Q2 2017 Earnings Call

Company Participants

- Roland Vogel, Chief Financial Officer & Member of the Executive Board
- Ulrich Wallin, Chief Executive Officer & Chairman of the Executive Board

Other Participants

- Andreas Schäfer, Analyst
- Andrew J. Ritchie, Analyst
- Guilhem Horvath, Analyst
- Ivan Bokhmat, Analyst
- Jonny Urwin, Analyst
- Kamran Hossain, Analyst
- Michael Haid, Analyst
- Nadine van der Meulen, Analyst
- Olivia Brindle, Analyst
- Vinit Malhotra, Analyst
- William Hawkins, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. Welcome to today's Hannover Re International Conference Call on Interim Results to 2017. For your information, this conference call is being recorded.

At this time, I would like to hand the call over to your host today, Mr. Ulrich Wallin, Chief Executive Officer. Please go ahead, sir.

Ulrich Wallin {BIO 4863401 <GO>}

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

With group net income of €535 million, our set of numbers for the first half-year 2017 fully supports our whole year profit guidance of a net income of more than €1 billion. The net income shows growth compared to last year of 9.6%, which however also has to do with the fact that last year's second quarter was a bit difficult.

With a foreign exchange rate adjusted growth of 8.7%, the development of our gross written premiums is quite positive. This growth entirely stems from our P&C business, and there in particular from significant new business growth of our structured reinsurance business. This transaction are often surplus relief transactions, with reduced risk transfer around the expected loss values. Some of the new transactions produced quite sizable new premium volumes.

Our income from assets under own management increased by 15.3%. This change was the main contributor for the EBIT growth, which at the half year stands at just under €800 million. The book value per share decreased by 4.8% to €71 due to the dividend payment including the special dividend in the second quarter, which is in line with our capital management effort.

In addition, the strengthening of the euro against the U.S. dollar meant that there are other significant parts of our capital which, for risk management reasons, we hold in U.S. dollar, saw reduction in value when measured in euro. The return on equity, on the other hand, grew compared to the first half-year 2016 to 12.2% and remains well above our minimum target.

Regarding our property/casualty reinsurance business, we saw diverging dynamics influencing our underwriting income. On the one hand, the decision of the UK government to reduce the discount rates for compensation payments associated with personal injury claims, the so-called Ogden rate, from 2.5% to minus 2.75% (sic) [0.75%] resulted in booked additional loss reserves of €291 million. On the other hand, the major losses of the first half-year 2017 only came to a number of €123 million, which is well below the expected levels.

However, both effects only had a marginal impact on the results. If in line with our common practice, we largely left the unused major loss budget within our IBNR reserves and, on the other hand, compensated for the additional reserves in relation to the Ogden tables from the redundancy buffers within our P&C loss reserves.

As a result and aided by a very positive contribution from the investment income, the EBIT of our property/casualty business grew by 12.7% to €634 million. As this was in line with the growth of the net earned premium, the EBIT margin remained constant at 14.7%, well above our minimum target of 10%.

On the life & health side, as expected, we saw a very positive development of the earnings of our financial solutions business which reached an EBIT margin of close to 30%. This positive development also compared to last year, however, was more than offset by continued higher-than-expected claims from our U.S. mortality business. This negative development relates to a large block of business that we assumed at the beginning of 2009 and which continues to produce a gross premium volume in the region of $1 billion.

As we have the opportunity on this business to adjust the reinsurance rate where appropriate, we have initiated a project for a very detailed analysis of the various aspects that have led to the significantly higher claims than we had expected. This project should allow us to more precisely tailor our in-force management activity to individual treaties of the block of business. As a result of this development, and in particular the higher-than-expected claims of the large assumed block of business, the EBIT reduced to €165 million, which is clearly below our expectations.

The gross premium development was rather flat with a slight reduction as a result of the discontinuation of some single-premium treaties and some financing treaties from the UK and China, which could not be fully offset by a positive new business development.

The return on investment from assets under own management came in at 3.2%, which is well above the full-year target of around 2.7%. This is mainly the result of very strong contributions of private equity and real estate portfolios.

On this note, I'd like to hand over to Roland, our CFO, who will explain these figures in more detail.

Roland Vogel {BIO 16342285 <GO>}

Thank you, Uli, and good morning from my side. The first half-year results of 2017 include a few material, one-off effects only, so I will try to concentrate my comment on them. Maybe one short remark before I start. For those interested in analyzing our reserve situation in more detail, we have published the P&C loss reserve triangles as of December 2016 on our website today as well.

We will see later that the favorable top line development in the first quarter of 2017 is entirely driven by our P&C business group whereas our life & health business showed a small decline in gross premium. Overall, the premium development is slightly ahead of the range where we initially expected for the full year. Net premium increased by only 4.9% adjusted for currency exchange effects. With the difference to the gross premium development driven by additions through unearned premium as the retention was fairly stable.

We are very satisfied with the investment income. Uli mentioned that already especially because the increase compared to last year is driven by strong ordinary income and lower write-downs. Other income expenses increased mainly due to the strong profit contribution from our life & health financial solutions business as a significant part of these treaties is booked according to the deposit accounting method and the profits from such contracts, therefore, show up in the other income lines of the P&L. Just for the sake of completeness, the tax rate is slightly down but still within the expected range.

Next page, operating cash flows continues to be very positive, very much in line also with the previous years. Nevertheless, assets under own management decreased to roughly €40 billion. This is entirely driven by negative currency exchange rate effects of overall €1.8 billion due to the strengthening of the euro against most of the relevant currencies. On top of this development, we had the payout of last year's dividend, which overall could only be partially compensated by the positive operating cash flow of a good €900 million.

On the next slide, to understand the development of the IFRS capital position, one should start reading that slide on the right-hand side. Shareholders' equity decreased by 4.8%, driven mainly by factors we have already mentioned. There was a payment of record dividend of €603 million in Q2. Additionally, the exchange rate movements as a part of the I had a negative impact of some €480 million.

