Q2 2020 Earnings Call

Company Participants

- Jean-Jacques Hencho, Chief Executive Officer and Chairman of the Executive Board
- Klaus Miller, Member of the Executive Board - Life & Health
- Roland Helmut Vogel, Chief Financial Officer and Member of the Executive Board
- Sven Althoff, Member of the Executive Board - Property & Casualty

Other Participants

- Andrew Ritchie, Analyst
- Kamran Hossain, Analyst
- Paris Hadjiantonis, Analyst
- Thomas Fossard, Analyst
- Vikram Gandhi, Analyst
- Vinit Malhotra, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. I welcome you to today's Hannover Re International Conference Call on the Q2 2020 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 Hencho {BIO 17457677 <GO>}

Well, thank you very much and good morning ladies and gentlemen. I'd like to welcome you to our conference call presenting our results for the first half of this year. As usual, I will start with an overview before our CFO, Roland Vogel goes over the financials in detail. I'll then comment on the outlook for the year and for the Q&A, I'm additionally joined by my board colleagues, Klaus Miller and Sven Althoff.

Despite burden of the COVID-19 pandemic, Hannover Re can look back at the first six months that demonstrated again the risk bearing capacity of our business model and in light of the fact that we have absorbed in total pre-tax impact of more than EUR660 million from COVID-19 in our P&C and Life and Health segments. The Group net income of EUR402 million is quite satisfactory.

The solvency ratio of around 225% at the end of the second quarter remained comfortably above our threshold of 200%, which is even more positive. Additionally, Hannover Re was able to grow the gross premium by 12.2% adjusted for currency effects, confirming the good position of the company in an improving market environment.

Going into the details of the COVID-19 impact, in P&C reinsurance, we have booked around EUR380 million related to COVID-19 claims in the second quarter, bringing the full impact to EUR600 million including the EUR220 million from the first quarter. This increase is the result of additional market information and further scenario analysis also including some bottom up market information at this time. The major part of the EUR600 million takes the form of IBNR reserves and affected business lines are largely the same as in the first quarter, namely business interruption, credit and surety, and event cancellation.

Apart from this, we expect some other lines to be impacted to some extent and have reserved for this accordingly. Due to COVID-19 related losses, the large loss budget of EUR414 million for the first half of 2020 has been exceeded by EUR323 million. This also explains the 102.3% combined ratio, which is above our target of 97%. The COVID-19 impact of the result of our life and health reinsurance business group was EUR63 million. Against this backdrop, the EBIT of EUR214 million is strong pointing to a good underlying profitability, particularly in our Financial Solutions business, which is unaffected by the pandemic.

Also excluding the COVID-19 impact, the US mortality experience was in line with expectations. At 2.7%, the return on investment is still satisfactory, even though initially effects of the volatility on the market at a moderate impact in the second quarter.

The next slide confirms that new business production is fully intact, despite the changes in our working environment due to COVID-19. Our profitable premium growth is the main driver for the very positive operating cash flow of EUR1.7 billion in the first half of 2020 and has also fueled the growth in assets under management shown on the right side of this slide.

Looking at the details of our assets, the positive change in valuation reserves was partly mitigated by negative effects from currency translation. Altogether, assets under own management stood at EUR48.8 billion at the end of the second quarter. Looking at our capital position, shareholders equity increased slightly. This is quite positive against the backdrop of our EUR663 million dividend payment in the second quarter. And given the fact that the Group absorbed a negative COVID-19 impact of approximately the same amount in the first half year.

Admittedly, the positive impact from the decrease in interest rates was helpful more than compensating for negative effect from increased credit spreads and currency translation, a leading to an overall increase in the OCI. The composition of the total capital on the left side of this slide is unchanged. The EUR500 million hybrid we issued in early July is not included in these numbers and will be reported in the third quarter. However, the picture on this slide might still look quite similar at the end of the third quarter because we have another EUR500 million of hybrid with first call date in September.

In any case, the new hybrid issuance can be seen as additional capital because we had already issued a EUR750 billion bonds in 2019. The reason for the issuance of additional hybrid capital is two fold. Firstly, the market environment is favorable and secondly, we want to be in the best possible position to take advantage of improving market conditions in the reinsurance market.

Finally, it is also important to mention that we still have a high degree of flexibility around hybrid capacity, also including the increased leverage.

On that note, I'd like to hand over to Roland, our CFO, who will as always explain the figures in more detail.

Roland Helmut Vogel {BIO 16342285 <GO>}

Yeah. Good morning and thank you Jean-Jacques. Moving directly to the segmental reporting, I will start with the development of our Property and Casualty business group. On a highly diversified basis, gross premium grew by 16% adjusted for currency effects and here the Americas and the APAC region contributed particularly well to this growth. And overall, the development was more driven by property than casualty business. The large loss situation for Hannover Re was similar to the first quarter and can be split into two parts, on the one hand the normal large loss experience was rather benign. On the other hand, we had the impact from COVID-19. Compared to the first quarter, our more detailed scenario analysis takes into account the additional information we have received over the last three months. For example, regarding the exposure for business interruption in all the different countries and sectors including their respective uncertainties. But our various scenario still produce a broad spectrum of potential impacts on earnings. We are in a situation, where we have not yet received the large number of claims notifications from our clients yet and hence around 80% of the estimated $600 million total impact consists of IBNR reserves based on our internal scenario analysis.

