Y 2019 Earnings Call

Company Participants

- Jean-Jacques Henchoz, Chairman of the Executive Board
- Klaus Miller, Member of the Executive Board, Life & Health
- Michael Pickel, Member of the Executive Board, Property & Casualty
- Roland Vogel, Member of the Executive Board, Chief Financial Officer

Other Participants

- Andrew Ritchie
- Edward Morris
- Kamran Hossain
- Paris Hadjiantonis
- Sami Taipalus
- Thomas Fossard
- Vikram Gandhi
- Vinit Malhotra

Presentation

Operator

Good afternoon, ladies and gentlemen. I welcome you to today's Hannover Re International Analyst Conference on the 2019 Annual 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>}

Thank you very much, and good afternoon, ladies and gentlemen. I'd like to welcome you to our conference call, presenting our results for the financial year 2019. As usual, I'll start with a short summary before our CFO, Roland Vogel will go over the financials in detail. And for the Q&A, I'm additionally joined by my Board colleagues, Klaus Miller and Michael Pickel.

The initial slide of the deck shows you the key metrics for 2019. We're generally satisfied with the business development. Last year, we had double-digit growth in earnings and premium, and we're able to achieve a return on equity of 13.3%, well above our minimum target. And it's particularly pleasing to see that the earnings growth kept pace with the strong growth of our shareholders' equity.

Group net income increased by 21% to EUR1.28 billion, and this record result was based on favorable underlying profitability and non-recurring items resulting from valuation gains from two participations, which we mentioned in previous quarters: Viridium in Germany, EUR100 million impact, and Skandia, a company in Scandinavia, EUR50 million impact, positive for the result.

Gross premium increased by over 15% adjusted for currency, which was mainly driven by P&C, where we saw an improving market environment. And P&C premiums were up by 20% from both our traditional and structured reinsurance business.

The combined ratio at 98.2%, was above our target, due to the large loss activities last year, which exceeded the budget and the development of Typhoon Jebi which we reported on in the past year.

Earnings in life and health were very strong due to favorable underlying profitability and better-than-expected U.S. mortality performance, plus the Viridium effect which I mentioned a minute ago. Life and health growth was steady and came mainly from the Asia-Pacific region.

The investment income was strong with a return on investment of 3.5% or 3.2% excluding the one-off in life and health, significantly exceeding our initial expectations of 2.8%. And the solvency ratio was at 252%, which was comfortably above our minimum target.

On Slide 4, you see the dividend development. And based on the strong set of results, we intend to propose a total dividend of EUR5.5 per share, which will be equivalent to EUR4 ordinary dividend and EUR1.5 special dividend. This dividend payout reflects the company's strong performance and our net income growth in 2019. We continue to see good growth opportunities this year and an improving price momentum, and part of the earnings will be used to fund future growth.

Moving on to the financial figures for the full year 2019. Let's start with the cash flow. At EUR2.5 billion, the operating cash flow is again very strong. And I'm pleased to add that the underlying numbers are even better because we wrote a large pre-financing deal in life and health reinsurance in the fourth quarter. This led to an operating cash outflow of around EUR350 million and explains the relatively low number in the Q4 standalone view. Such pre-financing is of course associated with future profits and respective positive cash flows in future years if everything goes according to plan.

On the right hand side, you can see that it's not only the significant positive cash flow that has led to 13% growth in assets under own management, additional factors contributing to the growth were the lower yields and credit spreads at the end of the year, as well as positive currency effects and the EUR750 million hybrid bond that we issued in Q4. Overall, invested assets amounted to EUR47.6 billion at the end of 2019.

On Slide 6, most of the effects mentioned are also supporting the strong increase in our capital base, as presented here, especially the green portion of our policyholders' surpluse reflects the additional hybrid capital outstanding with the first call date for an outstanding bond in summer. This might come down in Q3.

Nevertheless, the most important contributor to the 20% increase in shareholders' equity is the strong result that we achieved in 2019. The contribution from the valuation reserves in our asset portfolio even went up over the course of the first quarter this year and is now being impacted by some volatility, driven by the lower interest rates but also higher credit spreads as a reaction to the coronavirus.

The next slide shows the impressive long-term outperformance of our ROE target, but also the consistent delivery in each and every year with 2019 being the 11th consecutive year with a double-digit return on equity. Over the last 10 years, we have more than doubled our equity base, and at the same time we were able to grow our earnings per share by 5.8% on average per year.

Also in comparison to our peers in the reinsurance space, our return on equity is very favorable with Hannover Re coming out on top for both the financial year 2019 and the five-year average. Another point visible on this slide is that Hannover Re is outperforming the industry in the years with below average large loss activity like 2015 and '16, and even more markedly in very loss heavy years like 2017 and '18. This confirms the success and profitability of the business model and our approach to managing the volatility of our earnings by means of retrocession protection and conservative reserving.

With that, I would give the floor to Roland Vogel for more detail on the financials.

Roland Vogel {BIO 16342285 <GO>}

Yes. Good afternoon, and thank you, Jean-Jacques.

Let's directly move on to the group's figures for the financial year 2019. As usual, I will come to the details in the segment reporting. But to sum it up. Hannover Rerecorded very strong premium growth, driven primarily by our P&C reinsurance business, but also well supported by life and health.

The group net income increased even more significantly by 21%. Admittedly the negative effect from recaptures in 2018 on the one hand and two positive one-off effects in 2019 on the other played a part in the strong earnings growth. Nevertheless, we have managed to achieve another record result, which is quite remarkable in particular against the backdrop of the overall profitability for the industry, especially in light of the large loss burden, which we will see in a minute.

