Q2 2015 Earnings Call

Company Participants

- Roland Vogel
- Ulrich Wallin

Other Participants

- Andreas Schäfer
- Andrew J. Ritchie
- Andy D. Broadfield
- Frank Kopfinger
- In-Yong Hwang
- Kamran Hossain
- Michael Haid
- Michael I. Huttner
- Thomas Fossard
- Vikram Gandhi
- Vinit Malhotra
- Xin Mei Wang

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. I welcome you to today's Hannover Re International Conference Call on Interim Results Q2 2015. For your information, this conference call is being recorded.

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

Ulrich Wallin {BIO 4863401 <GO>}

Thank you. A very good morning, ladies and gentlemen, and thanks for joining the Hannover Re conference call. As usual, I'm joined by our CFO, Roland Vogel, and we are pleased to present you the figures for the first half year of 2015.

Our business developed favorable with a 20% increase in Group net income to €532 million for the first six months. This leading performance enables us to raise our profit guidance for the full year from around €875 million to around €950 million. The first half year of 2015 also saw particularly stronger earnings on the Property & Casualty business, on the Life & Health business, and most notably from our investment.

Gross written premium fared well with a growth of 9% adjusted for currency exchange rate effect. At 14%, we again were able to achieve an attractive return on equity well above our minimum target. Shareholders' equity increased to €7.7 billion, a little bit lower than at the end of the first quarter. This is due to lower OCI from unrealized gains due to the increased interest rates in the second quarter, and of course, also due to our special dividends that we paid in the second quarter.

And this has meant that the growth of our capital has been reduced and slowed a little bit. This, as far as the special dividend is concerned, of course, was the intention of it. So, book value per share is now €63.62, and that is for the end of June. The overall business developed especially gratifying because the general environment international reinsurers are facing continues to be challenging.

Property & Casualty reinsurance in particular continues to be intensely competitive. The resulting negative trends as rate decreases is now felt for two-and-a-half years or at least two years, since mid-2013. So, some of the businesses like the Florida cat business, we have the third consecutive renewals with reduced rates.

Needless to say that these adverse developments of the international reinsurance also has implications on our business. Nevertheless, so far, we have been able to position our company for continued success even in this climate. This is very much in line with our amended strategy under the headline long-term success in a competitive business. Particularly helpful has been our low expense ratio. And our extensive diversification, both within our business groups, Property and Casualty, and throughout Life and Health reinsurance, and between the two business groups.

Our Property & Casualty business recorded a pleasing currency-adjusted growth of around 10% for the first six months of the year. The increase was driven by a number of sizeable individual transactions, which are addressing specific reinsurance needs of our respective clients. This is in particular applicable to some treaties we wrote from Asia, North America, but also in the area of agricultural risks.

Additionally, our specialty unit, Insurance-Linked Securities, was very successful in the second quarter in particular, and added besides attractive margins, also some significant premium volumes. So, the growth overall on the P&C side is rather broad-based, as it stems from a number of different regions and different classes of business.

The combined ratio of 95.4% is quite unchanged compared to the previous comparative period. This is particularly gratifying as the confidence level of our loss reserves continues to be comfortable, thanks to the considerable cushion that we built over the past few years.

The development of the underwriting result which rose another 8% compared to the previous period reinforces our strategy that we have provisioned Hannover Re's Property

& Casualty portfolio in such a way to be able to preserve a stable underwriting result even in the current soft market. We are currently thoroughly satisfied with the premium development of our Life & Health reinsurance group in the first six months.

Gross written premium grew by 9% on a currency adjusted basis, for this is especially gratifying that the increase derived from the wide range of different areas and generated substantial new business volume from our longevity transactions, but also considerably expanded our business in South America, Australia and Asia.

The operating profit rose 29% to €200 million, this in line with the improved profitability we had anticipated for our Life & Health business in 2015 as compared to 2014. Nevertheless, it must be noted that the results in the second quarter on a stand-alone basis fell short of our expectation. This was due once again to an unfavorable development affecting parts of our US mortality portfolio in the second quarter, both the mortality and the lapse rates showing negative divergences from the expected values.

A further factor was the results of our branch in Paris, which was affected by the restructuring of business relationship with one of our major clients. Also, although this gave rise to a negative result in the second quarter under IFRS accounting, it should have a positive implication of Hannover Re's profitability over the medium and long term.

We are very satisfied with the development of our investments and our investment result with the ordinary investment income from assets under management increasing due to higher contribution from the fixed income portfolio, as well as the growing real estate portfolio.

On that note, I would like to hand over to Roland, our CFO, who will explain these good figures in more detail.

Roland Vogel {BIO 16342285 <GO>}

Good morning. Thank you, Uli. And as usual, I will focus on the half-year figures and try to keep my comments as brief as possible. However, I think in some cases, further explanation on the quarterly development might be helpful this time. As already mentioned, we continue to deliver strong premium growth even taking into account that roughly half of the growth is a result of the currency exchange rate movements.