Jean-Jacques already mentioned the affected lines of business. By region, the exposure is really across our book. We expect to see the biggest impact in the EMEA region, particularly from business interruption. Overall, even though the EUR600 million provides headroom for actual claims to be reported, we do not feel that we have sufficient data or are able to make assumptions reliably enough especially around the duration of the pandemic that would enable us to come up with an estimate we could call final.

As a result of the reserving for COVID-19 related claims, expectations, the large loss budget for the first quarter was exceeded by EUR323 million, which accounts for roughly 4.7% combined ratio points, adjusting the 102.3% reported combined ratio for this budget overrun the figure would have been close to our 97% target. Just as as a note to standalone Q2 budget of EUR226 million was exceeded by EUR227 million and therefore increased the combined ratio by 6.4 percentage points.

The run-off of our reserves overall was positive in the first half year 2020 and the development in the second quarter was more in line with our expectation, in contrast with the slightly negative runoff results in the first quarter. Altogether, the confidence level should not have changed materially since year-end, but we should also not assume that we were able to strengthen it.

Net investment income decreased by EUR40 million with lower contributions from private equity and inflation-linked bonds within the ordinary, as well as higher impairments only partly offset by an increase -- a slight increase in realized gains. Other income expenses were positive by EUR18 million, mainly driven by positive currency effect, altogether the EBIT margin decreased by 2% mainly due or sorry -- 4.2% mainly due to the weaker underwriting result.

Finally, the tax ratio is below the normal level, because of the COVID-19 IBNR reserves to a large extent affected the result of our higher tax entities and hence the share of taxable income in high tech countries is significantly lower than usual. Total net large losses including COVID-19 related claims accounted for EUR737 million in the first half year, exceeding the budget of EUR414 million by EUR323 million.

As you can see in the chart, the difference between the gross and the net is lower than usual because we have treated the main part of our estimates for COVID-19, as gross or net and our ILS business has not really been affected by large losses. Overall, the EUR737 million net loss already represents 80% of our EUR925 million large loss budget for the full year and we still have the peak hurricane season ahead of us. In the end, this means that there is an increased likelihood that 2020 will be the fourth consecutive year with large losses above expectations, which is not only true for Hannover Re, but for the industry as a whole and should trigger positive pricing movements going forward.

On the next slide, you see the large loss of this includes six events in the area of natural catastrophes, the largest being the tornadoes in the US with EUR31 million and one property loss. Altogether, this adds up to EUR137 million, which would have been very benign excluding the COVID-19 related loss.

The next slide shows the profitability of our P&C portfolio by line of business. Looking at the numbers for the first half year, the impact from additional reserving for COVID-19 led to an increase in the combined ratio in all regional markets with European being impacted mostly. Not surprisingly, the most visible effect is on our credit and surety business, where we expect to see an increased loss activity due to the impact of the economic downturn. Agricultural business was affected by the bush fires in Australia and on the positive side, the technical profitability of our aviation and marine business was very favorable. Overall, the combined ratio stands at the rather high 102.3%.

So let's move to the life and health. Gross year was mainly driven by a large financing treaty in Australia, which we wrote in the Q4 of 2019. However, this was partly mitigated by the expected reduction in premium volume due to the effect of recaptures in our US mortality portfolio, as a result of our management actions in the previous year. Altogether, gross premium increased by 3.6%, adjusted for currency effects. The impact from COVID-19 is more moderate compared to our P&C business group, additional debts related to COVID-19 had an impact of a bit more than EUR60 million in the first half year, more than 50% of the book numbers are IBNR here as well.

By region, a little more than half of the impact is coming from our US portfolio apart from COVID-19, the results of our life and health business group was quite favorable. The legacy US mortality portfolio performed in line with expectations and the earnings contributions from our financial solutions business in particularly continued to be excellent.

Adjusted for the good EUR60 million COVID impact, the EBIT would have been close to last year's level, which included a positive one-off of almost EUR100 million as you may remember. The net investment income decreased mainly due to the positive one-off effect recorded in 2019, in the first half of 2020, the favorable ordinary income was supported by an overall positive contribution from the change in fair value instruments through P&L, even though the impact from ModCo derivative was slightly negative by EUR10 million.

Other income and expenses are primarily driven by a further increase in the contribution from financial solutions business, for which a large portion is recognized, according to the deposit accounting method, currency effects in this quarter were slightly negative at 11.5% the tax ratio is low or is below the normal level. Also here, mainly due to good results from jurisdictions with the low tax rate.

On the next slide, we have included this one to provide some more insight into new business production on the life side as well. This is not necessarily evident by looking at the premium numbers according to IFRS due to the often long-term nature of the business. As you can see both the new business and the pipeline business are rather diversified by region and reporting category, but what is also visible is that developed markets in particular in the area of financial solutions currently offer very attractive opportunities.

Since we have only focused on the most important years in this overview, this does not mean that we do not see any opportunities in the gray areas on the map, altogether with the value of new business achieved in the first half year, we have built the good foundation to achieve our full year target of at least EUR220 million of VNB.

But please bear in mind that the value of new business is often a bit lumpy and driven by large deals. Against the backdrop of the significant market volatility in the first half year of 2020, the development of our investments was satisfactory. It is pleasing to see that with the return of 2.7%, the result is actually still in line with our initial full-year target, even though some negative impacts were visible in the second quarter.