This especially reflects the currency translation of the capital positions of our subsidiaries, the U.S. life, the Irish, as well as the Bermuda (11:11) company, balance sheets are denominated in U.S. dollars, which is the reason that the consolidation of their capital into the group leads to some volatility in the other comprehensive income on the group's balance sheet. We, unfortunately, have no influence on the U.S. dollar exchange rate. But together with our capital management via increased dividend payments, this development also supports the ROE of more than 12%.

P&C gross premiums increased by a remarkable 16.9% on an FX adjusted basis. This is mainly based on the successful new business written by our structured reinsurance team, and it is also fully in line with our reporting on this year's January renewals. Additionally, as a result of our strong position in the market, we also enjoyed healthy demand in a few other areas like, for instance, the U.S. or credit and surety leading to further diversified growth. Also, here, the difference between the gross and the net premium development was caused by the unearned premium reserve.

At 2.8% of net premium income, major losses were significantly below budget in the first half-year, mainly owing to the absence of large losses or large loss events in the second quarter. The combined ratio of 96.5% is admittedly slightly above the full-year maximum target of 96%. But we should be aware, as in previous years, we stuck to our standard practice and have kept our large loss expectations in the reserves.

As we have increased our Advanced Solutions book so remarkably and we do write these contracts with an initial combined ratio of around 99%, still making the margin. The combined ratio suffers somewhat from that increase in the Advanced Solutions book as well. As compared to the previous years, that effect accounts for approximately 30 basis points.

Uli had already mentioned and commented on the Ogden effect. So there is no need to repeat that here. Overall, based on the fact that we absorbed the negative effect within our existing IBNRs, the confidence level of our loss reserves should have decreased compared to the end of 2016, but it's definitely still on a very comfortable level. Apart from the Ogden rate, the run-off of loss reserves was slightly positive within the expected range, and did not include any other material effects.

Ordinary investment income was slightly ahead of expectations, mainly driven by the already mentioned strong contribution from private equity and real estate. Other income expenses improved by around €30 million. In the P&C segment, this was supported by positive currency exchange effects. Altogether, the net income for our P&C business stands at €444 million, up 17% compared to the previous year.

Major losses, significant, below the expected level. We've mentioned that. Most notably, we did not record any large loss in the second quarter of this year. I think this is premier for me. By contrast, the second quarter of 2016 was heavily impacted by a number of large losses. You may remember the Canada loss. The leaves us with a comfortable cushion number, around €700 million, to absorb large losses for the remainder of the year, including the unused approximately €220 million of carried forward from the first half-year.

The large loss list here on the next slide. It should look very familiar to you, as it is almost unchanged compared to the slide we showed for the first quarter. In total, the loss estimates for the large losses occurring in the first quarter were adjusted slightly downwards.

Next slide, you can see that most lines of business showed a healthy underwriting profitability. The 100% combined ratio for the UK London market and direct business stands out. And it is the result of the reserve strengthening for the change in the Ogden table. This also shows and demonstrates that the mitigating IBNR releases came from across the board rather than the UK motor business only or the motor reserves only.

Overall, the main contributor to the underwriting result in the first half-year was Continental Europe where we did not record any sizable large losses. Additionally, the combined ratios for our global cat business, as well as the specialty lines in our facultative business were favorably below the MtCR and did reach a good profitability.

In life & health, gross written premium decreased slightly by 1.5% adjusted for FX effects, which is still in the ballpark of our expectations. Also, for the full year, we have seen growth in a number of regions like China, Australia, and the U.S. This was, however, offset by reduced premium income due to the discontinuation of large volume treaties, especially also in our UK annuities segment.

As Uli already mentioned, the result of our U.S. legacy mortality business, again, fell short of our expectations in the second quarter, which led to an underperformance expectations of around €50 million in the first half year. On the other hand, the profitability of our financial solution business continued to be excellent, mitigating a good portion of this negative effect. Such developments are also reflected in their respective EBIT margins, as you can see. Finally, our longevity business showed a satisfactory EBIT margin of 2.3%, which is slightly above the target.

Income from funds withheld declined by €42 million due to the discontinuation of two large financing treaties. As explained earlier, the significant improvement in the other income and expenses can almost entirely be explained by the increased result from treaties recognized according to the deposit accounted method, with a total contribution of around €93 million in the first half of 2017, an increase of €60 million compared to the previous year. Currency effects, on the other hand, were slightly negative here.

Other investment income was in line with our expectation. Realized gains were a bit higher than in the previous years. And just for the sake of completeness, the effect from our ModCo derivatives was a plus €3.3 million in the first half year.

Looking at the investments, the development in the first six months of 2017 was very satisfactory, with investment income above our return expectations for the full year. In light of the strong contribution from private equity and real estate, the ordinary investment income increased by a remarkable 12.5%. The income from private equity, that, however, includes some extraordinary elements, which cannot be expected to reoccur in the second half. Still, the run rate will most likely stay above expectations.

Realized gains were on a similar low level as in the last year, as we continue our policy of maintaining the bulk of unrealized gains, instead of actively harvesting them. Depreciations returned to the expected level, mainly consisting of regular depreciation for real estate. That is because the write-downs on listed and private equity that we had in the previous year did also not recur.

The overall return on investment was strong at 3.2% which is why we now expect to achieve more than the previously targeted 2.7% in 2017. For the full year, variation reserves were stable at a high level compared to the year end of 2016, as the effect from spreads on the one hand and the interest rate movements on the other hand offset each other nearly completely.

The next slide shows the usual overview of how the different asset classes contributed to the ordinary investment income compared to where we are invested. On the right-hand side, you can see that we kept our asset allocation more or less stable in the first quarter to slight increase in higher yielding corporate bonds from 4% to 5% is in line with our barbell strategy, which we have explained before. And this is how we still invest the new investments - or invest maturities and free cash flow. And the overall risk appetite stays unchanged.

The left-hand side illustrates a very strong performance of the private equity portfolio and the continued positive contribution from the real estate portfolio. As indicated, the 12% from private equity is expected to trend towards a more normal level over the course of the year, still being very attractive.