Maybe worth mentioning on a group level, financing costs have increased compared to the previous years. We issued the new hybrid bond in Q4 to potentially refinance a bond with the first call date in September 2020. Still around EUR4 million of the increase is due to the first time application of the new IFRS leasing standard, which led to the reporting of such costs in the financing line.

Moreover, the tax rate came in slightly below expectation, which is to be attributed to the nearly tax-free gains on the higher Viridium valuations as well as on another sale as Jean-Jacques already mentioned that of an agency with some EUR50 million and that was also tax preferred. The latter amount is accounted for in the other income line as it is the result of a de-consolidation exercise.

On the next slide, property and casualty, reinsurance gross written premium grew by 20%, adjusted for currency effects stronger than initially expected going into 2019. Drivers here, were the slightly improved overall market environment in the reinsurance sector and very healthy demand for Hannover Re as a business partner. The growth was well diversified by region and by line of business. It is worth mentioning that this year, the contribution from the traditional lines was even higher than the growth in structured reinsurance, which had been the driver in proceeding periods.

The increase in net premium earned was less pronounced mainly due to the change in unearned premium, which is a normal phenomenon. When the book grows strongly, the retention remains stable slightly over 90%.

Now large losses, was already mentioned came in EUR81 million above the full year budget of EUR875 million, and on top of this negative development of Typhoon Jebi from 2019 impacted the underwriting result by another EUR80 million. As such EUR160 million translate into 1.3 combined ratio points. So one could argue that adjusted for them, we would have achieved our 97% target. Still, we will have a look at the development of the reserve redundancies in a second.

The budget overrun of the large losses was supported by the fact that two major events occurred outside our defined risk peak or peak risk definitions, so that the release from our retrocession program was less beneficial than in the last two years. Altogether, the combined ratio came in at 98.2% and with that a little bit above our target.

Initial reserving remained conservative as usual. The runoff of our reserve was again positive within the expected range but impacted by especially Jebi slightly lower as compared to last year. When it comes to the current confidence level in our loss reserves, we have to accept that also we were not totally immune against the developments from U.S. casualty losses. Conservative past reserving made sure that we did not observe any negative run of result, but based on initial estimates, reserve redundancies overall went down by approximately EUR200 plus million. As you know final numbers will be presented in October, so this is -- these are the first indications.

The negative experience here has already been reflected in our reserve setting for the 2019 year and partially led to higher ultimate loss ratio assumptions for such segments. It was mainly triggered by trends towards increasing healthcare costs as well as the opioid crisis and the reopening of all sexual molestation cases. We have reported more than once before that our exposure here should be limited as the majority of our highly diversified portfolio has a focus on small and medium players in the U.S.

Apart from that, the somewhat unexpected decision to set the new opt-in rate in the UK at minus 25 basis points, also had a negative impact on our reserve redundancies as the reserves reflecting an opt-in rate below zero had been treated as redundant in the past, which now up or down to minus 25 basis points had to be corrected.

Net investment in P&C increased slightly driven by the favorable increase in ordinary investment income. Other income expenses include EUR49 million gain from the disposal of our participation in the Swedish agency already mentioned. Apart from this, there are no other material one-offs included in this line. Altogether, the EBIT margin is exactly in line with our 10% target. The tax ratio was at normal level.

The next slide shows the profitability of our P&C portfolio by line of business, and here the impact from large losses is quite visible. North America was mainly affected by Hurricane Dorian. The Latin America reporting line reflects not only the riots in Chile, but also worldwide agricultural business, because it's part of that business line. Here we have seen losses from the bush fires in Australia and tornadoes in the U.S.

The cat XL segment includes a large part of the losses of the typhoons in Japan, and the combined ratio for UK and Ireland also exceeds the target affected by rather weak technical profitability of the Lloyd's business, which we support.

On the other hand, aviation and marine are significantly below target, benefiting from a favorable loss experience as well as some positive reserve runoffs. Additionally, the German speaking countries made a good contribution to the technical results.

On the next slide, we have already commented on the large loss situation. Net losses totaled at EUR956 million, exceeding the budget by EUR81 million. As you can see the difference between gross and net is smaller compared to the year 2017 and 2018, because retro was a little bit less effective this time.

In the first place, this is because no individual loss was large enough to figure our whole account cover. Secondly, it was due to a high frequency of manmade losses, which are less protected by our retrocession program. The third reason is Hurricane Dorian where a large part of the loss comes from proportional treaties, which are not covered by our K-Cession. And the same is true for the credit losses. Here Thomas Cook came in -- came slightly down, but still led to a burden of around EUR85 million nearly gross for net.

Looking at the detailed list on the next page. The large events were Hurricane Dorian and Typhoon Hagibis and Faxai on the nat cat side. However, the overall level of nat cat losses were still within expectations. This means that the reason why the overall large loss budget was exceeded are the manmade losses, and here a combination of frequency and sizable individual losses like Thomas Cook or the riots in Chile, and the refinery loss in the U.S.

So let's move on to our life and health reinsurance business. Gross written premium up by 6.7%, adjusted for currency effects, which was within our expectations. The main driver was new business written in China and Australia. Additionally, we were able to grow our longevity book.

The results from the U.S. mortality business improved significantly and even slightly more than anticipated. Here the absence of last year's recapture charges helped as well as better than expected mortality.

In 2019, it came only to minor recapture charges in the first half year. A few remaining open cases where the rate increases have not been accepted and the business has not been recaptured by the client yet are in arbitration. This means that the business will either be recaptured or the clients will accept the rate increases at a later point in time, assuming that we arbitrate successfully. We do not foresee any significant impact on our expected yearly results from such proceedings at least of today.