Two factors led to the decrease in ordinary income. Firstly, the contribution from our inflation-linked bond portfolio purchase to hedge inflation risk that was lower due to the decrease inflation -- increased inflation expectations and secondly, the returns from private equity were also weaker than usual in the challenging market environment. Realized gains are coming mainly from our fixed income portfolio apart from the normal portfolio turnover, we sold around EUR0.5 billion in lower quality credits, before the crisis actually started in Q1 and at the time, almost all sales within our fixed-income portfolios were associated with realized gains. Impairments and depreciations were a little bit higher than last year, mainly due to EUR45 million impairments from alternative investments. We have not really quantified the COVID-19 impact on our investments because it's even more difficult to argue what is really caused by the pandemic than it is in P&C or life and health. One would assume that those EUR45 million without COVID-19 would not have occurred. I already explained the main effect within the change in the fair value of financial instruments, here the negative effect from our ModCo derivative was more than offset by other hedging instruments. Unrealized gains increased remarkably to almost EUR3 billion, driven by significantly lower interest rates and more moderate the negative impact from increased credit spend, due to the recovery of the corporate bond markets in the second quarter.

On the next slide if you see, you can see that we have actually not changed too much in our asset allocation nor do we have any intention to do so, which you can see is that we have used the price corrections on the stock markets in March to carefully re-enter and list the equity buying a little bit less than EUR250 million. As I mentioned to you in May, we have been following a passive de-risking approach with new money being invested in high quality assets only and currently, we continue with that investment approach. The contribution to ordinary investment income is diversified as usual. At this time, with a little bit of a lower share from private equity as mentioned. I think this concludes my remarks and I hand back to Jean-Jacques.

Jean-Jacques Hencho {BIO 17457677 <GO>}

Thank you very much Roland. Moving to Slide 18. As you know we went through our profit guidance in April, due to the uncertainties surrounding the future development of the COVID-19 pandemic and with the peak hurricane season just beginning, we're not yet in a position to precisely quantify the effects of the current pandemic on our business and our investments over the course of the year. Looking at the target matrix with our initial targets, you can see that almost all profitability targets are affected by the pandemic with only the return on investments still above the set target. On the positive side, our business growth is largely unaffected and our capitalization according to Solvency II is comfortably above the 200% target.

On the next slide the June-July treaty renewals were successful for Hannover Re. We're clearly in an improving P&C market environment and we use this to grow our business at increased rates and improved terms. One of the drivers is the US markets, where pricing improved for both primary and reinsurance business.

On top of this, we were also able to increase our shares on a number of profitable accounts generally. In Australia and in our agricultural business, we similarly grew our portfolio at improved pricing and in credit and surety, we decided not to expand our book at this stage, but still benefited from higher rates. Overall, the reported premium growth of 11.6%. The risk adjusted price change was 5.1% for the total renewal business, and even higher at almost 10% for non-proportional business.

On the next slide, we have updated our current assumptions for the impact of the COVID-19 pandemic. There is still an elevated level of uncertainty, surrounding the loss experience and the capital market environment. Still we would expect that the significant amount of IBNR as part of the EUR600 million on the P&C side should bring us a lot closer to our final estimate for the COVID-19 impact.

We see some likelihood for knock-on effect on D&O, E&O and other casualty lines and have taken this to some extent into account for our half-year result. In life and health, we observed that the excess mortality in the most exposed markets in the US and the UK is considerably lower in our portfolio than in the general population, which can be explained by socioeconomic factors and a different age structure.

The negative effect for our book was as commented EUR63 million in the first half of 2020 and in comparison to P&C, I would say that we have not tried to get ahead of potential developments with significant IBNR reserves in the same way for our life and health business. Therefore, some further negative effects in the second half of the year are still possible depending on the development of the pandemic.

On the other hand, we might see some positive effects in our UK longevity portfolio.

On the investment side, the lower income from alternative investments and inflation-linked bonds is already visible and might also impact the results in the second half year. Apart from that, impairments are the main risk to our asset portfolio. Otherwise, we feel comfortable with our high quality investment portfolio. To complete the picture, market movements are having an impact on our capitalization, but not to an extent that would bring our solvency ratio below 200% in the year-end 2020. Therefore, we have no intention to change our general dividend policy for the financial year 2020.

On Slide 21, based on increasing demand for reinsurance and the favorable renewals year to date, we see our book growing in an improving market environment. This is true for most areas of our diversified P&C reinsurance portfolio and should also be supported by an already observed flight to quality with highly rated reinsurers with a strong balance sheet like Hannover Re, seeing higher demands than the average market players these days.

Looking beyond the financial year 2020, I would also expect the generally positive trend for P&C reinsurance market conditions to continue. The market environment is not changing as dynamically on the life and health side as in P&C. However, we expect additional demand for financial solutions business to support our clients in mitigating the impact of the crisis.

Apart from this, we see particularly promising growth potential in the Asian markets. The growth of our mortality business is impacted by the effect of recaptures in our US mortality portfolio. Overall, I would say I see the Hannover Re Group well positioned to absorb the impact of the COVID-19 crisis and to take advantage of opportunities in a hardening reinsurance market. We're constantly monitoring developments and updating our scenario calculations and we shall provide profit guidance again as soon as the underlying probabilities are sufficiently reliable.