I think that concludes my remarks. And, as usual, I leave the target matrix and the outlook to you, Uli.

Ulrich Wallin {BIO 4863401 <GO>}

Thank you, Roland. And, yeah, talking about the target matrix, as you can see, we have achieved all our group targets in the first half year 2017. The business group target's a little bit more mixed picture. There's some misses notably on the life & health side.

The treaty renewals in the second quarter which, of course, is the (22:42) renewals in Florida, through ILS 2017 renewals in the U.S., Australia, some Asia, and some credit and surety continued to depict a rather competitive market. This is, in particular, true for the Florida renewal at 2016 where, actually, the rate decreases were a little bit larger than last year, which was kind of a negative surprise. The other renewals, on the contrary, the 2017s and the other one, second quarter renewals were more positive and much more in line with the renewals at 1st of July and 1st of April, which show a slowing trend of the decreases.

From this background, we achieved good growth of our business by 10%, which was in particularly aided by our North American business, which actually grew by 15%. The main driver here was increased share from existing core clients, and here, mostly from the short-tail lines. We also saw some growth on our U.S. casualty business. However, no new launched additional transactions here. And we found that the casualty business actually remained quite competitive.

For treaties that has been loss-free, we saw further rate decreases, mostly in the range of 3%. However, treaties with losses, which we have seen in particular in the property per risk business, rate improvements could be achieved between 10% and 20%, in particular, as far as of course the U.S. business is concerned on the property side.

Australia and New Zealand, the development overall was quite positive, even though we've continued to see some premium erosion on loss-free business. However, we saw significant price increases on the Australian business due to the losses from the cyclone Debbie as well as the New Zealand earthquake at the end of last year. Our market position in Australia allowed us to increase the volume, to some extent, at a good overall rate, which meet our margin requirements.

And finally, on credit and surety. We have some new business. We also increased some of our lines, and that resulted here in a growth of the premiums of around 10%. I should add that this slide only includes the traditional P&C reinsurance treaty business and does not include the structured reinsurance business that, again, at 2017, we saw some significant growth, which was even more pronounced than the traditional business.

If I come to the next slide, which is our guidance. You can see that we have made some minor changes here based on the outcome of the first half-year and the midterm renewals. We increased our growth premium target to more than 5%, which is almost certain at this point in time, because most of the business has already been written, a very positive development of our investment income in the first half-year. We are now confident that we will be achieving a return on investment that is in excess of 2.7%. The group net income and the dividend payout ratio remains entirely unchanged. I would like to point out once again that we will continue, as our practice, to consider a special dividend in case that the results come in as expected.

Looking at the overall development of our property & casualty business by sub-segment, you can see that on the premium side, we see particular growth in the structured reinsurance business and also the ILS business. Credit and surety, and UK and Ireland are also growing. UK and Ireland also due to the significant increases that we are getting on the UK motor business, particular also excess of loss business.

On the other hand, Continental Europe looks more flattish to slightly down. And we also continue to see some decreases in marine and aviation, where in order to safeguard the continued positive results, we have to shed some premium. The reduction of income on the facultative side is mainly the result of some reclassification of facultative business to the direct business written by our subsidiary into Hannover. And that also contributed to the increase of the UK, London market, and direct business. Worldwide treaty and catastrophe excess of loss is rather stable. This continued lower market share on the catastrophe business than we have overall.

When it comes to the profitability, we continue to expect the margin requirements to be fulfilled. And we continue results of profitability, in excess of the cost of capital. Particular positive from the first half-year was Continental Europe. So, we expect to earn above the cost of capital, and the same is true for the marine business, as well as our facultative business. With aviation, UK and Ireland due to the Ogden rate table changes and natural catastrophe business, below the cost of capital, however, this would only come true, other than UK and Ireland, if we actually hit the expected losses. I suppose aviation and the catastrophe excess of loss business are, of course, non-proportional business. It needs exceptional losses in order to achieve the expected loss levels. So, overall, at this point, it's a soft market, still quite a good picture on our P&C business.

When it comes to our life & health business, we continue to see very profitable business at stable premium volume of our financial solutions business. Here, I have to say that the premium volume is less important, because the majority of, particularly the large transactions, are deposit accounted due to the low or not sufficient risk transfer for regions accounting, and therefore, the profitability largely shows up in the other income and expense line.

Longevity business, we expect a slight reduction in the premium, mainly from our enhanced annuity business, which due to the changing in the environment regarding tax deductable is actually decreasing. Mortality and morbidity, quite stable to slightly up. And from a result point of view, we expect that the mortality business will not achieve the cost of capital and that have to do with the U.S. mortality business. The remainder of the mortality business has actually quite attractive margins.

This slide should look rather familiar to you as we used it in previous conference calls as well. On the P&C was is our conservative loss reserve, strong market position, better terms and conditions on our (32:47). We are quite confident that for the full year, the combined ratio should stay below 96%, provided that the large losses remained within budget, so that the overall underwriting result should remain fairly stable.

On the life & health business, we continue to expect negative effects from our U.S. mortality business. This also includes negative impact, which we already expect for the third quarter of around $50 million. This relates to an expected recapture of a block of treaties from our U.S. mortality business, which have had performed very negatively. And the recapture by the client in this case would result in a one-time negative effect on 2017. But, of course, in the future years, it will actually improve the results, because the expected future year losses will, of course, not materialize as the business has then been recaptured by the client.

I have to say that in line with our in-force management activities, such occurrences could also happen in future, even though for the remainder of the year, none of those are actually in sight. As a result of this development, we have reduced our EBIT expectation for the life & health business from more than €350 million to around €300 million. There is no reduction beyond or below the €300 million. It's, again, the effect of the significantly increased profitability that we see from our financial solutions business. Net investment income, we expect fairly stable also due to the positive development that we already have seen at the first half year of this year.

On this note, ladies and gentlemen, I'd like to end our presentation here. And we would be more than happy to answer your questions.

Q&A

Operator

Our first question comes from Nadine van der Meulen of Morgan Stanley. Please go ahead. Your line is open.