As already reported with our half year results, we had some negative effects from disability income in Australia and we added some reserves for our UK business. In both cases, we did not see any further material negative development in the second half.

Investment income increased significantly, supported by the EUR100 million one-off, as part of the realized gains in the second quarter, while the change in fair value through P&L was also positive.

Other income and expenses mainly driven by a further increase in the contribution from the financial solutions business, particularly in the U.S. for which a large portion is recognized according to the deposit accounting method.

Altogether, the EBIT of EUR570 million is well above our EUR400 million indications even excluding the EUR100 million one-off. At 16.4%, the tax ratio is below the normal level driven by the tax privileged valuation gains.

On the next slide, in life and health, the 2019 financial year was very favorable in terms of not only earnings contribution but also new business production. The value of new business written in 2019 stands at EUR363 million, well above the target. The main drivers are financial solutions and longevity. Additionally, our Shanghai branch was very successful in writing new high-value business.

Coming to the investments, we are very satisfied with the development of our investments in 2019. The return on investment is appreciably higher than our initial expectations of 2.8%. And I'm very pleased that we were able to increase the ordinary income compared to the already strong number in the previous year, resulting in an ordinary return on investment of 3.1%.

The realized gains include the Viridium one-off and that is then boosting the ROI to 3.5%. But even if we adjust for that and Jean-Jacques has already mentioned it, the ROI would still be very strong at 3.2%. Realized gains in the second half were largely driven by the disposal of two real estate objects. The positive change in the fair value of financial instruments was an additional factor.

Unrealized gains increased significantly to EUR2.3 billion, mainly driven by lower interest rates and reduced corporate spreads resulting in an increase in the valuation of our fixed income portfolio. As of today and driven by the balance of interests going down and spreads widening, the number should even be EUR1 billion higher than it was by the end of the year.

On the next slide, you can see that our asset allocation remained rather stable. In 2019, we have slightly increased our corporate portfolio and improved geographical diversification of our fixed income book, mainly expanding our investments in emerging markets, where yields are still a bit more attractive. The overall diversified contribution to ordinary income is again supported by the good and very good results from real estate and private equity, but not to any extraordinary extent.

Next, we come to the preliminary update of our solvency reporting as of the year-end 2019. And even though the audit of the numbers is not yet final, we are -- we do not anticipate any material changes and are brave enough to present them today. We will publish the full reporting with all the detail on the 9th -- on the 7th of April, so I have to ask you to be a bit patient on full -- until the full details are available then.

The capital adequacy ratio has increased to 252%, very comfortably above our minimum target. According to our internal metrics, the ratio is even better. The difference here lies in the treatment of minorities, where we still think that this is capital we can work with. The regulator still takes a different view.

For the first time, we have applied the dynamic rather than the static volatility adjustment. We expect to get regulatory approval for this model change within this or the next month. But it had been agreed with our regulator that we can already use it for this reporting.

In contrast to the static volatility adjustment, the dynamic volatility adjuster is dependent on spread movement for different economic scenarios instead of being static for all the scenarios. This reduces our spread risk and has a positive impact on the owned funds. The first time application led to an improvement of around 15 basis points.

Owned funds have also been benefiting from the additional hybrid capital of which EUR500 million might be called in 2020. That accounts for another approximately 5 percentage points. So in aggregate, the ratio would have gone down without the two one-offs. This should not come as a surprise as we have been growing, so remarkably. Still the comfortable solvency leaves us room or leaves us the room we need to take opportunities in the future.

On the next page, you can see that the composition of the capital requirements. Property and casualty has of course increased as a result of the business growth, now representing the largest share. The market risk has also increased with the growth of our asset base, and a slightly increased risk appetite, but the use of the dynamic volatility adjustment has had a mitigating effect here. The diversification effect has improved by 2 percentage points and -- as compared to 2018 and now stands at 36%.

The next page, here are a few more details on the development of the capital adequacy ratio over time. Apart from the additional EUR750 million in hybrid capital, the main drivers for the increase in 2019 are as already mentioned, model changes and in this respect the first time use of the dynamic volatility adjustment, as already mentioned. This brings us then to the 200 -- over the 250% mark. This is in line with the 237% guidance provided at our Investors Day in October last year, because the latter number only partially included the EUR750 million of hybrid capital and the use of the dynamic volatility adjustment had not been taken into account at that point in time.

We now come to the reconciliation of IFRS in the Solvency II owned funds as well as the composition of the owned funds compared to the same picture of the previous year. The adjustments for technical provisions have decreased significantly by more than EUR1 billion. This can largely be explained by a higher risk margin, especially for our life and health business, and due to the decline in interest rate and the growth of the business.

I don't want to spend too much time on further details. The most important point is the continued very high quality of the capital with 87% being Tier 1. The second important takeaway is the high degree of flexibility with EUR1 billion of unused Tier 2 capacity still left. Again details to follow early April.

I think this concludes my remarks, and I'd like to hand back to Jean-Jacques for the target matrix.

Jean-Jacques Henchoz {BIO 17457677 <GO>}

Thank you very much Roland. So target matrics 2019 on Slide 27. Most matrix are met or exceeded. The target matrix generally confirms the successful strategy execution and a favorable year 2019. Almost all targets are achieved, but obviously in P&C the impact of the large losses is being felt on the combined ratio and the economic matrics.

Let me move to the outlook for 2020 on Page 29. You have an overview on our profitability and volume expectations based on the favorable renewals at 1-1. We see further growth opportunities in 2020 in most lines of business of our portfolio. Also the overall profitability has improved compared to the previous year. All lines of business earned the cost of capital or a good margin on top of it.