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

Questions And Answers

Operator

Ladies and gentlemen we will now begin our question-and-answer session. (Operator Instructions) And the first question we received is from Vikram Gandhi, Societe Generale. Your line is now open. Please go ahead.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Hello everybody, thank you for the opportunity, it's Vikram, SocGen. I've got three questions. Firstly, can you split the EUR600 million COVID impact on P&C across the four buckets, creating business interruption, contingency losses and others. The second is, I see almost no retro offset on the COVID loss estimate for P&C and I'm aware you kind of had a comment in your opening remarks that you haven't really assumed anything, but I just wondered why should that be the case, particularly from BI losses and whether the retro is expected to come into play if the gross losses rise materially from hereon. And thirdly, can you just help us understand what is -- what is the outlook that is being currently penciled in the solvency ratio of 225% in terms of the COVID losses versus what is already there in IFRS. Thank you.

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

Thank you very much. I think I'll ask Sven to address the first and the second question and Roland will cover the capital position.

A - Sven Althoff {BIO 19104724 <GO>}

Yeah. Very -- very happy to give you an idea about how the EUR600 million is split by line of business, we have approximately 40% coming from the business interruption side, 25% from the credit side, and 20% from the events cancellation and contingency business, which brings us to 85% and the remaining 15% of splits across other classes of business like travel business, engineering business, and a few other lines.

This is the result of our top-down view of the reserve position of the EUR600 million, so given the very low number of actually incurred losses that Roland has mentioned in his remarks, only 20% of the overall number, the remaining 80% are driven by IBNR. So the exact splits like a lot of business is maybe a little less precise compared to natural catastrophe losses at the same moment in time, but it's a good view on how the losses could split up in the end. When it comes to the benign retro recoveries, all retro vehicles are in place, but the numbers I have just given to you are indicating that our excess of loss structures are not at a level impacted yet, where we would actually be able to make recoveries and when it comes to our K-transaction, we have only book those losses against our K-transactions that have actually been advised as the incurred losses from our ceding companies, we have not booked any of our IBNR against our K-transaction. That will follow in the next few quarters, given that we will move from a top down more to bottom up reserving approach on COVID.

A - Roland Helmut Vogel {BIO 16342285 <GO>}

And maybe with regard to the the solvency ratio, if I understood your question correctly, it was -- how much is already kind of the considered also on a longer-term basis. The answer here is that we have considered everything, which has been accounted according to IFRS as well under Solvency II, sometimes the valuations differ a little bit.

Potential longer term changes for instance, higher mortality or lower longevity, this has not been considered yet and will only be done as soon as we know what the longer term impact might be.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Okay. That's very helpful. Thank you.

Operator

And the next question is from Kamran Hossain, RBC. Your line is now open. Please go ahead.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi, good morning. Couple of questions on life and health rate. You mentioned that you probably haven't baked in as much IBNR on the life side, as you have on the P&C side. In terms of the EUR63 -- in terms of the EUR63 million number that you've set aside, can you maybe give us a little bit of help on what that kind of baked in -- is that kind of debt as of now or is that kind of more access mortality in certain specific region going forward.

And then how to think about the potential drag from results going forward, should it be multiples less than EUR63 million later in the year or can you just -- any idea as how to think about that drag?

And then another question is on longevity benefits, you've outlined that you could see some benefits there, I imagine that would like to be the case, in the past you've been fairly reluctant to recognize some of these, tables have moved, but you want to actually see real kind of -- I guess people passing away before you recognize it. Are you starting to bake that in or is that just something that's another thing in your arsenal to kind of, you know, I guess having for buffers and kind of get earnings up in future years. Thank you.

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

Yeah. Klaus will address the two questions on them.

A - Klaus Miller {BIO 16886879 <GO>}

Yes. Let's start with the IBNR, because a pandemic is developing so far, we thought we should change our processes here a little bit. Usually we close the second quarter, six weeks before the end of June. So in mid-May for claims accounting, at least in the US, which has the most impacted market here, we have changed that and started booking claims until 30th of June till the last, very last date.

So the IBNR number is relatively small in the US, it's a little bit higher in the rest of the world. As Roland said, we have a little bit more than 50% of the EUR63 million from the US and there was a certain delay in these numbers we get in the US, and let's just talk about the US here, we get in the US 85% of our business reported on the claims' side on a daily or weekly basis, that means the clients and claims basically immediately to us.

There was still a delay of about three weeks from the person dying till the reinsurer gets the notification of the death. And there was an additional on top four weeks delay on average before we get the call of the death. That means our numbers in death counts are more up to date then the reason of the death certificate and the reason for death. So it's quite possible that we have even more COVID claims, we have already accounted for, but have not knowing that they are COVID. We have certainly an expectation that the claims we have seen in the first half of this year will be slightly higher in the second half of the year. This all in panic, the largest country currently impacted by COVID, the US start managing the pandemic or not. When you look at the largest countries impacted right now, it's the US and we have a significant portfolio there, then the next ones are Brazil and India and who's the next Russia I guess and we have next to no business there. So all depends on how the US manages the pandemic or start managing it.

On the longevity side, we have unfortunately to follow certain accounting rules that if you have loss in a treaty, you have to reserve immediately for whatever can happen in the future. If you have treaties performing better than expected, we cannot take that into account, so even if we change our model slightly and we expect a better longevity result in the future, we will account for it, as it comes in and not earlier. So we will not change that and we can't.

Q - Kamran Hossain {BIO 17666412 <GO>}

Thanks. Can I just clarify, so you said H2 is likely to be more in terms of claims than in H1. So if I can say EUR63 million, it's probably going to be a bigger number of that in H2.