Q - Nadine van der Meulen {BIO 15200446 <GO>}

Yes. Good morning, gentlemen. Thank you very much for taking my questions. First one is on the performance in life re, the negative impact from recaptures of around €50 million expected in the third quarter. Do you expect recaptures to continue to impact the performance beyond the third quarter?

And on the Europe redundancies, on PYD, if you will. Those have been pretty high in the last years, ranging from anything between 4% and 10% in the last eight years or so. And this quarter, the €50 million is, I believe, in line. What can we expect for the full year and in coming years?

And then, perhaps the last question on Solvency II. So, the ratio at 243%, I suppose the internal model approval of operational risk is not included, and that should perhaps (37:08) around 20%. Do you still expect that over the next six months or perhaps part of it is included? And in that light, you're getting in towards territory of over 260%. I believe you have a self-defined sources threshold of around 200%, so then that means towards €30 billion of access over that which was about a quarter of your market cap. Could you comment on what level you are happy with on a lower term view on the capital position? Thank you very much.

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes. Thank you very much for your questions. On the recaptures on the life & health side, this has to do with – I mean, in-force management actions, in particular, adjusting rates on negative performing business efforts.

On some of the treaties, I mean, this received a unilateral right that we have on many of the treaties. However, of course, we have to take into account the overall relationships that we have with our clients. And therefore, so far, in all of the cases, we try to come to neutral solution on this underperforming business. And this often is like sharing of the burden, which then means that it has a negative effect on our IFRS accounting, but it would have a positive effect on the technical provisions under Solvency II.

And while there is possibility is that more of that happens, even though as I said, we are not foreseeing it beyond the €50 million for this year, but certainly, the possibility that we see more of this next year. So, from that point of view, it has to be expected that the large block of business of U.S. mortality businesses that we assumed in 2009, potentially, will continue to be a drag on our result. Of course, increasingly offset by a very positive financial solutions business, which continues to grow and where we continue to see profit growth also in the coming years.

And, also, the new business that we write on the mortality solutions, of course, we write with a wealth of experience that we have from the underperforming block, and therefore, try to avoid the same pitfalls that we had then. And that of course, is very positive, and we see pretty good results on those. And as that business grows, I would say, by around 20% every year, that starts to offset the negative development of that big block. However, I have to caution that the development on the big block has actually continued to surprise us negatively with also the first half year in 2017 has been worse than the first half year 2016. And I have to say that we had expected more in line with the first half year 2016.

When it comes to our loss reserves, the redundancies on the loss reserves, on the P&C side, of course, we had pretty positive developments there. And with the soft market, we have expected at least for the last three years that the level of redundancies would gradually decrease due to the effects of the continued soft market.

Actually, until the end of 2016, that is not happening, as the underlying performance of the business has been a little bit better than one should have expected, considering the effects of the soft market. Well, of course, the development of the redundancies in the current year probably show reduction in the level of redundancies, but remaining at a very comfortable level. But this has two providers: one is, of course, the large losses hit the budget; and second, that the Ogden rates stay where they are. So, if those both providers are so true, we expect to see some reduced redundancies.

Solvency II ratio, still rather new to us. It is, of course, a little bit volatile. Yes, we have got the approval of our operational risk model for the Hannover Re group, which improved the solvency ratio. But, of course, you have capital markets developments, which can have also negative impact on this. Of course, if there's a change in the technical provisions on the life, which is of course projected for the next 80 years, also that can have a positive, or indeed, negative effect. So, we are quite comfortable to see this ratio higher rather than lower, I would say, for even this 260%, we would be relatively comfortable.

This also has to do with the fact that we also have to observe the rating agency development there. And if you, probably, have read S&P – I mean, confirmed our AA-rating, this is stable outlook. At the same time, S&P has made a number of changes to their model, of which we're always pointing in the direction of more rather than less capital needed. Hopefully, this rather long-winded answers gives you some answers to your questions.

Q - Nadine van der Meulen {BIO 15200446 <GO>}

Very clear, and very much appreciated. Thank you.

Operator

Thank you. And our next question comes from Jonny Urwin of UBS. Please go ahead. Your line is open.

Q - Jonny Urwin {BIO 17445508 <GO>}

Good morning. Thanks for taking my questions, just two for me. So, firstly on the second quarter combined ratio. I mean, it's the highest it's been for some time. And you've obviously flagged some mixed shift going on in there, driven by the growth in structures in reinsurance. I just wondered if you could provide some more detail. I mean, is it higher attritional? Is it higher commissions? It looks like it might be higher commissions. And I guess this a recurring change given the sort of continued growth plans (45:13) reinsurance there. How should we would be thinking about that combined ratio going forward?

I mean, secondly, just thinking a bit about this growth, so obviously, it's coming through very strongly, especially on the structured reinsurance side, but also in North America in the July renewals. I mean, how would you reassure investors about such high levels of growth in P&C at such a late stage in the pricing cycle? Do you think this changes the risk profile of the group? Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, firstly, on the combined ratio, yes, the structured reinsurance, which has rather safe margins but not very high margins, had, I mean, 0.3% effect on the combined ratio of the first half year, as Roland mentioned.

In addition, of course, I mean, we have the change in the Ogden rate table, which we used our buffers to absorb. But, of course, we only did that to – I mean, at the least, I wouldn't say, but a low possible extent. And as the P&C income – I mean, the EBIT was already driving double digit. We thought we keep as much in the redundancy buffer as we probably can, and therefore, we tolerated a higher combined ratio than we would normally want to see.

Actually, the underlying attritional losses have been reasonably favorable, I would say. I mean, particular on the specialty lines, I mean we saw improved underlying losses on credit and surety. Same is true on our marine business and also our European business, as well as our facultative business. So, we are not concerned to see underlying quality of our business and the underlying development.