For natural catastrophe risk, we intend to increase our capacities only carefully under selected programs with key customers. And the overall market environment remains very competitive, and large losses and results of the reinsurance industry in the past three years show that generally further needs to see some improving. Reinsurance rates is clear.

On Page 30, you have the same overview for the life and health business. We also see profitable growth in life and health reinsurance, mainly financial solutions and mobility business. And overall we see particularly promising growth potential in the Asian market, particularly China.

Profitability, as in P&C, is at or above cost of capital and our financial solutions business is expected to provide us with continued excellent profitability, which leads me to the guidance for 2020. The outlook for this year remains unchanged. We still maintain the expectation of a group net income of around EUR1.2 billion, which is an increase of EUR100 million compared to the initial expectations for 2019, if we remove the one-off items mentioned earlier.

It's a bit early in the year given the uncertainties on the portfolio, on the renewals later this year on the impact of the coronavirus on overall growth in the economy to move the guidance. Obviously, we have some outperformance at 1-1 in P&C on the top line -- at the top line level. But for the time being, we feel that the guidance should be maintained.

Before closing, just a few words on a very topical theme, of course, coronavirus. I'd like to make a few comments on the current situation on that front and the possible impact for Hannover Re. We obviously look into our own activities and business continuity measures are in place across the company. But there is no indication currently for operational losses or non-delivery of services. We have some local crisis teams, which are working in different locations. Traveling and meeting activities are downsized. Employees in some locations work from home, where needed and for other locations tele-working options are planned upon certain triggers.

Current insurance losses are minimal. We didn't see any impact so far, but depending on the further development of the crisis, we might see some losses emerging rather on the P&C side than life and health due to the low number of insured debt and feasibilities.

For the same reason, comparability to pandemic stress test with its focus on excess mortality is limited losses depends on the progression of event cancellations and supply chain disruptions throughout the year. Our loss monitoring is ongoing and current estimates are a bit speculative, but based on the initial analysis, the bottom-up from the different experts, we see some exposure for contingent business interruption and event cancellation in the order of EUR200 million.

Capital markets have shown strong reactions, of course. And currently as you know we have practically no listed equities and therefore are, on that front relatively comfortable. Up-to-date, there are no defaults in our asset portfolio and we continue to monitor market and asset portfolio performance on a continued basis.

The mid- and long-term impact will of course depend on the level and duration of the economic downturn. But at this stage from a pure reinsurance standpoint, I would say that situation remains manageable.

With that, I'd like to close the presentation part of our session, and I invite you to comment or ask any questions you might have.

Questions And Answers

Operator

(Question And Answer)

Dear ladies and gentlemen, we will now begin our question-and-answer session. (Operator Instructions) And the first question we received is from Kamran Hossain from RBC. Your line is now open, sir. Please go ahead.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi, afternoon everyone. Two questions for me. The first one is just I guess it's on the long-term impacts of where rates have got to in -- over the last few months, few days. How should we think about 2.7 moving to the level that you're kind of reinvesting at today? And how many bps should we be taking off a year going forward? And then are there any obvious actions that you can put in place to mitigate some of that impact?

And the second question slightly less number-y, but on Asia, you talked at the Investor Day about kind of expanding your capabilities, growing the business out there, hiring some people. Maybe could you just update on kind of how far you've got with plans, how happy you are and kind of when we should expect some kind of further concrete news on that? Thank you.

A - Roland Vogel {BIO 16342285 <GO>}

So I guess I should start with the rate environment. Not that we have not done any really simulations of how many basis points we will lose. The reinvestment yields have of course gone down on the one hand, because the -- especially the U.S. rates went down. I mentioned that the variation reserves have increased today by approximately EUR1 billion, so that is really driven by interest rates. If now the credit spreads widen remarkably further, this might come down a bit.

We will -- we only have -- the turnover, which we have presented at various times at the Investors Days, and we will have to expect that reinvestment yields, again are going down. We mentioned that 5 to 10 basis points we might lose. This will increase. What can we do against it? An immediate reaction, we cannot take. We pursue our programs in real estate and private equity and others, but other than that, we -- the answer is the same as always, at least medium-term, we have to reflect that in our reinsurance rates.

Q - Kamran Hossain {BIO 17666412 <GO>}

Okay. That's great. Thanks Roland.

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

And Kamran on your second question on Asia, we have started the recruitment plan later in the last year and are a little bit delayed. Of course the corona crisis has had an impact on the planning. But for 2019, we didn't have much new recruits based on our plan. The whole process is starting this year with some delays. So in essence, in terms of footprint, not a lot of more FTEs, but we have a significant number of FTEs planned for this year and next year.

The positive part is that the teams in Asia are within the plan or I should say the increased plan expectations which creates a situation where we need to hire people to manage the business. But so far, we're on track on the numbers, but are lagging behind a bit on the resources and are focusing on that, I would say, in the second quarter of this year and beyond, an increase in recruitment across Asia.

Q - Kamran Hossain {BIO 17666412 <GO>}

Thanks very much.

Operator

And the next question received is from Vikram Gandhi from Societe General. Your line is now open, sir. Please go ahead.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Hi. Its Vivek from SocGen. Good afternoon, everybody. Just a couple from my side. Firstly in the Group Annual Report, I see the 200-year aggregate annual loss utilization has gone up by nearly 20% year-on-year, while the 100-year and 250-year PMLs haven't moved up a lot so is this just a result of increasing exposure at lower written periods, or is there a completely different explanation to that deviation?

The other question is on the life and health re-EBIT for 2020 and beyond. Is your expectation still around EUR450 million or perhaps that gets closer to EUR500 million, given your actions on mortality results and the financial solutions business is doing extremely well? Thank you.

