. I think roughly EUR100 million of our ordinary income is only related to an increase compared to last year of the contribution of alternative investments, mainly private equity. So, I wouldn't really factor that in going forward for every year. I think that did come a bit as a surprise for me, to be honest, also the valuations on the private equity side, which have increased significantly. So, I wouldn't really want to expect that amount for 2022.

Inflation-linked bonds, the same picture there. We have seen a huge contribution, probably EUR100 million more this year as well, compared to last year, given the current inflation environment and the way the amortization of our inflation-linked bonds work. So, there are two -- at least two effects in the ordinary already, that we will see to some extent in next year, but we have been a bit more cautious on that end.

On Solvency II, if I got the question right, Thomas, but please add. So, how much from the SCR increase would we attribute to our growth in 2022? I don't have the exact number. But I think overall, it's certainly on the Solvency II ratio, probably a double digit -- low double-digit number, or a high single-digit, a low double-digit number that is attributable to that effect. But again --

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes. I think, Clemens, I was more thinking about the prospective COVID-19 mortality losses that you are expecting to incur in 2022, which may already be reflected into your Solvency II ratio at Q3.

A - Clemens Jungsthofel {BIO 22251357 <GO>}

Yes. No, that is not -- I don't think that is included in the SCR and in the own funds yet. We will do an update of that planning and the effect I think in the fourth quarter, but it's not reflected. But it wouldn't be in a substantial amount as mentioned earlier anyways.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes.

A - Jean-Jacques Henchoz {BIO 17457677 <GO>}

Sorry, Thomas.

Operator

The next question is from Iain Pearce, Credit Suisse. Your line is now open. Please go ahead.

Q - Iain Pearce {BIO 19522835 <GO>}

Hi. Thanks for taking my questions. The first one is just on the growth numbers. When we look at the impact on the Solvency II ratio and the increase in the cat budget, the implication is probably that growth is going to be significantly ahead of 5% especially in P&C rates. So firstly, do you think that's a fair assumption?

And then secondly, is there anything in terms of life and health growth that you're thinking is going to be lower, that's leading you to maintain that 5% growth target? The second one was just a quick clarification, the life retro kicks in, is it a 100% excess of normal mortality that the trigger for that parametric cover?

And then, the third one was just on longevity releases and the potential for these going forward. Sort of -- you sort of cautioned us against factoring in too much here, but if you think -- if I thinking in sort of your key longevity markets, mortality has been trending favorably consistently over the last couple of years before we even factor in any impacts from COVID. Why should we not be thinking that these are going to be some -- there's going to be continued favorable longevity development?

A - Jean-Jacques Henchoz {BIO 17457677 <GO>}

Thank you. So, Klaus, maybe you can address the life and health point and the growth in P&C, Sven you can add there again.

A - Klaus Miller {BIO 16886879 <GO>}

Okay. Let's start with the growth on the life and health side. We are quite optimistic that we are growing, but most of that will be -- and this is where our focus is on the bottom line, it's not on the top line. Top line happened every now and then, and you have to understand there are basically three ways to grow the top line here.

On the -- either we really write new large blocks of business, that will increase top line or most of our treaties on the mortality side -- morbidity side are via treaties, and as these treaties get older, that mortality rates, morbidity rates grow exponentially. So, the risk premium grows, even if nothing happens, even if no new policies are added, these treaties grow for the existing portfolio, because we have risk premiums, which are growing.

Of course, at some point in time, this goes the other way, because in 50 years all these treaties have runoff. But as long as they are still young, 10, 15, sorry -- 10, 15 years old. These treaties are growing. And then, of course, we have treaties, which are open for new business, and this is another source of growth. So, in general, we expect to reach the 5% maybe a little bit more, but this mainly depends on large block transactions, especially on one of our focus areas. And that is longevity.

Then your question on the retro, yes, it kicks in at 110% population mortality. And that is the, as mentioned earlier by Clemens, it's a weighted average of the U.S., UK, and Australian population mortality, weighted with the portfolio of Hannover Re.

So, we try to get the correlation between this parametric cover and the results in our own portfolio as high as possible. So, we tried to optimize that by using our own portfolio structure to define the parametric cover. And as I said earlier, it's currently stands close to 113%, according to our own calculations.