I mean we seem to be increasing - to your second question, increasingly successful in further improving our positions as a preferred reinsurer with our clients. And that resulted in quite good growth, underlying growth also outside the structured reinsurance in pockets (47:52). And this is not by writing significant new large treaties, but it's more by increasing lines on existing treaties. So, from that point of view, I would argue that it is actually healthy growth and that the underlying risk profile is not changed actually. It's probably continuing.

And also, I mean, yes, we are on the fifth year of the soft market. But it's still a little bit heterogeneous. Yes, on Florida, cat, I mean, we probably already lost 60% of the rating quality. But that's not an area where we are particularly heavily involved. And other areas has a more mixed picture. I mean, if you look at Continental Europe, there's some areas like German motor where we see increases. We also see some other small segments or larger segments with better development. So, we feel rather comfortable, as I said, growth even though I appreciate your concerns that you say, well, how can you grow when the market is actually soft.

Q - Jonny Urwin {BIO 17445508 <GO>}

That's great. Thank you.

Operator

Thank you. Our next question comes from of Vinit Malhotra of Mediobanca. Please go ahead. Your line is open.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes. Good morning. Thank you very much. I just wanted to quickly check on some topic which have been addressed, but just let me - in the renewals, the change in the share that we track I think is the highest positive change in a long time. Just a comment, is it just same thing that we just discussed because you did say that property was something you have grown in the U.S. So, if you could just comment once again that this is presumably not Florida but just somewhere else in the U.S. That is one question.

The other question is - for Roland on the - there's a comment on the P&C other income which is quite confusing to me that the positive FX in 1H caused this. Now, I mean the dollar literally crashed in 2Q. So, I mean how could this be such a positive number for you?

And just lastly on the Ogden, I think there's a comment somewhere that there's a bit more - I mean, what should we think - I mean, this was a very large move. If there's more to come, is it - are you happy assuming Ogden doesn't change? Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, firstly, on the change in shares, well, that's in particular the kind of growth that we'd like to see because, I mean this is business we know. And of course, we screen our business that we have. And of course, there's always some treaties where we'd like to have a larger share. And naturally, I mean if we do achieve that, that is less risky than writing new business. I mean it's not much on the cat side because we haven't increased our risk appetite on cat. It's more on the per risk business which where we have leading position in the U.S., and some of those is a long-tail line. (51:37) I mean it starts to aid us a little bit that we are not aggressively competing with our insurance clients, and that helps us at times to increase our shares.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Can I just follow up the share you're winning is from very, very small players, do you think, or from other mix life there? Could you comment a bit – or larger players?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, I guess, on the long-tail business, of course, if you've gained shares, it would be from the larger players because, I mean, they are mostly involved in the long-tail business. In general, I would say it's probably more from the larger than the smaller players in this case.

I mean on Ogden, what we have done on Ogden – I mean we haven't, I mean, taken the Ogden losses and run it against our UK model, IBNR reserves, which we could have done but we've chosen to reserve them in addition. So, I mean outside – in addition to what we have put up on Ogden in the second quarter, which is the €290 million of which around €230 million is UK motor excess of loss.

We're still holding €250 million IBNRs on our UK motor business which, of course, we could have used to bolster the Ogden. But we just wanted to highlight the effect of the Ogden table rates. I mean, there might be further development in the Ogden losses, primarily because – I mean if we have new claims now, of course, they will also be reserved in accordance to the Ogden rate, which would mean that that reserve would be higher.

And, of course, some of the claims that have already occurred are still in the phase of the assessment of the injuries and the assessment of the quantum of loss, therefore, and of course, both of them higher expected losses are being used. And that will, of course, then be offset against the actual UK motor IBNR reserves. So, I would say, with the addition of the Ogden rate reserves, our – I mean sufficiency of our UK motor reserving has actually slightly improved.

And I think the other question is for you, Roland.

A - Roland Vogel {BIO 16342285 <GO>}

I think that was – the question's around the effect of the currency exchange rates. So, Vinit, you mentioned that the U.S. dollar had weakened and this should have a negative rather than a positive effect. I would not agree to that. Well, you know that we usually try to be as matched as possible currency-wise. I have to compromise my matching exercises as I have so many balance sheets to match. It's a German GAAP balance sheet. It's the IFRS balance sheet. It's also an economic balance sheet. They deviate from each other, so I have to compromise here or there. So, I can never be 100% matched on an IFRS basis.

So, it happens that I'm long in dollars or short in dollars. So, for instance, I have to determine how much U.S. dollar assets I have by the end of the quarter, so exactly the 30th of June. Still, the reserving exercise happens a little bit later so actuaries (56:00), so just to demonstrate that it is not an easy task. So, I can be long; I can be short. The difference driven from the currency exchange rate for P&C was, I think, some €19 million (56:12), an effect which we have. So, this compares to the matching exercise of more than €20 billion in reserves.

So, you can foresee that it can be a little bit volatile. So, in that respect, any movement in volatility is a demonstration that the CFO didn't do a good job in matching his balance sheets. So, it's not this direction is always positive or this direction is always negative. Again, I can be short; I can be long in my matching exercise. So, it's a little bit coincidence.

Moreover, there is one other aspect which is included here. We did write off all our receivables in Venezuela last year, some of which could then still come in, so there is another positive effect, which is where we benefited, where we had a little bit of loss last year and a little bit of profit this year. So, it is unfortunate that we cannot avoid the volatility of that line entirely.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay. Thank you.

Operator

Thank you. Our next question comes from Kamran Hossain of RBC. Please go ahead. Your line is open.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi. Morning, everyone. Just coming back to life reinsurance, and apologies for that. Just thinking about 2018 and the outlook for that business and the EBIT. So, I guess we started this year with €350 million. We're now down to €300 million. I guess when you take the charge in the third quarter next year, you'd expect 2018 to improve as a result. I just want to understand whether that's starting from the €300 million base or the €350 million base as a kind of starting point.

And then, I guess, on top of that, do we need to think about a greater contribution from financial solutions next year? So, that – kind of where do we start, is it €300 million or €350 million, and then do we need to factor in greater financial solutions contribution? Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, I mean there's no apology for this question because it's very high on our minds. I mean, if you look at the results here, I mean good is becoming better and the bad is becoming worse, is probably fair to say. I mean, as I've already pointed out, I mean the development in the first half-year of the actual versus expected was a negative surprise to us.