A - Roland Vogel {BIO 16342285 <GO>}

Let's start with the second question on the life side. The EUR450 million is probably the current plan and expectation for 2020. Of course, we work and hope that we can improve that in the future, but the outlook right now is rather difficult. I don't expect any from the corona crisis, but it depends on how clients will look for financial solutions in the next couple of years in the aftermath of the corona crisis.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Okay.

A - Michael Pickel {BIO 3139005 <GO>}

Just -- Michael Pickel, just to your first question and do not have the figures exactly before me. But in some countries, the regulator ask the clients to buy higher capacities for risk. And therefore we followed this. And therefore it could give us certain shifts. So for example, I make the practical example of Canada, where the regulator is very tough on buying limits. And then we followed up, and this may distort some figures you might find there. And maybe as well in Germany for example as well Solvency II always drives the demand for cat business. And having the same line with our clients you follow them as well in the upper layers and that could distort.

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

So we'll follow up offline on this just to make sure that you have the proper response. We will check the exact driver for the change if it's okay with you.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Sure, sure, sure. If I can just come back to the life and health EBIT and financial solutions. Just trying to understand, what is the biggest risk that you see to the growth in financial solutions business?

A - Klaus Miller {BIO 16886879 <GO>}

Do you mean in terms of insurance risk or that we don't get any business in the future?

Q - Vikram Gandhi {BIO 18019785 <GO>}

Yes. The growth kind of doesn't live up to the trajectory that it has shown overall for financial solutions.

A - Klaus Miller {BIO 16886879 <GO>}

The biggest risk is definitely changes in regulation in the sense that the regulator like we have seen in the transition from Solvency I to Solvency II, we had an awful lot of Solvency I business, which was basically not helping the client any longer under Solvency II. And therefore the client had some extraordinary cancellation rights. The same could happen to all kinds of regulations around the world in China, in the U.S., in Germany, in Europe, depending on how regulation is going.

What we're doing on the financial solutions side is basically getting the existing regulation more in line with economic reality. And if the regulator for whatever reason decides like in Germany, you need higher reserves to finance your guarantees, you have to build that ladder. That's fine. We were prepared to do that. And then the regulator came around the corner with a 16-year transition period. And suddenly all our business we wanted to write disappeared. Because if the clients get it for free from the regulator, they're not interested to buy anything from the reinsurer.

Q - Vikram Gandhi {BIO 18019785 <GO>}

Okay. That's very helpful. Thank you very much.

Operator

And the next question we received is from Edward Morris from JPMorgan. Your line is now open, sir. Please go ahead.

Q - Edward Morris {BIO 16274236 <GO>}

Thank you for taking my questions. The first one, just thank you for the update on the coronavirus. I wonder if you could just talk a little bit more around how you see potential exposures there. So you mentioned a figure of EUR200 million. Is that something that you see as a sort of upper limit or what are the assumptions that you're including in that? I believe that's mainly on the P&C business.

I'd also be interested to hear you talk a little bit around life and health. It seems that you see it as pretty unlikely that there'll be an impact on the life business. But if you could just talk a little bit more about why that would be the case? And what would have to happen for you to change your assumptions there?

And then second question just coming back on the reinvestment rate. Can you just clarify what is the reinvestment rate on the fixed income portfolio now? And yes, thank you.

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

I think I'll invite Michael to comment on coronavirus and the P&C perspective, and Klaus on the life and health side first.

A - Michael Pickel {BIO 3139005 <GO>}

Yes. I think coronavirus for us and how we brought together the sum was a bit a risk assessment of our current portfolio. This is not really the worst case, but it's a realistic case how we address things because for the moment, we do not have any loss advice. And therefore, I think it's essential just to ring-fence where something could come up. And there are some closer cases and there are some longer shots.

So for example, property normally business interruption is not granted for corona, because it's too far away, but it could be an implication on certain sub limits, which may occur. And so far, we have assessed the number and put a figure for this. The other thing is contingency. For example as well. For the moment, we are not very strong in this market. But if you see on the longer horizon, how long corona could be Olympic games are in danger. So we put there a figure for just addressing the figure.

Two other classes of business we've factored in. One is for example credit business. There's as well really a question whether credit really and corona fits together, because when you have a company which has financial problem, corona maybe is the last shot to bring it in into insolvency, but it's not really the reason why. Therefore, I think we assessed it. We said some countries are in better shape, in worser shape and then we put up a number.

And then last but not least, we figured in as well E&O business. I think it's very questionable whether E&O is really a class of business, where you could address claims, because then you really are not diligent for your people. And most people know about health organizations worldwide what they should do and behave accordingly, but we have assessed this as well in order to have a realistic scenario all over our offices. And this is the number Jean-Jacques has laid out.

A - Klaus Miller {BIO 16886879 <GO>}

Okay. Maybe on the coronavirus impact on the life side. If you just take our standard business and I have to use very simple numbers now in a telephone call. Let's assume we have a 10% margin. So if mortality increases by 10%, what does that mean? In the U.S., you have 350 million people. The average mortality should be about 1%. So that's 3.5 million who die each and every year in the U.S. That's one of our largest markets.

If this increases by 10%, then you would expect that our profit margin is gone completely. 10% of 3.5 million means you need 350,000 coronavirus deaths in the U.S. And as long as you don't see that, I can't see that our bottom line will be impacted. I see much more in the financial markets, nervousness there. But in terms of really death claims, this is very, very unlikely, especially because we just talked or I just talked about population mortality, which is usually much worse than insured population mortality.

And the real high sums insured are usually wealthy people who try to stay away from infectious areas, have probably good access to the health system. And therefore the likelihood is even lower than what I just tried to calculate. But this is really a back-of-the-envelope calculation. But I'm absolutely not nervous when it comes to the life and health result on Hannover Re.