A - Klaus Miller {BIO 16886879 <GO>}

Yeah. It will be a bigger number.

Q - Kamran Hossain {BIO 17666412 <GO>}

Okay. Great. Thank you.

Operator

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

Q - Andrew Ritchie {BIO 18731996 <GO>}

Hi, there. Sorry, I wanted to go back first of all to, Sven made a comment that you haven't assumed any K session recoveries. I mean, I'm assuming quite a lot of the BI losses will ultimately be claimed by your against CAT XL treaties, which I thought CAT XL would be covered by the K vehicle, so do we have a situation where your net COVID P&C loss could actually reduce over the year, as the losses convert from IBNR to reported claims and a lot of those would go through classes of business covered by K.

I think that's the implication, but maybe just clarify that. The only other questions I had, why was the life result so strong underlying like COVID, I mean do we extrapolate that or are there some one-offs in terms of non-COVID biometric experience or the deposit treaty businesses. And then the other question was a non-life excluding COVID, the underlying I think it was 98 something combined in Q2. And as I'm always hesitant to draw any conclusion on one quarter, is there any driver or this is very conservative current year reserving ex-COVID?

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

Thank you. Sven will cover the retro parts and the underlying business of the non-life side and Klaus will follow-up on life and health.

A - Sven Althoff {BIO 19104724 <GO>}

On the retro part, Andrew, the small difference between gross and net on COVID, the 8.4 million we are showing on all large loss list, is actually as a result from sessions against K. As I said, we have only booked those losses against K, which have actually been advised by ceding companies if not done the same for our general IBNR positions here.

And I would not like to guide you to say this gives the potential that the net number should be lower than the EUR600 million, but if you can look at the EUR600 million with that feature being additional conservatism built into the number.

Q - Andrew Ritchie {BIO 18731996 <GO>}

I mean, I guess maybe the question is on the BI losses, as they become notified claims, is that going to be mostly through proportional contracts, which aren't covered or mostly through just CapEx, which would be covered by K.

A - Sven Althoff {BIO 19104724 <GO>}

Andrew, that will be -- that will be a mix, it will be some pro rata, some risk but of course also from some CAT protections to the extent that the policy language under the CAT protections are providing coverage for pandemic exposure, which is not always the case. So we can assume that there will be additional bookings against K. But when I said that the 40% of the overall EUR600 million figure is business interruption related, which of course brings you to a number of EUR240 million, this would not all be suitable towards K given that this is coming from a mix basket of the pro rata risk and some CAT.

Q - Kamran Hossain {BIO 17666412 <GO>}

Okay.

A - Klaus Miller {BIO 16886879 <GO>}

And could you repeat the question on the underlying?

Q - Andrew Ritchie {BIO 18731996 <GO>}

Well, I just -- it looked like the underlying combined ex-COVID was relatively high in Q2, I think you said 98 something. And I think it was running around 97 underlying in Q1, so was there something else occurring or conservative booking or high attritional losses or something else in underlying business.

A - Klaus Miller {BIO 16886879 <GO>}

Well, as my colleagues have mentioned, we are EUR323 million over and above our large loss budget for the first half of the year, if you deduct that from the combined ratio, you are at 97.6%. Yes, that is higher than the target combined ratio of 97%. But let me put it this way, if we had only had the EUR130 million of non-COVID with major losses and we would still have booked the full loss budget for the first half of the year, I'm pretty confident that we would have shown a combined ratio below 97%. But given COVID, given that the hurricane season is ahead of us, we decided to just let those 97.6% out of our machine and not really adjust on it.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Okay.

A - Klaus Miller {BIO 16886879 <GO>}

On the life business, the underlying profitability was pretty strong in the first half year. There are two reasons for that. One is we have increased our Financial Solutions business and of course, this should continue for the next couple of years. So this is not a quarter effect, this will be there for the next couple of years.

And of course, I also expect that we get more claims, as Jean-Jacques pointed out towards the end of the year to support our clients to have problems with COVID-19 and the balance sheet. The other thing is, please be reminded that we have retention of EUR20 million for life and two more claims could make a EUR40 million different and a swing of plus-minus EUR50 million in the quarter would be absolutely normal and it was a good quarter, we didn't have any really large claims. But still, if you go through all the numbers and add them up, you will find a plus 10, minus 10 every now and then. So it was a good quarter, natural volatility to the positive side plus more financial solutions business, which is here to stay.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Okay. Thanks very much.

Operator

The next question is from Paris Hadjiantonis, Exane BNP Paribas. Your line is now open. Please go ahead.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Yes. Good morning, everyone. I hope you are doing all well. A few questions from my side as well. Firstly, I think going back to the normalized combined ratio, I just wanted to check if there is any benefit from lower frequency or do have actually seen any lower frequency from other lines of business that benefit to an extent from COVID. so I'm thinking motor business et cetera. If you have seen that have booked it, so you see XX 97.44 for the half year, probably a bit higher or do you see the usual cautionary bodies already in the numbers. Then the second question is on more reinvestment yield. Can you give us an idea of where it stands right now given the the pronounced moves in interest rates. And lastly, I guess this is more of a strategic question. Hannover Re historically has been a company that it doesn't really led the crisis go to waste. So given what is happening right now in the market, do you think that there are any opportunities for you to expand strategically in certain region for through M&A. So if you could give us some ideas on that front that would be quite interesting. Thank you.