And I mean, this re-occurring surprise, we would be optimistic still to assume that the second half-year on the actual to expected would revert to our expectation level for the entire year. So, we are not expecting that. Gradually, we believe that we should see an improvement here from the fact that we are actually increasing rates or seeing recaptures initiated by our clients, which means that future losses are actually reducing.

On the financial solutions side, we continue to have a pretty full pipeline of new business. Therefore - I mean there is a quite big increase of the results this year. As these treaties are not single year treaties but multi-year treaties, I mean certainly we start the next year at the same level than we end this year. And then the new treaties, which we're expecting in addition would come on top of that. So, I mean, also for next year, you will - we can pretty certainly expect the increased profitability on our, particularly U.S. financial solutions business. But I mean we have become extremely cautious on our - a large block that we assumed on the UK (sic) [U.S.] mortality business.

So, at this where I stand (01:00:51) now, I would say, for 2018, I mean I would probably be cautioned and say maybe the EBIT should stay at around the €300 million mark, and we should not budget for an increase.

Q - Kamran Hossain {BIO 17666412 <GO>}

Okay. It's very clear. Thank you very much.

Operator

Thank you. And our next question comes from Guilhem Horvath of Exane BNP Paribas. Please go ahead. Your line is open.

Q - Guilhem Horvath {BIO 18460437 <GO>}

Yes. Thank you. I'll come back a little bit on life insurance. Once again, I appreciate that you're remaining cautious and that it's probably too soon to tell. But just going back on the project you mentioned earlier, I'd like to know when do you think you'll be able to have a better view on how much recaptures on EBIT or how much rate increases? Because you mentioned 2018 to Nadine's question, do you think this is the kind of timeframe needed in order to re-price the business and to get rid of the bad bits of the business or do you think it's a much longer process? That's my first question.

And the second is on return on investments, private equity, real estate and parts of it, which is not sustainable. Can you discuss a little bit what you think is sustainable, and also, when you think the ordinary income on fixed income assets will stabilize because you mentioned once again the decrease this half year. And I'd like to know if you see some stabilization at some points on the fixed income part? Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, we expect that on the U.S. mortality that, at the latest, by the end of the year, we should have the result from the project as regards the expected future losses and the change in those expectations. And well, of course, the in-force management actions will start or have already started, but we'll accelerate them. And we expect quite a lot of that happening this year and the remainder next year. Conclusion of the whole exercise will probably take, I mean the best part of two years, I would say.

A - Roland Vogel {BIO 16342285 <GO>}

Yes. And to the investments, the private equity, so the extraordinary portion within the first half-year was a little bit short of €30 million according to our internal calculation. If we expect a little bit but less in the quarters to come and annualize that, you could argue that, for instance,10 basis points did come from that. And so, this would be the extraordinary portion, which is included here.

So, longer term, we see that it's still positive and it is remarkably above the 2.7%. We do calculate the 2.7% nearly without realized gains and losses. We had realized gains and losses or realized gains on the same level than last year. So, if we take these things out and look at the 2.7%, I think we mentioned that also for 2018, our fixed income book has an expectation of around 2.7%.

That is also true for 2019. We are in the middle of the planning phase. I will be a little bit more concrete at the occasion of the Investors' Day. But I think for the years to come, we see a stabilization on the 2.7% level. Now, we have to see what the outperformance components of this year will do in the years to come. But it is slightly more positive than we had anticipated before.

Q - Guilhem Horvath {BIO 18460437 <GO>}

Okay. Great. Thank you.

Operator

Thank you. Our next question comes from Ivan Bokhmat of Barclays. Please go ahead. Your line is open.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Hi. Good morning. I have two questions. The first one is on reserve redundancy. I just wanted to try to make sure I understand the message. So, the Ogden reserve of €291 million, I understand it wasn't fully offset with the reserve releases, which, as normal, you've been mentioning in the past around that €50 million per quarter.

Does it mean that in reality, the reserve redundancy that you've put through in the first half of the year was a little bit over €150 million? Is that the right way to think about it? Or maybe you can give a better indication. And secondly, whether you have any further releases planned related maybe to Ogden rate in second half of the year?

And then, the second question, more broad. You've mentioned that in the loss affected buckets of the market and renewals, you did see then 20% rate increases. At this stage of the soft market, how does it compare with what you've seen in the past? Let's say in Fort

McMurray losses, how did the market perform or in the earlier occasions? Are we seeing a more muted increase in rates after loss occurrence? Thanks.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, to Ogden, I mean the reduction in the redundancy, I think your figure of €150 million is probably in the ballpark, I would say not being an actuarian. Of course, the actual (01:07:00) calculations have to be done. I would say between €110 million, €200 million, something like that.

And while – I mean, the increases following the Fort McMurray fire, so a little bit higher than we have seen on the loss-affected treaties now, that hasn't necessarily to do with the soft market but the Fort McMurray fires were basically the largest cat loss in Canada and affected an entire market. When we talk about loss-affected increases in the, say, on the (01:07:43) renewal, these are individual treaties that have losses, and are not – I mean losses that affect the entire markets.

So, it's just the individual (01:07:57) like you have a property per risk treaty and on business that is written 100% by the clients that was a big fire loss. So, this program then have the loss. While the other programs of the other clients remain loss-free and, of course, there's a little bit, of course, of an offsetting of the goodwill to bad; and therefore, I mean, in this situation then that's largely what we have observed insofar this year, of course, (01:08:32) increases will be lower and have been lower in all market cycles. But we still are relatively pleased that the market, with very few exception, has retained its ability to respond to losses with rate increases.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Thank you.

Operator

Thank you. Our next question comes from William Hawkins of KBW. Please go ahead. Your line is open.