A - Roland Vogel {BIO 16342285 <GO>}

Hey. If I then continue with the reinvestment rate. You know the number we usually publish is more than the yield to maturity. So what happens if I sell everything today and reinvest tomorrow? The number today if I look at my report is 1.2%. For the fixed income portfolio, I would expect that to increase as I mentioned that we would expect credit spreads to widen a little bit against the decrease of the interest rates.

If the book yield, and that is also a realistic number is around 2.5, to date, we lose 1.2 or 1.5 with a modified duration of 5. And the very simple again back-of-the-envelope calculation, which has led us not too badly over the last years would then result in 12, 13 basis points per year. Again, as I mentioned before, we had expected 5 to 10. Now it may be 10 to 15 but the impact should be limited.

And again I mentioned with the strong unrealized gains, I think if we touch the portfolio, we will at least in the first years also see realized gains. And in that regard, I do not expect that our expectation for the year really comes under pressure.

Q - Edward Morris {BIO 16274236 <GO>}

Perfect. Great to hear answers. Thank you.

Operator

And the next question we received is from Sami Taipalus from Goldman Sachs. Your line is now open. Please go ahead.

Q - Sami Taipalus {BIO 17452234 <GO>}

Yes. Hi. Thanks for taking my questions. The first one is just on the life new business value, which was very strong this year. Is it possible to just provide a little bit more detail of how that broke down between the different products? For example, was there a particularly strong impact of the longevity business this year? That would be very helpful? And is it also possible to give some form of outlook for 2020, what's the pipeline looking like in terms of deal or should we really just consider this figure as an exceptional number for 2019?

Then my second question goes to the U.S. casualty reserve charge. Could you just talk a little bit more about the extent of the adverse experience that you've observed here? How big has it been and what does it relate to? And is your decision to reserve more prudently purely related to what you've seen on your own books or have you used some external data or external observation to take this decision? Thank you.

A - Klaus Miller {BIO 16886879 <GO>}

Yes. Maybe I'll start with the life side. The more than EUR600 million of value of new business is dominated by longevity on one hand and financial solutions as well as some new business in China on the other. The reason is value of new business is relatively big if you have long-term treaties. If you have just a one- or a two-year treaty, value of the business can't be that high because then it's only one or two years of EBIT margin. So longevity has certainly an impact here.

And the second one is our financial solutions deals usually 10, 15, up to 20-year deals. The only area in which we make a lot of a create value a lot of value of new business from treaties which are already in force is probably in China where the market is growing, population is large, and an awful lot of business is sold. This is really true new business in the sense, we had a treaty and then new business was sold and reinsured with us. Whereas in the other cases, longevity and financial solutions, it's usually block transaction. And this is the reason why this is a pretty volatile number. It depends on five, six, seven large deals we write in a year. Does this answer your question?

Q - Sami Taipalus {BIO 17452234 <GO>}

Yes. That's very helpful. Okay. So I guess your conclusion then is that we should think of this as normal volatility rather than anything to...

A - Klaus Miller {BIO 16886879 <GO>}

We will do our best to stay always above the EUR220 million and do whatever we can get.

Q - Sami Taipalus {BIO 17452234 <GO>}

Okay. Cool. But the EUR220 million is the best guidance. Thank you.

A - Michael Pickel {BIO 3139005 <GO>}

Yes. Look just from the U.S. side in casualty business, I think it's important for me to say that we are a bit a strange animal in the U.S. casualty business because we hate larger limit. So we focus always on limits management when it comes to casualty line of business. And we are mostly writing regional business, no excess casualty program.

And our idea was really to create a portfolio where we do not underwrite auto business, commercial auto. We have umbrella private line business. We are a bit on the general liability, workers' comp. And we ring-fence these segments and saw that the half market years develop nicely, but we saw that there is some development in the years 2013 and 2016. And then it was our take to reserve it more prudently and not to factor in that we have positive development as we have seen that in the past.

So our data is, first of all, client information, paid, and then our own actuarial assumption on the portfolio. And then finally as well we could not abstain from social inflation. We see this in hte U.S. and this brought us a bit more to the conservatism that we reserved it accordingly. Does this answer your question?

Q - Sami Taipalus {BIO 17452234 <GO>}

Yes. Okay. So you're saying you're basically seeing adverse development on the 2013 and 2016 years but your response has been across all the prior years and in the current year as well. Is that correct?

A - Michael Pickel {BIO 3139005 <GO>}

As well in the current year, we used a conservative loss fix, but this we did already in the past. So we always ultimate and then we are reducing them what we have not done, we have not reduced and for the past years and we had for the years '13 to '16, we brought precautionary measures.

Q - Sami Taipalus {BIO 17452234 <GO>}

Okay. Okay. Great. Thank you.

Operator

And the next question we received is from Andrew Ritchie from Autonomous. Your line is now open, sir. Please go ahead.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Hi, there. A couple of questions. First of all, a boring technical one. In your annual report on the balance sheet, there's a very dramatic growth of the unearned premium reserve. And I appreciate that's because you've grown new business, but it looks very high. Is there some other accounting change? When I look at the year-on-year movement, there seems to be some change of consolidation or something, maybe just clarify that.

Secondly, could you remind us about the scope for noise in the life and health results from ModCo as credit spreads bounce around? This was obviously an issue a few years ago. Just sort of can you give us any sense of the sensitivity as credit spreads widen and how that comes through in ModCo?

The other question for Klaus. Why could your mortality risk requirement go up so much, when you're not really growing some straight mortality business? I mean, you tell us you're growing mostly in financial solutions and longevity, but the mortality risk requirement went up nearly 40%. And then linked to that, with the financial solutions business, in the past you've told us is essentially riskless, but there is tail risk. What is the tail mortality risk on financial solutions business? Thanks.

