Q2 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

Other Participants

- Andrew Ritchie
- Ashik Musaddi
- Kamran Hossain
- Thomas Fossard
- Vikram Gandhi
- Vinit Malhotra
- Will Hardcastle

Presentation

Operator

Good morning, ladies and gentlemen, I welcome you to today's Hannover Re International Conference Call on Q2 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, thank you very much, and good morning, everyone. Welcome to our conference call presenting our results for the first half of this year.

As usual, I'll start with an overview before our CFO, Clemens Jungsthofel, goes over the financials in detail. I'll then comment on the outlook for the year thereafter. For the Q&A, I'm additionally joined by my board colleagues, Klaus Miller on the Life and Health side; and Sven Althoff for P&C.

I'm pleased to report that with a group net income of EUR671 million Hannover Re has successfully taken the next step towards achieving its full-year guidance.

Additionally, we continued to grow our business at attractive terms, at 12.2% the return on equity, return to pre-COVID levels even though the results of our Life and Health business group were still impacted by the COVID-19 pandemic.

Gross premium increased by 14.2% adjusted for currency effects. This is mainly driven by our Property and Casualty business group, where we recorded continued strong top-line growth on the back of improving market conditions.

The price improvements in P&C markets also support the technical profitability of our portfolio, which is in line with expectations at a very healthy level. Overall large losses stayed within the budget. Thanks to a benign impact from natural catastrophes in the first half.

In addition, our net estimate for COVID-19-related losses remained unchanged compared to year-end 2020. Hence, the combined ratio of 96% is a good reflection of the underlying profitability in the first half-year, and additionally, we have built up a further buffer of EUR150 million for large losses in the second half of the year.

As mentioned, the ongoing global pandemic, it's still having an impact on life and health reinsurance results. The main insurance market affected by COVID-related excess mortality continues to be the U.S. even though as expected the numbers decreased over the course of the first half-year.

Outside of the U.S., we recorded losses in particular in South Africa where Hannover Re also has a strong market position. All in all, losses connected to COVID-19 amounted to EUR263 million in the first six months.

As already disclosed in Q1, the restructuring within our U.S. mortality portfolio led to a positive one-off effect of EUR129 million, partly mitigating the COVID impact.

Finally, we reported pleasing premium growth of 7.3% adjusted for currency effects. At 2.7%, the return on investment is ahead of our expectations, driven by favorable ordinary income for capitalization according to Solvency II continue to be excellent confirmed by our strong solvency ratio of 250% at the end of the second quarter, well above our threshold of 200%.

The operating cash flow in the first half of 2021 was a particularly strong EUR2.7 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 this restructuring within our U.S. mortality portfolio of EUR640 million, driven by this positive cash flow, total assets under own management increased to a record high of EUR52.8 billion. This growth was additionally supported by ForEx effects and the issuance of EUR750 million in hybrid capital in March this year.

This new bond issuance is also visible on the next slide, bringing our total hybrid capital to EUR3 billion. We still have flexibility regards to our total hybrid capacity and shareholders' equity is up by 0.5%, which is quite positive bearing in mind that we pay the dividends in the second quarter. However, the group net income in the first half of 2021 was already sufficient, comfortably cover this dividend payment.

Finally, the change in OCI was only slightly negative because negative valuation effects were mitigated 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 20496428 <GO>}

Yes. Thank you, Jean-Jacques. Good morning, everyone. I hope you are all well.

As Jean-Jacques mentioned, the performance of our P&C business group was very pleasing in the first half of 2021. Gross written premium grew by a remarkable 17% adjusted for currency effects, which accounted for 5 percentage point. The growth is highly diversified, was particularly strong momentum in North America, Germany and South East Asia. And on top of this, we successfully expanded our structured reinsurance book where we continued to see a very healthy demand.

As already reported in the first quarter, the recognition of premium from the underwriting year 2020 supported the growth. But as mentioned also in the first quarter, this effect will dilute over the course of the year, bringing the premium growth closer to the growth numbers we reported for our renewals.

Major losses came in at EUR326 million, clearly below our half-year budget of EUR476 million, and as you know, in line with our usual practice we have kept the unused part of the budget within our IBNR as a buffer for the remainder of the year.

Additionally, we still feel comfortable with the overall net loss estimate of EUR950 million for COVID-19 and hence, did not see a need to change anything on this front.

The runoff of our reserves was at normal levels in the first half of 2021, development in second quarter was more favorable than in the first half. As we have not changed our conservative reserving approach, I would expect the confidence level of our reserves to be stable compared to year-end 2020. Altogether, the 96% combined ratio is fully in line with our expectations.