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

Thank you, Paris. So the first question on P&C, Sven will address. Reinvestment yield, Roland and I'll take your third question.

A - Sven Althoff {BIO 19104724 <GO>}

Yeah. On the normalized combined ratio side, we are seeing improved frequency in classes like motor, but we have not changed our ultimate loss ratio assumptions going into the year 2020. We may do so later in the year, but given that we are only seeing that improvement for a few months by now, we didn't feel that it's prudent to already change the ultimate loss ratio assumptions. So in a few classes, which clearly have lower losses due to the much lower economic activity, there is a certain level of conservatism built into those usual our assumptions due to the fact that we have not reduced them, but I wouldn't overestimate that effect at this stage, given that we're only talking about the number of months rather than quarters, where we are seeing that improvement of frequency.

A - Roland Helmut Vogel {BIO 16342285 <GO>}

Yeah. Paris, I am actually not really in a position to give you an exact reinvestment yield, as we usually do, so because we have implemented this de-risking strategy to some extent, so in that regard it would be a bit difficult to say if we reinvest exactly as we are invested today, reinvestment yields would be XYZ. We definitely do invest at remarkably lower rates than we currently earn. So there will be a drag on the ROI if that continues. Again, I think we will present the more concrete numbers at the occasion of our Investors Day. In that regard, the 2.7% might not be achievable for the full year, but that also really depends a little bit on the investment -- reinvestment policy and approach, which is a bit uncertain right now. Sorry for that.

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

And on your third question, I think the immediate opportunity is related to the market environment. We have loss activities for the last few years, maybe not CAT. We have the COVID exposure and the expected losses and uncertainties in the market related to that and this is going to push the reinsurance market towards price adjustment and I think this is a big opportunity for us, where we've seen a momentum confirmed during the July renewals. So the 1st of January renewals on the P&C side, I expect it to be going into the right direction from our end. I think we already see the flight to quality in the market when alluded to that and we received numerous requests from clients, from the broker community for increased shares, as there is a focus on the better capitalized companies. So an additional window for us to grow and then we will take advantage of that flight to quality.

I think the third aspects, which Klaus mentioned is financial solutions, but also generally balance sheet protection also in P&C, where we are increasing the dialog with our clients and we probably see a number of transactional opportunities in the coming 12 to 18 months, also partly related to the COVID situation.

M&A, we always look at M&A, but of course we benchmark on the one hand side the valuations, the knowledge and acquisition will bring to us. And the cost of complexity versus organic scenarios, which gave us additionally attractively priced business. At this stage with the current rate of growth in our business, the benchmark is very high for an M&A play, but we keep looking and we never excluded, but I think the organic opportunities are very material for us and particularly for '21.

Q - Paris Hadjiantonis {BIO 19703051 <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>}

Yes. Good morning. Thank you. So two questions from me please. One is just, when I look at the Slide 10 and see the credit surety 130% combined ratio, which probably implies for the full year 115% or something on that. It's quite higher than even in the crisis, the global financial crisis 10 years ago or 12 years ago, is there any assumptions in your loss estimates of governmental health on this credit surety line. That's the first question.

Second question is, when you talked about the knock on effect and thanks for splitting the credit -- the COVID losses by line, but I noticed that the last element, the other you didn't clearly mention the D&O, the casualties those kind of lines, you said that it's still not there yet, or is it within that line and that's what we should take away. Thank you.

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

Sven?

A - Sven Althoff {BIO 19104724 <GO>}

Yeah. Let me -- let me start with the second question, classes like D&O would be in the 15% bucket, which I mentioned. Yes, you're right, I've only mentioned engineering and travel, but D&O and few other classes within that bucket, but at this stage, it's only pure IBNR, I mean there is no loss estimates from the client side and we will have to wait a little bit for potential losses to materialize on that site, one lot that -- that this an area of particular uncertainty.

When it comes to the credit combined ratio, yes, you're right, with the 130%, we are significantly over and above the additional combined ratio, we had to book during the financial crisis. But of course, the 130% are only booked against half a year of earned premium rather than the full year's worth of premium. And secondly, the economic situation is much more severely impacted than during the financial crisis in '08 and '09 and what that will mean from an insolvency point of view, which is the main trigger on the credit insurance, as you know, we -- I mean, it's still very much crystal ball glazing. I mean, you know that a lot of governments have eased the rules for companies when they have to report insolvency situation due to COVID. So the companies have extended reporting lines, some of them are coming to an end now. So we might see a first spike of insolvencies during the third quarter.

And so of course very, very difficult to pre-empt what may happen in the future when it comes to companies declaring insolvency and what will then subsequently happen with -- either calling the debt or restructuring the debts, which of course is always a loss mitigating factor for the banks and for the credit insurers, restructuring of debts. So therefore, we have been a little bit cautious and put a little extra on our financial crisis, experience in 2008 or '09, but that's a great deal of science around that, it's a lot about our own expectations.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay. Thank you very much, Sven.

Operator

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

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes. Good morning everyone. One question left on the life side. I think that in the past you provided the sensitivity to your EBIT number, which was a 5% excess mortality was implying a negative EUR130 million on your EBIT for life. Just wanted to know if you could put a EUR63 million in the context of this guidance or the sensitivity and if it was really a valid one going forward.