A - Klaus Miller {BIO 16886879 <GO>}

The last one is the easiest. We have usually mortality rate which can easily deal with a 200%, 250%, in some cases even 400% of expected mortality. So as long as the coronavirus does not go up to that level, there is basically no tail risk. And all these treaties have a clear purpose for the client, which is usually driven by capital solvency in his own balance sheet. And as soon as he has no problem with that any longer, he wants to get the business back. Otherwise, he would just pay for something he doesn't need.

Q - Andrew Ritchie {BIO 18731996 <GO>}

And there's no requirement to mark any of that should any of the clients retention be consumed? Is there any requirement to reflect any of that in any additional reserve for the financial solutions business?

A - Klaus Miller {BIO 16886879 <GO>}

It's so far out of the money that there is no requirement to do that.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Okay.

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

So Andrew maybe I come to your technical question. We have not changed any accounting practices. We've looked at where it comes from and it comes from all over the world. So in this regard the assumption should be that really the strong growth maybe also in some financial or structured reinsurance contracts to a larger extent really have contributed to the strong contribution to unearned premium reserves nothing extraordinary.

I see that China has contributed to that as well quite remarkably, but again, it's obviously driven by the growth. Maybe technically to come back to your question, why has the capital requirement for the life business increased so much? I did mention and again we will come with a deeper analysis early April. We have not yet seen each and every detail, but one main contributor is the low interest rate, which is a little bit difficult to understand, but you should bear in mind that the risk margin also depends on the interest rate. So that really goes up because also it's a discounted factor, and the discount factors go down remarkably. So it's the risk margin plus the growth of the business which bring that up so remarkably.

Now ModCo, the overall volumes, they have come down. So the volatility should be lower than what we have seen at around 2009, 2011 and 2012. I cannot really tell you we will have to look at the portfolio. We will have to look at exactly what is in there because to now use the spread widening overall of the last week will not lead us there. Of course if credit spreads widen, the ModCo derivative will be affected. It should be not as pronounced as we have seen 10 years ago. But I have to admit I don't have final numbers with me now. We will have to look into those portfolios on an individual basis.

Q - Andrew Ritchie {BIO 18731996 <GO>}

That's fine. And finally, is that unearned premium reserve more skewed by multi-year deals? I mean, for example, some of the structure of these, so I shouldn't expect it to earn through as quickly as normal, I mean just given the size of it or would you expect it to be earning out over the next 12 months?

A - Roland Vogel {BIO 16342285 <GO>}

Well, as I see here from the report in front of me, most of it is P&C. So in this regard, I would not assume that it is really driven by multi-year contracts. The earnings pattern should be comparable to the past years.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Okay. Okay. Thank you.

Operator

And the next question we received is from Thomas Fossard from HSBC. Your line is now open, sir. Please go ahead.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes. Good afternoon. Two questions. The first one would be for Roland. Maybe Roland, can you tell us what is your credit exposure to sectors like oil and gas, travel and leisure, and maybe also the automotive in your corporate bond portfolio?

Second question would be probably for Jean-Jacques. Maybe it could be difficult for you to say something at this stage but we've seen two days ago big announced merger within the brokerage industry between Aon and Willis Towers Watson, which is creating really a giant. It's already a pretty concentrated market. You've got 67% of your P&C business coming from broker. What's your view? What's your take? And what's your level of dependency, and how you see things going forward? Thank you.

A - Roland Vogel {BIO 16342285 <GO>}

Yes. Thomas, I start and I give you indications. Of course, it also depends on definitions. We have a corporate portfolio of around a little bit less than EUR15 billion. The energy, oil and gas contribution to that would be a little bit above EUR0.5 billion. Hotels and travel and leisure is less than EUR150 million so that is more or less negligible. The same is true for airlines.

Automotive is also an area or an industry which comes into question a little bit here. It is around EUR600 million. So you see, we have always been really focusing on the fact that we have a highly diversified portfolio. It goes all over the world, all over industries. So in that regard, we will be affected, but there is no concentration whatsoever in those industry which you have mentioned.

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

So Thomas on the question on the merger, indeed, it's a little bit early to say. Of course, this is very much in the context of continued consolidation in the brokerage industry, so not totally astonishing. It'll take a little bit of time until this merger is completed. I think it might be up to one year. On the negative, clearly for us choice and options are really important and seeing the consolidation process gives less choices.

On the other hand, we are a great partner to both companies and we continue to grow with them. And what is clear is that the intent is also to increase the scope of insurability. So it's not only about only of their respective market shares, but also to create new concepts, new ideas. It's about innovation. And from that standpoint, having scale and the wide range of services is important for a brokerage company and gives us access to more business,

so clearly some negative, some positive. What I should say is that although the consolidation process continues, this also triggers a lot of different moves from people who want to establish new brokerage companies. So I don't see this as a unique process. There will also be new players in the market to make sure there is healthy competition in the brokerage industry.

Q - Thomas Fossard {BIO 1941215 <GO>}

Okay. Thanks. Does it change your view regarding the speed at which you would like to enrich your product offering? I think that initially you thought that you told us that this is something that you had in mind over the next maybe two to five years. Does this kind of move, strategic move in the brokerage industry, I mean, potentially accelerating for you the need to come up with this kind of new services you were talking about?

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

No, I don't think this news per se changes our intent I think we always had this incorporated in our strategy. I think we need to continue to be very relevant to our customers, but we continue to be very clear broker partner on the P&C side. So we also wanted to stay relevant to the broker world. So it would not be for me a trigger for shifting our strategy or starting having a more service focused approach to the business.