Net investment income increased based on the strong ordinary income and lower impairments, other income and expenses amounted to minus EUR109 million, mainly driven by negative currency effects, as we've seen in the first part of EUR77 million. Altogether the EBIT increased strongly to EUR778 million. Thanks to the improved underwriting result, which was heavily impacted by COVID losses in the previous year.

Finally, the tax ratio was slightly below the normal level due to a favorable earnings contribution from lower tech subsidiaries. As mentioned the total net large losses accounted for EUR326 million in the first quarter, EUR150 million below our budget, together with the regular budget for the second half this means we have a large loss budget of EUR774 million available to absorb losses in the second half of this year.

This is a comfortable starting point, I would say, but as we all know that we have already seen significant losses in the third quarter, with the biggest impact expected to come from the cloning events in Germany and neighboring countries as well as impacts from the riots in South Africa.

There is still uncertainty around the flood losses. But our initial estimate would be in the range of 200 million to 250 million for our net position. For the riots in South Africa, we expect a net high double-digit million loss.

Adding up those losses this means that we have started to utilize our actually Q3 budget, but more importantly, that we still have a significant buffer available for the remainder of the third quarter.

On the next slide, you can see that the largest individual event was the Texas winter freeze, with the total net loss of EUR136 million, this number reflects an increase compared to the end of the first quarter, which is mainly the result of late claims notification.

Still the overall impact from natural catastrophes was below expectations, on the man-maid side we have seen an above average frequency of losses. Altogether, we have already used up around two-thirds of the full year budget set aside for man-made losses.

The next slide as usual shows the technical profitability of our P&C portfolio by reporting line, picture is a mixed one as usual for our highly diversified portfolio yet we also do see material deviations. We do not see material deviations from the target combined ratios, large losses like the Texas freeze and man-made losses had an impact on a combined ratios in some of the segments as you can see, but the overall is 96% combined ratio, is fully in line with our target.

On the next slide, let's move to Life and Health. The pleasing business growth is reflected both in premium and in value of new business. We were particularly successful in expanding our financial solutions business in the APAC region, and in longevity, the growth is starting to also come from outside the U.K.

As Jean-Jacques mentioned the technical result was still affected by losses in connection with COVID-19, the main impact is visible in our U.S. portfolio where we have recorded losses of EUR167 million as expected the impact in second quarter was lower than in the first given the progress in vaccination.

Apart from the U.S., the (inaudible) of the losses from South Africa and as explained at our Q1 conference call, the restructuring part of the ING portfolio in our U.S. mortality book led to a positive one-off effect affecting different line items in the P&C [ph]. In total, the positive impact was EUR129 million partly mitigating the COVID-19 losses.

Furthermore, the underlying mortality experience in the second quarter was more favorable than in previous years. The ordinary investment income was, I would say, in line with expectations, the fair value of financial instruments decreased materially and the negative impact was driven by the valuation of a derivative embedded in a life insurance contract in the first quarter as we've reported in the first quarter already, while in the second quarter, the valuation increased slightly.

Other income and expenses are 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 effects was slightly positive in the first half-year and altogether, the EBIT of EUR179 million hits satisfactory and adjusted for the different positive and negative extraordinary effect actually slightly better than expected.

On the next slide, as usual, we also have a look at the non-IFRS metric for business growth in life and health, the value of new business according to Solvency II. On this slide, you can see that we were quite active in all reporting categories and also the pipeline for new business remains healthy.

The business opportunities we have seen and are seeing going forward a highly diversified, but the opportunities are particularly good in developed markets and -- by reporting categories in the area of financial solutions.

Looking at the indicator for new business value, at the bottom, we have achieved roughly half of the full-year target, but as you know, transactions in life and health are often right about the -- and the value of new business is also closely linked to the duration of the business written. In any case, I think it's fair to say we are well on track in terms of new business production in life and health.

The next slide, the investments, the development of our investments in the first quarter of 2021 was very satisfactory in the first half. The ordinary investment income is particularly strong, this is mainly driven by increased contribution from our alternative investments, I wouldn't say that these contributions are extraordinary but the distributions of our private equity funds can naturally be volatile from quarter-to-quarter, this also means that one should not simply extrapolate those (inaudible) for the remainder of the year.

Further drivers for the strong ordinary results are the increased asset volume in the slide strategic shift in our asset allocation, which is certainly helping to stabilize the book yet [ph] in our fixed income portfolio.

Realised gains are mainly the result of normal portfolio management and around EUR50 million are linked to the partial disposal of listed equities in the first quarter.

Impairments and depreciations decreased compared to the previous quarter, where we had recorded some impairments in the volatile market environment. So this year's number is more or less as expected low levels, I would say, to a large extent comprising regular depreciation on our real estate investment.

As explained in my comments on life and health, the derivatives valuation was negative. The overall return on investments was 2.7%, meaning that we are on a very good path to achieving our full year target of roughly 2.4%.