Q - William Hawkins {BIO 1822411 <GO>}

Hi, guys. I'm sorry, I'm coming back to the life business because I've been learning stuff as you've been answering questions. Could you just clarify some points for me? On slide 9, you've talked about this €50 million below expectation for the technical results. Is that figure only the impact of the recapture that you talked about or is that also reflecting the comment you made about underlying in the first half being poorer than the first half last year? If it's not included in that, could you try and scale the amount by which the underlying has also been poorer?

And then also, I was going to ask whether you're finally going to do a sort of a fuller review of all of this business and you seem to imply in an answer to a question that you are because you've just mentioned the process is going to take a couple of years. Again, as much as you can scale the risk from this, are we talking sort of the €50 million kind of range that you referred to when you were talking about 2018 EBIT or is there a risk that you're doing a fuller review that could be something more material for the Hannover Re Group? I mean I appreciate this is quite scaled down within Hannover Re Group in general, but I'm just wondering, is this a double-digit issue or could we, at some point, have to face something slightly bigger? I'll leave it at that. Thanks.

A - Ulrich Wallin {BIO 4863401 <GO>}

Okay. Thank you, Will. Firstly, on the €50 million, the €50 million in the first half-year is entirely this (01:10:23) recapture. There was just actual to expected, worse than planned.

Q - William Hawkins {BIO 1822411 <GO>}

Okay.

A - Ulrich Wallin {BIO 4863401 <GO>}

So, the €50 million recapture that's – and one is euro, the other is U.S. dollar, which I would have said is almost the same but no longer maybe, the €50 million is pretty safely to be expected development which is subject to conclusion of some agreements here.

Yes, we take a fuller (01:11:02) review. I would say yet again on this business and the numbers involved are relatively large, but they go both ways. I mean if you look at it from an economic perspective, we already strengthened the technical provisions last year on our Solvency II balance sheet by more than €500 million from this big block of assumed business. Of course, there was other business, which was a lot more positive. So, we're talking relatively large numbers here, but in both directions.

I mean, of course, one is the rate increases that we are pitching for, of course, depend on the losses we are expecting because, I mean on business which goes well, we would of course not even thinking about rate increases. And business that goes marginally negative, also we would probably not do any rate increases. It's only business that performs very badly and of course one aim of the project is that we identify the exact level of rate adjustment that is necessary on individual treaties on this one.

And, of course, that's what I mean (01:12:40) that this treaty's what – then of course, after the action being done and agreed with a client, we would then, of course, have no further negative effect from these treaties. But, yeah, I mean, the important cost that we have is that we are able to stir the development of the future premiums in line with the development of the future losses, which on the block I was talking about is clearly up.

Q - William Hawkins {BIO 1822411 <GO>}

Got you. If I may just ask one other clarification please. The €93 million deposit accounted other income, you made this comment that that's sort of a sustainable number. And I just wanted to double-check that because sometimes the deposit accounted business, you can sort of get an IFRS new business profits that then kind of fade next year. But you're clearly saying that you've got €93 million in the first half of this year, and therefore, there would also be €93 million in the first half of next year?

A - Ulrich Wallin {BIO 4863401 <GO>}

Yeah. From the deposit accounted, that's absolutely true. I mean these treaties are or these transactions are really – I mean, multiyear transactions. And I mean they run – they're risk remote. Otherwise, they wouldn't be a deposit accounted. And I mean they run exactly according to plan.

Q - William Hawkins {BIO 1822411 <GO>}

Okay. Lovely. Thank you.

Operator

Thank you. And our next question comes from Andrew Ritchie of Autonomous. Please go ahead. Your line is open.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Hi there. Two very quick clarifications. On Ogden, I guess none of the Ogden reserves or very little of the Ogden reserves that you've taken, I guess, relate to claims that have actually paid out. So, should there be (01:14:37) in Ogden rate backed up? What happened with the reserves you've taken? Will they just be incorporated into your reserve buffer? And linked to Ogden, what kind of level of rate increases have you been seeing across your UK matrix (01:14:57) book?

And the same question, it's just a bigger picture one, Uli, you're encouraging us to take down our numbers for life EBIT assumingly forever. And I guess, for 2017, you've offset that at a group level. The guidance of group net income hasn't changed because of higher investment income and, I think, from effect (01:15:22) from higher non-life premium. Just thinking through to 2018, are there any offsets? Do you still anticipate further follow-through from the additional non-life volume you put on this year or there will be margin offsets negating that? Thanks.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, I mean firstly, on Ogden, I mean if the rate would be swing back up, of course, the majority of the additional loss reserves would not be necessary. And the reason is that they basically come from UK motor excess of losses, which mostly attach an excess of €10 million. And, of course, I mean these existing claims have grown into the layers which previously were below the layers.

And, of course, I mean if the Ogden rates go up again, it would be taken from the top and, therefore, the entire fact would actually come out of our reserves which, however, for the time being, we have to I mean expect the Ogden rate as they are. And that's also reflected in the price development. Then, I mean, we have seen region's rates doubling which, of course, it has a compound effect with primary rates increasing as well to the absolute premium volume has been more than doubling.

This is not an outrageous increase (01:17:05) because at the level where we're playing, also the expected losses have doubled. So, I mean, just purely, I mean, adjusting the rate for the effects of the Ogden rate and that has been available in the market. So, it's nothing particularly exciting because, I mean, we just adjust the rate to what is necessary in line of the Ogden rate.

I mean, on the EBIT of the life, still I would say for the medium term, we expect an increase there. Actually, quite a hefty increase to the extent that we can get the problem on our U.S. mortality business soft, I mean we would have a significant higher run rate of EBIT. In the meantime, we think that certainly for 2017, and the first half-year depicts that actually quite well, I think the P&C side and the investment income should be, I mean, filling the hole that the life & health leave within – compared to our planned figures. So, from that point of view, I mean the other aspects of the business should be sufficiently profitable to safeguard the guidance.

And for 2018, of course, not yet time to do a guidance for 2018. I think the growth in the P&C side, we would also expect some growth in the profitability of our P&C business.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Okay. Great. Thank you very much.

Operator

Thank you. Our next question comes from Michael Haid of Commerzbank. Please go ahead. Your line is open.