The second question was on the 15% net premiums earned gross in P&C, I mean looking at the guidance, the initial guidance for 2020 that you put out early in the year, I think that you were very cautious still at that stage on the gross of, the achievable gross on PC. So I was wondering if you could mention any big and large quarter shut deals, which may have inflated the number, maybe didn't think obviously the 15% growth. And the last question is just -- just to understand on the Solvency II basis, so the 225%, I understand that actually you have not provided any 12 months forward-looking view in this number. So it's more, maybe Q1, which has been updated for the mark-to-market movement in capital generation, COVID-19 losses, but not the economic one which would be closer to a kind of ultimate loss estimates? Thank you.

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

Klaus on the life side.

A - Klaus Miller {BIO 16886879 <GO>}

Yeah. I have to admit that to a large extent, this is pure guess work and as I said earlier, it all depends on how the US will handle the pandemic in the future. The 5% was the calculation we did a couple of weeks ago, we have seen that the mortality spiked in the US, I guess in the second quarter when population mortality was 20% higher, but we have seen that only a small fraction of that really found its way into the insured population and even less into the reinsurance population. We have been quite lucky in the sense that two years ago, we for totally different reasons increased our rates on the permanent business and you know that COVID is especially a problem for the older population and we had a problem with old age mortality and this was one of the reason why we increased rates, where we could, so the effect on that was the business to a large extent was recaptured. Now, I can't tell you what claims we don't see now, because we don't have the business any longer.

So the 5% we used here was an artificial calculation that we assumed, let's say, the 20% mortality increase in the population will lead to a 5% increase in our portfolio. We might be lucky, it might be less. We still feel comfortable with this scenario, but I would not even call it an estimate. It's a scenario calculation. I'm sorry that I can't be more precise here, but there are too many uncertainties.

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

Sven, on P&C growth.

A - Sven Althoff {BIO 19104724 <GO>}

On the P&C growth side, we have a rather diversified, picture. So yes there are a very few big transactions in there like a new motor quota share, which we have written in Canada and also one or two bigger transactions, which we have written in China, but the growth is coming from many lines of business and many territories. So there is no single reason driving this development, it's a combination of the better rate, which is not only giving us more premium on the existing business, but it's also making a business, which we have not written in the past, writable again, which we have carefully started to do and it's the flight to quality that Jean-Jacques has mentioned. So there is a very, very high demand for our security right now and we could have grown even more if we had not respected ourselves in a few areas like credit or US wind exposure, where we don't feel that the time is good for us to grow our portfolio on that side. This will come back towards the end of the year for two reasons.

First and foremost, there's hardly any business renewing from now until the end of the year. So there will be very few areas, from which additional growth would come from. And then of course in Q3 and Q4, we will see a little bit of a damp manufacturing from COVID in our premium because in some classes of business as you know, insurers have decided to return certain parts of that premium to policyholders, in reaction to the frequency topics we'd be discussed earlier in the call. And as that there is always a little bit of a time lag between the ceding companies doing so and us seeing it in our accounts, you will see a little bit of that in Q3 and Q4. So for the entire year, I would still expect a double-digit figure of growth on the P&C side, but closer to 10% compared to the 16% now.

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

And Thomas, to come back to your Solvency II question, I think I did explain that everything which has been considered here according to IFRS has always been -- has also been considered in our solvency calculations. So that means the 600 are in, and if they hold by the end of the year, it's one of the scenarios, so this one of our best estimate scenarios, if the hold that is a fully considered. Klaus mentioned that the likelihood that potentially the IBNR in life might not have the same likelihood to hold. Moreover, we have already included in our Solvency numbers, the capital requirements from the remarkable growth, otherwise the ratio would have looked even a little bit more positive, it has also been considering the impact from the very, very low interest rates, which is a trigger for higher capital demand.

So in that regard, if that all holds, then I would say the solvency ratio does consider, if you then imply that there is a longer term impact in life, where we have potentially our contracts run 20 years or 30 years or even longer, then of course that would need an assumption, how long it will be impacted by COVID losses. The same is true for positive impact on the longevity side, those have not been adjusted yet. And again, if 2021 does see additional losses again that would only be one year of a long role of Solvency to future cash flow implications.

I hope that addresses your question.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yeah. Thank you. Just seeking clarity on that, just because some of your peers are taking the 12-month view on Solvency II, when one-year solvency calculation. But you make it clear. Thank you.

Operator

(Operator Instructions) And we do have another question from Vikram Gandhi, Societe Generale. Your line is now open again.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Hi. Thank you once again for the opportunity. I've got a conceptual question on life and health, specifically with respect to the higher assured policies. I think the comment made was that the net retention by life is [ph]$20 million to $25 million, which is consistent with what you've said in the past. My understanding is that these policies are generally meant for the ultra high net worth individuals at all the rate groups, who go for this tax wrapper, if you like for inheritance tax planning or estate tax planning. However for a policy of say [ph]$20 million, the premiums should be around [ph]$15 million, $16 million hypothetically. And so the net amount at risk, if that's the correct technical term to be used, should be pretty low. So then, why should a couple of claims on these large sum-assured policies be really a material swing factor for the EBIT is my question.

A - Roland Helmut Vogel {BIO 16342285 <GO>}

Yeah. I take that. No nobody else volunteered to answer that. When you have a royalty treaty, you have the risk premium base and there is -- although you're absolutely right, over the lifetime of the policy, you would expect that somebody pays the amount he finally gets. But the way how it works on the accounting side from a reinsurance perspective is that we have the one of T-premium, the risk premium and if somebody dies, then this is a full claim for us, because there is no reserve, you have to distinguish between level premium, where you get the same premium over what about the lifetime of the policy. And then you're absolutely right, but usually this is re-insured on a risk premium basis.