Unrealized gains decreased by around 500 million, mainly due to the increase in interest rate, in particularly in the first quarter. In the second quarter, we've seen some reversing trends bringing the total to a very high level of EUR3 billion.

On the next slide, a quick glance on the asset allocation, I think it's -- the asset allocation has developed pretty much in line with our strategy, the most notable change, as you can see is that we've slightly increased the share of corporate to 32%, here we invested according to, I would said, a broad-based approach with a focus on developed markets.

The contribution to ordinary investment income is diversified as usual. The highlight is probably the recovery as mentioned in the contribution from private equity, to the very strong levels, we had seen before the market volatility caused by the pandemic in 2020.

On the next slide, for the first time, we have also included the final result of the 2020 annual reserve review by Willis Towers Watson, which we usually published for our investors, let's say. This year the report was available ahead of the Q2 publication and hence we thought it would not make sense to withhold that information until October.

So looking at the numbers, the overall redundancy level have increased by 80 million in the year 2020, should not be surprising because it's fully in line with our comments from March. That still -- it confirms again that the results we achieved in a challenging year 2020 was not at the cost of our reserve and quality, and that the buffer of more than 1.5 billion remains to be very comfortable.

To conclude my remarks, the overall results for the first half of 2021 does include a few larger extraordinary effects but both the reported net income and the underlying business development very much support our guidance for the full year.

And I hereby, hand back to you, Jean-Jacques for the target matrix and for the outlook.

Jean-Jacques Henchoz {BIO 17457677 <GO>}

Thank you, Clemens. A look at our target matrix confirms the successful business development in the first six months of this year. Growth is significantly ahead of the strategic targets and our main profitability target for the group. The return on equity is well above our minimum target.

The EBIT growth targets in P&C and Life and Health are somewhat distorted by COVID claims. The targets are more oriented towards normalized growth over the course of the strategic cycle.

The mid-year treaty renewals were again successful for Hannover Re, we were able to further grow our business as improved pricing, one could argue that the price increase of 3.2% in total and 6.4% in non-proportional business is a slow down compared to the January and April renewals.

However, I'd like to point out that the rate increases in the mid-year renewals in 2020 were the strongest in terms of rate increases for Hannover Re and therefore the 3.2% rate increase achieved this year comes on top of a higher basis than in January and April.

In North America, one important driver is the continued positive trend in primary insurance markets, both in terms of pricing and volume growth. Both factors have a direct positive impact on our proportional portfolio because we wrote the business at overall stable commission levels.

In Australia and Latin America, rate increases were most visible in loss affected areas. The development in credit insurity was slightly more stable, but here too, the quality and volume of our book went up. Altogether, the growth rate of 14.7% is the highest in this year's P&C renewals and I'm very pleased with the overall outcome of these mid-year renewals.

This brings us directly to the next slide. Looking back at all important renewal dates in 2021, the expectation for the full financial year looks quite favorable. The volume in most areas is going up at attractive profitability levels, for the entire portfolio, Clemens already flagged the pickup in loss activity in the third quarter, which together with the outcome of the hurricane season and other loss activity will determine the profitability levels and also the momentum for further price increases in 2022.

In general, I'd expect the underlying pressure for rate increases in reinsurance to carry on to the next year. Mainly because interest rates are expected to stay on the low level and also climate change related loss trends, which you again became visible with the recent flood and drought events, will not only further support the need for pricing discipline but should also act as a driver on the demand side.

Finally, the currently higher inflation levels will also have to be reflected in the upcoming pricing negotiations. In Life and Health reinsurance growth is expected to be well supported by our strategic initiatives and most pronounced in financial solutions and longevity.

In both cases, the profitability expectations are clearly above the cost of capital. In mortality, there remains uncertainty around the further development of the pandemic. Excess mortality will be most visible in countries where progress with vaccination programs is slow. However, the trend in depth in countries where vaccination programs have slowed at a higher level is also dependent all the management of the pandemic in the respective countries.

In particular, in the important U.S. markets, we've not seen a reversal of the decreasing numbers of COVID-related depth. The premium in mortality is expected to be stable and the same applies for the overall development in morbidity.

As mentioned earlier by Clemens, the business development in the first half of 2021 is in line with our guidance for the full year. The improved technical results in P&C is fully in line with expectations and our COVID-19 reserving, in P&C's confirmed to be adequate at EUR950 million net.

Additionally, the losses already impacting the third quarter. Do not have an immediate impact on the guidance because we have a large loss budget of EUR774 million available for losses occurring in the second half.

COVID losses in Life and Health were slightly higher than expected. But on the other hand, the performance of our investment portfolio is ahead of expectations for the full year.