And then, the longevity release, yes, we are, when we started 15, 20 years ago, we have longevity and nobody else was doing that. We embarked on a pretty conservative way of accounting for that. So, in the first couple of years and this is still valid today, we only show about 2% to 3% profit in terms of an EBIT margin. And if the portfolio develops as expected, we would see and you've seen that now a release of these PADs especially when we do these cleanup of portfolio. With COVID, especially in the U.K., we got the -- U.K. is the largest market, we had a lot of claims and most of these claims have not been accounted for fully, because the release you have seen probably only includes the updated portfolio information 12 months ago. So, an awful lot of COVID is still not in there.

That is something what we hope to release sometime in the future as soon as we know that we have valid data for that from the clients.

A - Jean-Jacques Henchoz {BIO 17457677 <GO>}

On P&C growth, Sven, do you want to add?

A - Sven Althoff {BIO 19104724 <GO>}

Yes. As I said earlier, the increase in the major loss budget is not a good proxy for our expected growth in net earned premium on the P&C side next year. From a process point of view, we are fixing the major loss budget in the autumn of the previous year, so like we are doing now. So, the EUR1.3 billion is fixed for 2022. Same, of course, goes for the EUR1.1 billion we fixed for 2021. And we -- when we were fixing it at the time, we did not expect a premium growth of about 14% after three quarters on the P&C side, but we were more expecting a growth in the 5% to 7.5% range. So, a good part of the increase in the major loss budget is explained by catching up with the actual growth, which we have achieved in 2021, plus then the expected growth for 2022.

As Jean-Jacques said for 2022, we are expecting a more pronounced growth than the 5% on the P&C side. But you should think more along the lines of the mid-term average I gave you during the Investors Day, i.e., the at least 7% number I gave you a few weeks ago, rather than the 14% after three quarters. By the way, the growth number will come slightly back more to what the 10% growth number on the P&C side on the -- for the full year. The reason why the growth rate in the third quarter was particularly high, reset on our biggest structured contract, we have increased our share. So, there was a significant premium entry booked in the third quarter. But under that contract, we every year too have the appropriate premium distribution on an earned basis and written basis, there will be a significant number of premium booked out in the fourth quarter in 2022 on that particular contract. And that's why the final number for P&C will be closer to the 10% rather than staying at the 14.5%, where we are after three quarters.

Q - Iain Pearce {BIO 19522835 <GO>}

Perfect. Thank you.

Operator

The next question is from Darius Satkauskas of KBW. Your line is now open. Please go ahead.

Q - Darius Satkauskas {BIO 19724328 <GO>}

Good morning. Thank you for taking my questions. So, your Solvency II ratio have declined 11 percentage points since the end of July. Could you tell us how many Solvency II points did the expected growth account for? And then, is this capturing the next 12 months? So, the 4Q 2022 as well or -- sorry, is it capturing the next 12 months or the entire 2022?

And then lastly, do you have a comparable figure for last year, because if I look at the Solvency II decline in 3Q 2020 relative to 1H '20, it's much less pronounced. So, yes, could you give us a comparable figure if possible? Thank you.

A - Clemens Jungsthofel {BIO 22251357 <GO>}

Yes. On Solvency II, it's actually the business growth that we've seen in 2021, that is reflected. So, we've updated our model for the current business growth, which has been significant so far and also it includes the full 12 months of 2022. So, that's really the usual planning cycle that we complete in Q3, and then we include that in our SCR calculation for the full year 2022, so that's the new business both in P&C and in life and health. So that increases -- and then, of course, the higher capacities here and there in P&C and life and health. So that's the main driver.

I don't have the exact number, but it's going to be a double-digit number, which has been offset by some other effects, but I think it's about a double-digit number here. And again, another contributor was, of course, the asset risk due to our slightly changed asset allocation and the increase in alternative investments as mentioned earlier. That was another contributor.

Q - Darius Satkauskas {BIO 19724328 <GO>}

Thank you.

Operator

And we have a follow-up question from Vinit Malhotra, Mediobanca. Your line is now open again.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes. Thank you for the opportunity. Sorry to ask again, but on the life side, I mean, I'm just curious about a few things please.