We will have selective services and solutions to expand further, but I don't think this really triggers a change.

Q - Thomas Fossard {BIO 1941215 <GO>}

Okay. Thank you.

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

Thank you.

Operator

(Operator Instructions) And the next question is from Vinit Malhotra from Mediobanca London. Your line is now open, sir. Please go ahead.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes. Good afternoon. Thank you for the opportunity. I have one question, please. The redundant reserves being down by EUR200 million and also accompanying that we have the statement on the presentation that the conservative reserving on initial years continues. Could you help me understand what's your kind of outlook, if you like, on how soon this can be rebuilt?

And I'm also asking because one of the comments made was the casualty losses or casualty impact on reserving and you mentioned that you're more exposed to SME regionals. And then as the problem trickles down in that segment from large corporate, that's always an open-ended question. So I'm just curious to know how you think about redundant reserves, the rebuild and any risks to that from casualty this year? Thank you.

A - Roland Vogel {BIO 16342285 <GO>}

Yes. Vinit, if I start and I might then ask Michael to step in when it comes to the casualty details. I think by the end of the third quarter, we were still of the opinion that 2019 might be a year when we could add. So there would have been a little bit of room to do it, then the large losses came in remarkably higher. We were well aware of the final impact of this Ogden rate. But again, it also added a mid-double-digit effect to the reserve redundancies.

So we went then into the reserving season with well nearly unchanged or some slightly increased ultimate loss ratios, but the resulting redundancies then came a little bit lower, because of the increased loss development assumption. So in this regard, we just have to accept that the reserves have been used for an occasion. We have always told you that this is why we have them.

Also when the Ogden rate event happened for the first time also there, we have been using them. Now we had experienced a slightly less than expected performance, we have increased here the reserves. And this is again why we have used them. We always mentioned that we will use them in case we need it. And if there is an opportunity to add to them next year, we will do that again. And the most important thing is that we are very transparent about it and that we have not changed our overall reserving policy as such.

A - Michael Pickel {BIO 3139005 <GO>}

Yes. I think only just to add. In the Brazilian market, it's a developing situation. We are not a big reinsure in the Brazilian market. Our sweet spot mostly fits in the agro and property business. And so far we are sitting a bit on the side steps with a very limited exposure on casualty and specialty lines. That's my take for the moment.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay. Thank you.

Operator

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

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Yes. Hi, and good afternoon from my side as well. The first question is on your runoff result. Basically, when I look at your triangles in your annual report, there is a large negative effect coming from the 2018 underwriting year. I know it can be a bit technical, but the absolute number looks quite large. So I don't think it's only explained by Jebi. So if you could give us some details on that that would be helpful.

The second question is on financial solutions and the contribution to the other income. For 2019, I think it was EUR287 million. And you are saying that you plan to increase volumes or your value of new business is showing that you have already increased volumes. So should we be thinking that this EUR287 million is going to be growing quite a lot for 2020 onwards?

Lastly, and I know you don't really give a lot of details on Solvency II, but if I could just check maybe qualitative your operating capital generation for 2019. I assume that it was more or less in line with expectations given that the difference from the 237% that you've shown in your last disclosure is more or less explained by the model changes from the dynamic volatility adjuster. Thank you.

A - Roland Vogel {BIO 16342285 <GO>}

So if come back to the runoff result, you mentioned, I think it's a little bit we've seen that or it's a pattern. We've seen that before that the most recent years where we usually then add reserves is negative. That had been the case before. It's a little bit increased this time by Jebi. There is one other impact from a large advanced solutions contract which is nearly risk free,

but this is more a technical change between a profit commission and losses. So this is more technical. There is nothing unusual in that respect. Overall as mentioned, the runoff result has been positive within the expected range and a little bit impacted by Jebi and some other really overall developments going down, but nothing extraordinary.

A - Klaus Miller {BIO 16886879 <GO>}

On the financial solutions side, yes, we expect to develop this business. But as I mentioned in one of my earlier answers, this will be very lumpy. We have a changing regulatory environment for our cedent. And therefore it's very difficult to have a steady growth expectation here. But in general, yes, we would like and we expect this line to grow.

So anything else we have forgotten?

A - Roland Vogel {BIO 16342285 <GO>}

Capital generation.

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

The capital generation question. Paris, could you rephrase your third question, please?

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Yes, yes, sure. So basically I was just wondering whether or not your operating capital generation for 2019 on a Solvency II basis was more or less in line with your expectations at the Investor Day.

A - Roland Vogel {BIO 16342285 <GO>}

Yes. As mentioned, I think we gave you the forecast at the Investors Day. At the occasion of the Investors Day, we only referred to the potential additional hybrid. So the difference between the EUR750 million issue and the potential call in 2020. So we added EUR250 million, and we disregarded the dynamic volatility adjuster because BaFin approval was not certainly enough to already consider that at that point in time. If you really add the two components which we had not taken into consideration at that point in time, we are exactly there.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Thanks for the answers.

Operator

As there are no further questions, I hand back to Mr.Henchoz for some closing remarks.

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

Well, thank you very much. I think we had a comprehensive overview. Thank you for all the questions. I hope the presentation and the discussion gave you the necessary background on our numbers in 2019. We're going to have our AGM in May. And I don't know when the next meeting with our analysts will be probably just for the first quarter.

A - Roland Vogel {BIO 16342285 <GO>}

Right.

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

What's the date?

A - Roland Vogel {BIO 16342285 <GO>}

It's on the 6th of May.

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

6th of May will be the next opportunity to exchange. So thank you very much and have a great afternoon.

Operator

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