So even though some factors within our guidance deviate from our initial planning, we continue to feel comfortable with the guidance for group net income and has kept it unchanged.

Also unchanged is our positive view on the dividend policy and the potential to pay a special dividend if profit targets are reached and our capitalization remains strong.

This concludes my remarks and we would be happy to answer your questions. Thank you very much.

Questions And Answers

Operator

(Question And Answer)

(Operator Instructions). And our first question comes from Vikram Gandhi, Societe Generale. Please go ahead. Your line is now open.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Hello. Good morning, everybody. I've got three questions, all related to P&C. Firstly, appreciate the COVID loss estimate is unchanged at EUR950 million but if you can shed some light on the moving parts within that EUR950 million, whether some of your estimates are going down, some are going up, lets say, quick insurity coming in a bit benign, BI going up. Any color there would be appreciated.

Secondly, can you help us with the overall level of IBNRs within that 950 million?

And thirdly, if you can help us understand how the runoff result has developed over the second quarter on P&C? That would be great. Thank you.

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

Thank you. Sven will address your questions.

A - Sven Althoff {BIO 19104724 <GO>}

Yes, good morning also from our side. Happy to give you a little more insight into our COVID numbers. So you already heard from Jean-Jacques that the net number stayed at 950 million as the year end closing 2020. We had very little movement on the gross side of the loss. We saw some additional claims coming in from the contingency event, cancellation business, which was roughly 30 million higher compared to the previous quarter.

All other reviews that developed very stable. So this is the only markable increased on the gross loss. The reason why is the net position stayed unchanged, is that due to seasoned advisors more of the property claims moved from bulk IBNR into treaty specific reserving. So that we could book those losses against our web professional structures keeping the net position overall unchanged.

On the credit insurity side, you're right. What we have seen so far is relatively low level of reserves coming in relation to the 235 million, we have booked on that side, but we have not decided to reduce that number in the second quarter. We will obviously, closely monitor that situation but I would say that 235 million we are starting to see some prudency by now.

And it comes to the distribution of pet versus IBNR losses on COVID, we saw an increase of the pet number going from 15% from the first quarter to 21% in the second quarter, which of course is fully in line with expectations. The overall level of IBNR, be that bulk or be that treaty specific IBNR is still at the level of 54%. So we currently feel rather comfortably reserves with our 950 million on the P&C side.

And it comes to the run-off result in general, the first half of the year and the second quarter in particular that not show any development which were outside of expectations. So the run-off, the ordinary run-off result for the second quarter standalone was a positive 190 million, as I said, fully in line with our expectations.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Thank you very much.

Operator

Our next question comes from Andrew Ritchie, Autonomous. Please go ahead. Your line is now open.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Hi, there. Good morning. First question, apologies, if I ask this at every renewal, but I wonder, Sven, if you could just recap again. How we should think about the reflection of pricing changes on proportional business? I guess, I think the effectively you're not obviously reflecting the underlying original change in pricing, you're just reflecting any changes in exceeding terms. But maybe if you just give us a bit of color again around that to the extent to which the headline price doesn't necessarily reflect the underlying economics of the business.

Second question related to pricing. I guess, I'm just interested in opinion on European cat pricing and then the outlook. I mean, for years, it's been regarded as a diversifier and therefore it gets heavily subsidized and the pricing doesn't necessarily react too much to loss experience. Do you think that's going to change with the effect of these losses and/or higher profile or higher awareness of risk?

And the final question was on the reserve surplus of the year-end '20. How is COVID reflected in that? I'm assuming the COVID claims are not part of that reserve surplus, there's no assume surplus on the COVID claim within the reserves. But I'm more interested in the good news that COVID helped, particularly, in terms of the nine frequency because I think everyone experienced, an increase -- a technical increasing reserve surplus in 2020 because ex-COVID claims notifications were benign. So how's that been sort of reflected in the analysis? Thanks.

A - Sven Althoff {BIO 19104724 <GO>}

Yes. Let me start with your question on the pricing size, Andrew.

The pricing effect on the (inaudible) side is, of course, mainly driven by the (Technical Difficulty) consistent, so production including commission, for example, but we are also reflecting some of the price increases, we are seeing from our leading companies still the primary market, is when we are looking at price adjusted improvement.

We always take a haircut on the (inaudible). For the simple reason that we are not in full control of what are the underlying factors when our exceeding companies are reporting about their rate increases. We not always have full transparency to what extent those before the numbers are risk adjusted. So therefore, we are taking a haircut, but the combination of the two would be what we are giving numerous information on the same pricing on the approval.

When it comes to your question on European cat pricing, we as Jean-Jacques already said, we still see positive movement in both the insurance and free reinsurance markets. So a general assumption would be that there will be a small (inaudible) plant in European cat pricing in general. But of course, we expect higher increases on the lot impacted the business, would be expected this stage that this is going to be much more significant increases and you saw for 2020 that I would say we don't have that expectation right now.