Q - Michael Haid {BIO 1971310 <GO>}

Thank you very much. Good morning. Just clarification. Sorry that I have to come back to life re. The problems of the U.S. mortality group, just to understand, is this only the book that you acquired in 2009, i.e., the former ING Scottish Re portfolio? And have you done the math regarding the accumulated loss that this book incurred? And how come that you so materially misjudged the healthiness of that book over the past – or when you actually acquired this book? That's my only question.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, it's only that books because all the other U.S. mortality business is going according to plan. You may recall that we have also assumed two smaller blocks from Scottish Re, both of them performed better than expected, and so that's what we call the organic business which is the new business that we are writing.

I mean how come that we have misjudged it and we clearly have. I mean there's no discussion about that possible. I mean the reason is that this was block of a very large number of individual treaties, which had I mean an even exponentially large number of underwriting years. And the assumptions that were used at the time, they're not detailed enough to capture the individual risk parameters of all the different treaties and different portfolios that we were assuming. So, in other words, there were some general assumptions on mortality, on lapse and other policyholder options that policyholders have in the U.S. that have an effect on the expected claims.

There was also probably, it's too broad assumption on the expected mortality improvement, in particular, for the older ages that is not resembling in the actual experience that we see on some of the treaties. That, I guess, was the reason. It's not a good reason because it's never a good reason if something goes wrong, but (01:22:06).

Q - Michael Haid {BIO 1971310 <GO>}

And you acquired this book back in 2008 or 2009. It's almost 10 years ago. How much of this book has matured already? How much – yeah.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, if you look at the net amount at risk, which is basically the sum insureds, it's about 45% of the sum insureds or the net amount at risk that had come off the risk, that have come – they just expired.

Q - Michael Haid {BIO 1971310 <GO>}

Thank you very much.

Operator

Thank you. Our next question comes from Andreas Schäfer of Bankhaus Lampe. Please go ahead. Your line is open.

Q - Andreas Schäfer

Yeah. Thanks. So, just one question regarding your reinvestment yield for the first half of this year. So, is it still around about 2%, as far as I can remember? And on second question is clearly why do you expect, let's say, for a longer period of time – I understand two or three years – a more or less unchanged investment yield in your portfolio?

A - Roland Vogel {BIO 16342285 <GO>}

Yeah. It is – again, as I mentioned, we do do the planning exercise right now. On the one hand, we have reinvestment yields, for instance, in the U.S. dollar, where we invest monies today higher than they mature. Again – so this – and it also depends a little bit on the maturity profile. So, it's not the run rate for – which I can comment on, on the next 10, 15 years. But as we had been looking at the maturity yield or the yields of the maturing book and the current reinvestment yields and that in combination, with the anticipated and planned changes of the portfolio to move the reinvestments not to exactly where we are today.

But to other areas, so for instance, we do not reinvest a lot or even nothing into covered bonds these days. So, if we add all together these effects, the reinvestment yield should be higher than 2%. Also in the fixed income base, and together with the anticipated and already achieved changes in the portfolio at least – and if we compare that with the maturing yield, we see that for 2018, most likely also 2019 that the – we have no dilution of the ROIs.

Q - Andreas Schäfer

Okay. Thank you.

Operator

Thank you. The last question on the queue so far is from Olivia Brindle of Bank of America. Please go ahead. Your line is open.

Q - Olivia Brindle {BIO 17273762 <GO>}

Hi there. I guess we've exhausted all the questions on U.S. mortality. But I wanted to ask about another part of the life book, and that's the longevity business. So, just interested in your thoughts because one of the large UK players just yesterday released a significant amount of longevity reserves based on the trends in life expectancy increases. I'm just wondering on where you stand with your assumptions there? Is there any chance that there's potential upside for you depending on how you model those life expectancy increases going forward? Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, I mean the development on the UK, I mean pension blocks is actually quite positive when it comes to, I mean, the expected claims. However, we have locked in the assumptions on those treaties, which we have taken at the beginning of the period. And as a result, we are not, I mean, showing any IFRS profit as a result of this, I think for this business, more positive development. Luckily, our involvement in the UK mortality business is minimal, so, there, our effects of the change in these life expectancies is also very, very small.

So, yeah, I mean it creates additional conservatism in the business. We still haven't altered our pricing matrix there mainly because I mean, it is long-term business. It is, of course, subject to change and we try to be cautious there.

Q - Olivia Brindle {BIO 17273762 <GO>}

So, just to clarify on that, are you still using the older assumptions and matrices for the longevity part of your business in the UK?

A - Ulrich Wallin {BIO 4863401 <GO>}

Certainly, for reserving purposes.

Q - Olivia Brindle {BIO 17273762 <GO>}

Okay. Great. Thank you.

Operator

And we have one final question coming through. That's a follow-up from Vinit Malhotra of Mediobanca. Please go ahead. Your line is open.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yeah. Thank you. Sorry. (01:27:40). Just this slide 15, please, which shows the outlook by line of business. I mean just comparing it to the last quarter, the trends have inverted, I mean changed for both North America and Continental Europe in terms of profitability outlook. So Continental Europe seems to have gotten better, and I understand that's because of German motor, but North America has gotten a bit (01:28:06) worse and still you're growing so rapidly into it. Could you comment a bit about this (01:28:13) worse of profitability in North America and also your continued growth there? Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, this is, of course, the outlook for 2017. And the change really reflects the result development in the first six months. So, on Continental Europe, the first six months were very, very favorable. And if we assume that the remainder of the year will remain as originally expected, of course, situation improves. Converse is true on the U.S. site, where we have some individual claims particular on our property per risk book. And again also there, we assume that the remainder of the year will be as expected, and therefore, it's worse than we thought at the beginning of the year.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay.

Operator

Thank you. And as there are no further questions, I'll hand back to our speakers for the closing comments.

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes. Thank you very much for listening in. Thank you for all your interesting questions and have a nice day.

Operator

This now concludes the conference. Thank you all very much for attending. You may now disconnect your lines.