One is that, if I just start with the operated -- the reported EBIT of EUR41 million, and add back COVID mortality data, the longevity is at EUR83 million. And then somewhere from the presentation, I picked up that financials -- the deposit accounting was also EUR95 million. So, ex deposit accounting, we actually have a loss of about EUR12 million. And I've been made aware that there are some derivatives which went up against in the financial -- in the financial statement. I mean, is there anything that you could comment on this surprisingly negative result on the life side, please? That's really my question.

And second question is, on this cover on the pandemic, I think there was a conversation also in the 2Q results, where it was mentioned that the cover wasn't being activated yet, because of Australian mortality trends, if I recollect. Has that changed? Or is there some update on that, that makes you think that next year you could choose this cover?

And last follow-up is on getting a question from (inaudible) is there any idea to break out this burned between (inaudible) and the whole account, please? Thank you.

A - Clemens Jungsthofel {BIO 22251357 <GO>}

Okay. The first question was the EBIT. I fully understand that you do a little bit of, let's say, recalculation, take a few things out and add others back in, but the COVID reporting of COVID claims is, let's say, at least very delayed, if not completely unreliable. So, making calculations especially on the quarterly basis, what the usual number would be, it's quite difficult. We don't get correct information from all our clients, and we definitely don't get it in time. So, adding or subtracting COVID claims from, let's say, audited claims numbers is -- it's a nice intellectual exercise, but I would not necessarily rely on the outcome here.

I can't see that we have a negative -- of course, we have a negative results if you look at the COVID claims on mortality side, it's highly negative, but we have a very stable financial solutions result. What you have seen in the other result here is the 351, of which 278 is deposit accounting treaties and they are completely unaffected by COVID. We also have very positive longevity result, plus even if you ignore the one-off of nearly EUR100 million, which is also only slightly positive impacted by COVID. And the EUR400 million COVID claims, of course, drag it down, but the underlying profitability is extremely high and stable. The great unknown for us is how the next COVID variant will develop in '22. And nobody can tell you anything about that.

A - Jean-Jacques Henchoz {BIO 17457677 <GO>}

Vinit, to briefly add probably, it just brings to my mind, what is the driver, and which might explain what you have observed is in part what Klaus mentioned the profitability of the underlying business, but has probably been a bit more pronounced in the first and the second quarter and less in the third quarter. But then on top of that, I think the investment result on the life and health side is less pronounced than on the P&C side, that's mainly attributable to the fact that alternative investments are mainly sitting within our P&C book. And also, the contribution from inflation linker is mainly P&C. And then, we have the mentioned derivative in the U.K. results and that is -- that was a deviation in the third quarter of roughly EUR10 million. So overall, that should round up the picture probably.

A - Clemens Jungsthofel {BIO 22251357 <GO>}

But definitely the COVID -- the reported COVID claims, not necessarily booked claims, but as COVID -- or the identified COVID claims have reporting lag of four to six weeks and even then they are not necessarily reliable, because an awful lot of people, everybody who gets into a hospital, gets tested on COVID, and if it's positive, even if that has nothing to do with the fact that, he just had a car accident and if he dies, he will be reported as a COVID claim in many countries. That doesn't happen. So I don't really rely on this analysis. Definitely not on a quarterly basis. And then, could you just repeat your question on the retro whether we have included that already in 2021?

Q - Vinit Malhotra {BIO 16184491 <GO>}

As the life pandemic cover was already running at a higher and I think at 2Q, you had said that you were not yet counting it in or factoring it because of Australian mortality claims.

Maybe I'm misunderstanding the whole thing. But maybe -- yes.

A - Clemens Jungsthofel {BIO 22251357 <GO>}

The cover is for all three countries in total. So, it's a parametric cover and this stands at 100 and close to 113 right now. If nobody dies for the rest of the year, this will fall below the 110 and we don't get anything. It's unlikely that we don't even see normal mortality. So, I expect definitely something in -- for this year, but it will only be calculated next year, because the calculation agent relies on official statistics and official statistics, population statistics for 2021 will only be available sometime in 2022. And sometimes it's not January or February or anything like that, well the second half of the year. These are civil servants who produce that.

And the calculation agent will only start calculating the final recuperation for us here, as soon as he has all the official statistics from the U.S., from Australia, from the U.K.