And lastly, yes, of course, you're right. The general benign environment in 2020 in many -- of business due to COVID, like for example, in motor business, but I would say given that I don't have a precise number for you, how much status played in to increase in redundancy that we have reported. Debt reduction frequency is mostly involving very young underwriting years. We are normally -- we are not needing reflecting any redundancies in our deposit come [ph] or if we do both very, very limited extent. So this should not have been the main driver of us showing a higher redundancy --

Q - Andrew Ritchie {BIO 18731996 <GO>}

Okay. Thanks.

Operator

Our next question comes from Kamran Hossain, RBC. Your line is now open.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi. Good morning. Just wanted to ask about the Life and Health business. You've pulled out, I guess, for the first half South Africa was a major part of the claims that you saw in the life business. Could you maybe talk about how this is Q1 versus Q2, you didn't specifically go out just South Africa in Q1, but you did it in first half. Just eyeballing a chance of kind of COVID deaths in the first half of the year, it was pretty bad at the beginning of Q1 and it didn't really kick up until right at the end of Q2. So just interested in weather is any late reporting factors or something else going on there? And I guess given the ex-U.S. component of the life claims in Q2 about EUR50 million I think just kind of -- envelope. Is that a reasonable number for us to -- into the third quarter? Thanks.

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

Yes. I'm happy to take that. First of all, most of all our claims are still been from the U.S., so 60% of the claims we have seen this year is from the U.S., about 20% was from South Africa and this picked up especially with the delta variant in the second quarter. Main issue is that the vaccination rates in South Africa are still very low, although they're now picking up and this is what I would expect around the world in most of the countries, where we currently have been, let's say, little bit surprised about the COVID claims, Latin America is one other example.

Vaccination rates will go up significantly in the next couple of months in these countries. So I'm not really concerned for the full year, I'm still concerned for the next one or two months. But in total, this is a small part of our bottom line result.

And -- sorry, what was your question about the 50 million? I didn't quite get that.

Q - Kamran Hossain {BIO 17666412 <GO>}

-- the ex-U.S. COVID claims in Q2, they look like they're around 50 million, given that Patrick is now going at a higher pace now, in terms of deaths and it was pretty much in line with what you saw at the beginning of Q1. Just trying to get an idea where the 50 million for the quarter is a reasonable number for us --

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

There is certainly a little bit of late reporting here. We have even in developed countries, the late reporting of four to six weeks for the cause of death, and you can certainly expect this in South Africa as well.

What is -- especially, a very special in South Africa, a lot of our business in South Africa is cash financing business. And this has a certain risk, which comes with lapses and with mortality, but there is an implicit buffer for these cash financing deals.

The client usually wants to have the option to recapture the business after a certain while and especially when we believes we paid back the initial financing amount and this has a buffer implicitly built-in and as long as we ultimately get back our money, higher mortality claims even increase profitability because the treaty just runs three, four, five years longer, as long as we still get back our money and so we have absolutely no negative from this.

But it might take a little bit longer. So this can be seen as just an additional financing. Because in certain years like this year, there was a loss and there was no repayment or recuperation of the initial amount, but if the treaty just runs three-four years longer, we might not even have a claim there.

Q - Kamran Hossain {BIO 17666412 <GO>}

That's right. Thanks so much for the additional color. Thank you.

Operator

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

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes. Thank you. Good morning, everybody. So maybe three questions in a bit quick follow-up. The first one. So first is on (inaudible) the profitability outlook on Slide 23 today. As Americas bit lower and Asia-Pac a bit improved. And also Asia-Pac you mentioned somewhere significant premium growth under APAC growth initiative. Could you just help us understand what's the magnitude here? I mean and -- what's the rationale for the Americas lowering results? That could be important.

Then the second question on credit insurity, there is 20 million launch -- mention. Also the combined ratio 1H is much worse than 1Q, 94% in 1H, 83% in 1Q, is it all coming from this large loss or is there also something else? Because I think I also heard you're trying to say that credit insurity still benign for COVID.

Then third question is, seeing your report comment about IO part, harmonization policy for third country insurance for the convergence plan and you highlighted it as a risk. We -- good to know whether you, I mean, how big is the problem you think this could be?

And just very, very quick one, fourth one is, there is a mention of another layer of extreme mortality cover placed, you comment on whether any life mortality has seen any recovery from some of these parts? Thank you.

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

Thank you. So, Sven will address the P&C question and mortality will Klaus. On (inaudible) we don't have an immediate answer to your question, I think we might need to come back to you thereafter on exactly where the information comes from. Sven, first.