And then the balance is the diversification in our portfolio, where people don't die and just pay the premium and one or two might die. But these one or two if we expect, three of these claims in a year and we have five then it's two more than expected and that is basically the full amount minus the risk premium of that particular year. This is how the accounting is done.

Of course it should balance out, but it doesn't have to. Over the long run, it would balance out, but we don't get level premium every time. And honestly in these days, we don't like level premium that much because then you have to invest and you have to tell the client okay, if you give me the level premium, I take into account 3% or 4% of interest return and nobody makes that these days. So the client is interested to keep the cash and only pay the risk premium to us.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Okay. So the level premium presumably must be on the coinsurance treaties.

A - Roland Helmut Vogel {BIO 16342285 <GO>}

Right. That's great.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Okay. Got it. Thank you very much.

Operator

And the next question is again from Vinit Malhotra, Mediobanca. Your line is now open again.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes. Thank you. Very quick one, sorry. Klaus, for life side in the US, are you able to provide some indication of how much are the older age is in proportion to the population or something and I'm sorry, you might have commented in another Investor Day, but I can't seem to recollect that if you have provided that. Thank you.

A - Klaus Miller {BIO 16886879 <GO>}

We have about, I think 1.2% of our portfolio is age 80 or older, by amount and if you just count the lines, then it's only 0.8%. So this is relative to our competitors, I guess a slightly smaller amount of old age people. Basically due to the fact that in the very early days, let's say, before 2008, we were not really a big writer and then we bought a broad portfolio and later on we started writing more business what you will probably know under the name of the organic business and the organic business is pretty young. And it's already a large chunk of our portfolio. But we have only written that from 2010 onwards. And from the broad portfolio as mentioned earlier by me, quite a substantial part of the YRT treaties of permanent life -- whole of life have been recaptured. So this is why our share is a little bit smaller here.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay. Thank you, Klaus.

Operator

And there is another question from Andrew Ritchie, Autonomous. Your line is now open again.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Hi there. Two short ones I think, one potentially very short. On the business interruption assumptions, are you able to say this is quite of live court cases is one particular significant court case ongoing, are you able to say have you made a sort of risk adjusted assumption on the outcome of those court cases or I mean, should they go against the industry, would that necessitate additional reserves, can you give us any sort of more specific color on that.

And the second question just on ordinary investment income. I wasn't clear, is there a sort of temporary effect on lower dividends from low returns of private equity and real estate or I mean, would you consider some catch that there might be some catch-up on that or is this, should we just adjust ourselves to a permanently lower level of return from those alternative assets.

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

Sven?

A - Sven Althoff {BIO 19104724 <GO>}

On the business interruption side, we have assumed that there is no retroactive change of coverage in the United States. So that would not be baked into the EUR240 million I was mentioning. And for Europe and a few other court cases elsewhere, outside Europe, we have taken a balanced view. So if all these cases would go against the insurers, then the EUR240 million number would not be sufficient. If insurers should win all cases everywhere, than the EUR240 million would be prudent number.

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

Andrew, with regard to the expectations of the income from alternative vested, I don't see any reason why this would not recover or even catch up and I'm sure that the private equity fund might also see opportunities driven by the crisis, because it's uncertain as to when that will happen, but to now assume that even after a recovery of the economy, investors will digest or accept lower yields for such exposures doesn't -- wouldn't make sense to me.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Okay. Thanks very much.

Operator

And we have another question from Thomas Fossard, HSBC. Your line is now open again.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes. Thank you. A very last one, regarding the situation in Lebanon, I made it very early days, but again that's the level of understanding, we have of this kind of market is pretty low. So could you shed some light on where and how you would expect losses to hit the market not -- maybe not Hannover Re specific, but more a high level comment if you have any. Thank you.

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

Well, first and foremost, we're very sorry to see this tragedy happening yesterday and it's very, very early days, so we don't have an overview when it comes to loss of life or loss of property at this stage. Of course, the impact for the infrastructure will be massive from an assured point of view, it's too early to say what is the penetration of insurance in that particular area, given that it's a harbor, industrial related area, we have to assume that there is a good level of penetration here. So from that point of view, I guess, you will see that on our major loss list in the third quarter, but I would have no feel at this stage to what extent this will be a major losses. It will be a major loss for us, I see us pretty certain, but whether it's a low double-digit or high double-digit or even three-digit number, it would be impossible for me to comment right now.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Sure. 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 Hencho {BIO 17457677 <GO>}

Well, thank you very much for your participation and your questions. I think we covered the ground very well. We wanted to give you the latest updates on our best estimates on the exposure on COVID-19. We tried to be very cautious, looking at client information, market information, our old portfolio bottom up view, still difficult to predict we said there are still remaining uncertainties. But at this stage, our best estimate is that this will be an earnings event for Hannover Re in 2020. The underlying business is very strong, as we discussed, and we're very confident about the quality of the portfolio and the outlook is positive. We have price momentum particularly in P&C. We have growth opportunities and a strong pipeline in structured reinsurance. And I think the flight to quality phenomenon continues to give us additional life science, so that's I think the key messages for today. But thank you very much for your attention and participation and have a good day.

Operator

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