Q - Vinit Malhotra {BIO 16184491 <GO>}

And the EUR32 million booked in the U.S. COVID 3Q, that looked a bit lower and that could be also this late supporting, Klaus, that you mentioned?

A - Unidentified Speaker

Sorry --

Q - Vinit Malhotra {BIO 16184491 <GO>}

That in the third quarter, the U.S. was rather low mortality in booking of EUR32 million versus the deaths and the excess straight were nearly EUR100,000.

A - Clemens Jungsthofel {BIO 22251357 <GO>}

Vinit, sorry, I think -- apologies, Vinit. Go ahead.

A - Jean-Jacques Henchoz {BIO 17457677 <GO>}

I think the effect in Q3, the overall effect in Q3 was EUR140 million, EUR70 million to EUR80 million stemming out of South Africa. So that was the bulk. And I think, it's probably a bit higher number than you assume for the U.S. actually, but that was as expected, Klaus, wasn't it in life and health in the U.S.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay. Thank you very much. Thank you.

A - Klaus Miller {BIO 16886879 <GO>}

Yes. On burned, Vinit, you know that we have placed a little over EUR300 million of whole accounts coverage. So, you should think about burned in the terms of being a substantial partial loss against our whole account cover. I would not be comfortable to give you the precise split for the simple reason that the loss happened in the quarter.

So therefore, we have not received enough information yet to book each and every element of the loss on the bottom-up basis. So, there are still some top-down assumptions included in our gross number for burned. And depending on how that will fall in the end on individual contracts, the split between K and whole account is subject to change. So, whatever (inaudible) split, I would give you today, would be subject to that change. So therefore, I would feel uncomfortable to giving you very precise numbers. But as I said, you should think about burned as a substantial partial loss against our whole account structure with the remainder going to K.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Thank you very much. Appreciate it. Thank you.

Operator

(Operator Instructions) And we do have a follow-up from Thomas Fossard, HSBC. Your line is now open again.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes. Two quick questions. The first one would be on the life reside, this longevity PAD. I guess it was included in your EUR600 million EBIT contribution initially targeted for 2023 and that you move to 2024, but just wanted to -- I guess it was included at the time of the Investor Day. But just wanted to update on that, just to be fully aligned and fully clear. And the second question would be on the P&C side or P&C NatCat. What's your overall assessment of the profitability of your book? Maybe you could share with us the year-to-date combined ratio or the return on allocated capital you're getting on this book despite running ahead of budget? Thank you.

A - Clemens Jungsthofel {BIO 22251357 <GO>}

Yes. Thomas, this is indeed taking into account the longevity and benefits also that -- that's including the EUR600 million.

A - Klaus Miller {BIO 16886879 <GO>}

And on the NatCat, so as Jean-Jacques explained in the Q&A, during the Investors Day, of the NatCat portfolio is modeling well against our profitability hurdle rate. So, from pricing point of view, the last two rounds of rate increases certainly helped to get that portfolio to a better level of profitability. We expect further rate increases on the loss impacted business into 2022. So, from that point of view, we are okay with our profitability on the NatCat side, but at the same time, as we already mentioned on the Investors Day, we will keep our relative risk appetite for NatCat stable nonetheless. We are not seeing rates yet, which would make us fundamentally change our risk appetite.

On the result point of view, I'm afraid, I don't have those numbers for you. The NatCat is not a separate segment we are reporting upon, as you know, for few quarters now. So, I would not be able to give you those numbers, but Claude can get back to you on those.

Q - Thomas Fossard {BIO 1941215 <GO>}

Thank you. Thank you.

Operator

And there are no further questions at this point. So, I hand back to the speakers for closing remarks.

A - Jean-Jacques Henchoz {BIO 17457677 <GO>}

Well, thank you very much for joining, and thank you for the great questions. I think we covered the ground very well. You've seen a year impacted by large losses on both business segments that numbers demonstrating resilience, net income improved, the ROE above 10%. And I think the key message is that the profit guidance has been confirmed for this year with a positive outlook for 2022. The guidance for '22 shows both the growth trajectory of the company and the improved quality of the book. So, I think the key messages were addressed today. Thank you very much for all the questions and see you next time.

Operator

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