A - Sven Althoff {BIO 19104724 <GO>}

The reason why we changed the profitability outlook from plus or minus for APAC to plus and the Americas from plus to plus, minus is just a reflection on the combined ratios, we are reporting after the first part of the year.

You can see on Slide 10, that the Americas are currently over and above their target combined ratio, the main driver here, of course, is winter storm Uri, whilst at the same time the APAC region is significantly below its target combined ratio in the first half of the year.

There are no structural problems in those portfolios from a profitability point of view, but we just felt it appropriate to switch our two guidances around particularly for the U.S. because we still have the full hurricane season ahead of us, so it's always a little difficult to predict how much of a positive catch-up we will have for the remainder of the year to eventually bring Americas into line with the target combined ratio.

On credit insurity, you're right, as I said, the actually reported losses from COVID so far have been below or significantly below our expectations. We have nonetheless decided going into the underwriting year 2021 to have a relatively high ultimate loss ratio picks compared to the historic average for the simple reason that many economies are only just starting up after long lockdown period from COVID.

We still have positive government measures in place in many countries, which are bound to go into run-off at some stage, which of course is leaving the question will we see a heightened level of insolvencies later in the year. So out of precaution, we have therefore decided to start the year conservatively from an ultimate loss ratio point of view. And of course, you're right, one of the ingredients here is the credit loss, we are reporting due to payment delays for a project engine in Africa. Hope that answers your question on the P&C side.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes. Thank you.

A - Klaus Miller {BIO 16886879 <GO>}

Then I will continue with the retro cover on the life and health side. I guess, you're referring to our increase of the pandemic cover, we have recently placed again. So far we had for this year, and last year we had 255 million cover, which is about to attach or has already attached.

So we have placed another EUR18 million starting with 1st of January 2021. That means we have covered this year. Same terms and conditions as previously but the reference year is always the last year. So we need significantly worse experience for these EUR80 million compared to last year. And last year obviously was higher than the year before.

So, it still attention says, 110%. But the reference here, is last year. So, it's a little bit more out of the money, but the EUR255 million, we have in place already are covering us for this year.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Right. And we have recorded some benefits already in 1H?

A - Klaus Miller {BIO 16886879 <GO>}

No. We have not taken that into account. The reason for that is, we have an expectation that currently the index is at about 112%, but if the mortality is significantly lower in the rest of the year and we're not talking about population mortality in general, we talked about the weighted-average of the population mortality in the U.S., U.K. and Australia, and the waiting is according to our portfolio, if this is significantly better and for instance in Australia that could be the case because they are all keeping their distance, they don't let anybody into the country and they keep mortality very low, this also keeps infections very low and maybe mortality in Australia could even be better than the attachment we currently see might disappear by year end that's possible or it grows if there is another variant of the virus. So this is the reason why carefully accounted for we didn't take that into account so far.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Thanks, Klaus. Thank you.

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

And we'll come back to you. We had a generic statement on IOPA more to comment on the development of Solvency II rules and the different discussions with the commission which is like to look at it. There was more of a general statement but we'll follow up with you on the specific topics which are in under discussion.

Q - Vinit Malhotra {BIO 16184491 <GO>}

You mean this is all really useful (inaudible) to it generic comment. That's also helpful to know. Thank you.

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

Thank you.

Operator

Our next question comes from William Hardcastle, UBS. Your line is now open.

Q - Will Hardcastle {BIO 16346311 <GO>}

Hi there, guys. Two quick ones, one long term. Just thinking about the reserve redundancy, very good to see this going up year-on-year, despite the tough 2020 backdrop. I didn't quite get the answer they're relating to how I should think about COVID at year end, and how that influences year-on-year, is this blurring the number or could you just give me a quick answer, follow up also on that if that's possible?

And how do you think about this number, do you tend to give us the absolute number, so the 1.5 billion or as a percentage of net reserves when considering adequacy sales, when looking at the business?

And then a bit more shorter time, I guess, is there any more information you can provide on the European flood loss anything to do with industry loss assumptions, how you derive your estimate? And whether there's any assumption of retro attaching and perhaps there's an extension to that. Is there any aggregate protection you have in place that would therefore more -- be more like these be utilized should the remainder of year see increased activity? Thanks.

A - Sven Althoff {BIO 19104724 <GO>}

The reserve redundancy as Clemens already mentioned, there is a zero impact from COVID in the reported numbers. So we are not reflecting any redundancy out of our P&C COVID reserve and the EUR1.5 billion we are reporting form -- the way we are looking at it, we are of course not only looking at the absolute number but also on the relative number in relation to our overall reserves.

Here we could see a slight uptick coming from to 5.5% in 2019 to 5.6% in 2020. So the increase of 18 million was a little higher in proportion than our general increasing reserves, which of course is a positive developing -- development considering that we have more than -- we have EUR950 million of new reserves from COVID alone, which of course goes into that take relation as well.

On the flood loss, we said that we expecting a net position of 200 million to 250 million, of course, extremely early days in assessing the situation, but (inaudible) we would say that the associated market loss was this range is between EUR5 billion and EUR7.5 billion. It's also a little too early to tell how exactly our reinsurance structures will or retrocession of structures will come into play because so far we have mostly worked on bulk numbers and in order to know the precise effect on how our retrocessional cover is going to attach, we need more treaty specific information in order to see what may trigger, what may not trigger.

So we will, of course, be able to report on that when we are talking about our Q3 figures in a few months time. But for now, I can't give you a precise information here.

To your last question, I mean, on the property side we are buying three vehicles of retrocession, one of the proportional contract, our -- transaction, then we have our event tower what we call our whole account -- loss protection and the last ingredient is our aggregate cover on large losses, so to answer your question, yes, we do have an aggregate cover in place, right now given the general benign NatCat environment in the first half of the year, even with the flood loss we are not near the attachment point yet, but in case, we should see frequency and severity for the rest of the year, this protection of course potentially will come into play.

Q - Will Hardcastle {BIO 16346311 <GO>}

That's great. Thanks.

Operator

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

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes, good morning, everyone. Two questions. The first one will be on the top line growth, so since the start of the year combining PC and live free, you grow your growth region premium by EUR1.3 billion. It's pretty significant number. Could you maybe tell us how much capital this has required to support the growth in the business? That would be the first question.

And the second question. Just following up on Will's question regarding the redundancy on the P&C side and because you're bringing this information to us today. Can you talk a bit more about combined ratio -- reported combined ratio. And I would say the economic combined ratio because I mean, actually it's now two years in a row where you're reporting nice improvement in pricing. But I mean you're combining -- your reported combined ratio is relatively flattish or in line with your guidance but flattish, implying that actually you're not showing yet any improvement in the margins. So I guess that there is something going on in the background. So, yes, it would be interesting to talk about economic combined ratio. And at the end of the day, if there is a -- to go back to the 1.8, or to somewhat I would say, higher redundancy reserve at the percentage of reserves, using the current relatively hard market cycle, which will increase again your confidence level?

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

Maybe we start with that P&C question on combined ratio, Sven.

A - Sven Althoff {BIO 19104724 <GO>}

On the combined ratio is always what we have said over the last couple of quarters when we changed our guidance from 97% to 96%, is that -- this is a food and approach from our point of view, we are not translating rate increases one-to-one and two -- ultimate loss ratio reductions when it comes to our Actuarial picks.

We do take cuts on that and by -- reserve -- conservative initial reserve, which the profitability will show, but it will show all the time. It will not only show in one calendar year. But hence, we are comfortable with our 96% combined ratio targets and of course also quite a bit of our growth is coming from the structured business where margins are typically in the 2% to 3% area. So what the traditional P&C business is of course seeing very good levels of rate increase.

The margins on the structured business are relatively unchanged. Here of course our main competition other financing instruments and you all know what the interest rate environment looks like right now. So therefore margins on that size have been relatively stable and that business is standalone would produce combined ratios over and above the 96% target combined ratio.

Q - Thomas Fossard {BIO 1941215 <GO>}

Thank you. Clemens, a word on capital consumption?

A - Clemens Jungsthofel {BIO 20496428 <GO>}

Yes. On capital consumption, Thomas, I mean, I don't have the exact nominal number top of my head, but if I try to answer the question by looking at our Solvency II ratio both at year end where we stated a roughly fleet 235 and now at 250, say, the main driver between some movement on credit spreads and interest rates and currencies such as being, the main driver was with 10 to 12 percentage points, certainly the hybrid.

And I would say a single digit number is really attributable to the business growth. So that has to some extent, the effect to number, but not to a material extent.

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

I could add something from the life side here. I know that this is the smaller number of compared to P&C but even they are you cannot just expect that the premium growth will be reflected to 121 in the capital requirement. The main areas where we are growing is longevity, and financial solution and the premium number in financial solutions, just comes from cash. Cash financing and build lines of business longevity as well as cash financing diversified very well in our internal model. So, the additional capital requirement are minimal from the life side.

Q - Thomas Fossard {BIO 1941215 <GO>}

Excellent. Thank you.

Operator

Our next question comes from Ashik Musaddi, JP Morgan. Please go ahead. Your line is now open.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Yes. Thank you, and good morning, everyone. Just a couple of questions I have is. First of all, sorry to go back on the reserve rudimentary number. I mean, you're at 5.6% at the moment, historically I think Thomas was flagging this as well. I mean, you were at the higher number. So, would we have any intention to move to a higher number? What needs to happen for you to move to a higher number when given the pricing backdrop? Would you say that you'll be going to work 6%, 7%? Or you're okay with the current level?

And secondly, I mean, if I look at the life insurance because I mean, if I you had large doses on COVID in this quarter as well as investment income was pretty low compared to historical standard but yet the earnings were pretty strong on a relative basis like after COVID and or investment. So what is driving that underwriting thing in life business would be good to get some color? And just last question is on investment income, your ordinary investment income increased quarter-on-quarter by about 30 million, 40 million is that the function of second quarter dividend or is this some one-off some alternative investments as you mentioned on the course? Thank you.

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

Clemens --

A - Clemens Jungsthofel {BIO 20496428 <GO>}

I'll start with a first one and then catch up with you probably on the last one, I didn't fully get it but we can probably pick up that one. So on the reserving side to be honest I think it's fair to say that, we don't really plan the redundancies sort of as part of our planning process we do we will do a reserve study of course at the end and we see how, all the elements it's been mentioned etcetera, how that comes into play and how we can build up redundancy. Having said that, I think we do feel comfortable with the reserve level that we have at the moment, but we would also be prepared to build up further buffers as the surpassed by. And if you wouldn't mind, -- would you mind repeating the last question?

Q - Ashik Musaddi {BIO 15847584 <GO>}

Yes, sure. I mean, your ordinary investment income increased by about 30 million, 40 million quarter-on-quarter. So, I think last quarter was 330 million to 335 million this quarter is 375 million. I think the increase -- I just want to understand is that increase just as -- because second quarter is dividend heavy, the probably you've got some dividend and that's why it hits an increase or is it driven by any one-off revaluation or anything like that from alternative investment?

A - Clemens Jungsthofel {BIO 20496428 <GO>}

Yes, it's really coming from -- mainly from our private equity portfolio. Well spotted, it's really -- we've seen already is in the first quarter that we saw a pickup particularly compared to last year on distributions from our private equity investment portfolio and that has actually accelerated further in the second quarter. So year-on-year, that's really the increase in contributions in our ordinary income. There's a slight impact also from our inflation linker. We do see a higher contribution from our inflation linker, but there is a time lag in the way we amortize these into our ordinary income. So we will see further impacts probably in the first quarter.

Q - Ashik Musaddi {BIO 15847584 <GO>}

You mean the positive impact?

A - Clemens Jungsthofel {BIO 20496428 <GO>}

Yes.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Okay. Thank you.

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

And Klaus, maybe --

A - Klaus Miller {BIO 16886879 <GO>}

Yes. I'm very happy to take the life and health question. We have the pretty strong underlying profitability for our book. This has been a little bit difficult to see in the last couple of years where we had some brock impact, some disability impacts from Australia so three, four years ago, but the shift you have seen in our portfolio even for the last 10 years was way from risk business 12 financial solutions business and longevity. And we're working on that for about 10 years now.

And the financial solutions business has a profitability, which is basically stable in these times with COVID, longevity is stable or even positively impacted. And of course, we have significant mortality claims. We have paid 260 million last year, 260 million already this year in the first half, so more than half a billion of claims, but the underlying profitability is extremely strong and extremely stable. On the longevity side we expect profit, profitable cash flow in the next 20-30 years of more than 1 billion. But there won't be any spikes. It will just come through in the ordinary way, and the way how we calculate and I reserve for that. So, I'm personally not surprised by those relatively strong results excluding COVID.

Q - Ashik Musaddi {BIO 15847584 <GO>}

But you would not say that this is like driven by longevity one-off, just because -- just is the opposite effect of mortality. You would not say just that, there is some underlying as well.

A - Klaus Miller {BIO 16886879 <GO>}

It's not run by any one-off on the longevity front. The longevity result was 3.5%. And that's exactly in line with our expectation, 3.5% of premium margin. Not a really good margin, I always argue against it, we shouldn't look at it this way, but the expected margin on the longevity side should be something between 2% and 4%. And we are just in that range right now.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Thank you.

Operator

(Operator Instructions) And we have not received any questions at this point, I'll hand back to the speakers.

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

Thank you very much for joining this call. As I think we wanted to convey the key message that we're well in line with our full-year guidance, we have solid growth across the board. We have good momentum in P&C with the pricing, solid pipeline both life and non-life.

And we can confirm with a good level of confidence. Our outlook for the year and the guidance in spite of the continuing COVID burden in Life and Health, in P&C COVID as discussed is expected to be stable and we can confirm that with this outlook and assuming result inline with the guidance we intend to pay an attractive dividend, which would include an extraordinary dividend if conditions are met. That would be the key messages for today. And thank you very much for joining and see you next time.

Operator

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