Net premium earned increased by around 8% at unchanged currency exchange rates. That is slightly less than the topline due to our ILS activities, where we get the premium in and seed it out and some also fronting arrangements in the P&C segment.

Investment income, as mentioned, very satisfying, benefiting from the positive one-off effect in Life & Health reinsurance in the first quarter. Additionally, our growing real estate portfolio is paying off nicely. And finally, the strong dollar is also helpful, increasing the income streams from our US dollar investments.

Other income and expenses still benefited from positive currency exchange effects, which were mainly incurred already in Q1. Interest on hybrid capital still is at last year's level. You may remember that we had the €500 million bond redemption on June 1. That is, therefore, not yet visible. On the other hand, for the full year, this will of course have an effect and lead to reduced interest payments as compared to last year.

After the slightly inflated level in the first quarter, the tax ratio is back to a normal level of around 25%. As you might remember, we already indicated three months ago that we, very early in Q2, received a tax refund at approximately the same level of an extraordinary burden or payment in Q1, so this is fully in line with what we expected.

If we look at the capital side on the next page, you can see that the effect of the €500 million perpetual bond redemption in June, the remaining €1.5 billion of hybrid capital is now at a level that we feel comfortable with. On the other hand, with the implementation of Solvency II next year, this current level leaves us with a remarkable increase in financial flexibility, as there is now a material headroom in all Solvency models going forward.

When it comes to the shareholders' equity, the effect of the interest rate movement is very visible. In the first half of this year, the trend observed in the first quarter reversed as a consequence of higher interest rates in the second quarter, with unrealized gains decreasing by almost €450 million in the second quarter to minus €240 million year-to-date.

Still for the first half of the year, this was more than offset by the weakening of the euro. Moreover, the half year net income makes nearly exactly up for the 2014 full year increased dividend payment, which then leads to the only slight increase overall.

Cash flow on the next page continues to be very positive in the first half year, slightly less than €200 million above the previous year. The number for Q2 standalone seems to be surprisingly low, but this is driven by some one-offs. We had a high cash outflow for the Deepwater Horizon claim based on the legal clarification between the insureds, and the same goes for the Tripoli airport claim from last year.

Moreover, there was one more technical item, as we had agreed with one cedent to transfer monies we had kept as deposits on our balance sheet into a separate account, which still serves as collateral for us, but now is no longer part of our assets. So, that accounts for approximately €70 million.

All in all, we expect strong cash flows for the year in the region of the previous periods. But, we should bear in mind, with additions to redundant reserves going down and growth driven by large quota share arrangements, it should not be surprising if cash flows in the years to come will come down from their peak levels.

Assets under own management increased by 3.2% to a level close to €37.4 billion. The decline relative to the first quarter was mainly driven by lower valuation reserves as a consequence of higher interest rates at the long end of the maturity curve. Overall, decreasing valuation reserves had a negative effect of around €400 million in the first half year.

The positive impact from currency exchange rate effects, in particular here the USD was around €1.8 billion. P&C gross premium we mentioned that increased by a remarkable 10% on an FX-adjusted basis. Uli already mentioned the areas of growth, mainly driven by large individual transactions in Asia and North America.

Overall, it's quite pleasing to see that there is a rather healthy demand among our clients for high-quality reinsurance products and services. At 5.1% of the net earned premium, major losses were again below the budget in the first half year. However, the large loss experienced in the second quarter increased compared to the very benign first quarter, with the budget being exhausted for Q2 on a stand-alone basis.

The underwriting results is again on a very good level, the combined ratio, 95.4% is as expected and below the full year maximum target of 96%. With the very positive overall result in mind and in line with our practice, let me again repeat that we repeated our practice employed in the past that we kept our large loss expectations as IBNRs within the reserves, and that overall accounts for approximately a buffer of €100 million.

Apart from that, let me mention that reserves ran off positively, but to no extraordinary extent. So, we saw the usual positive run-off. The confidence level of the reserve portfolio should overall be at least stable. And by the way, let me mention that you will find the loss triangles published as usual – usually on our website at that point of the year.

Mainly as a result of currency effects, as already mentioned, other income and expenses improved compared to last year. Altogether, an EBIT margin of more than 15%. Net income increased by 20% to above €400 million. The P&C segment performed very satisfying in the light of the challenging market environment all around the world.

P&C results by line of business on the next page demonstrate that most lines of business continue to show good underwriting profitability. On the other hand, it is clearly visible that margins get closer to their respective hurdles, and also that the cat business, which with its very low losses is an important contributor to the overall results.

Aviation impacted by three large losses that incurred in the first six months. In Marine too, we experienced a number of large manmade losses. Here you have to bear in mind that those claims, to a larger extent, also impacted the Facultative business line.

I think we can through the next slide rather quickly. As already mentioned, major losses below average budget, entirely driven by the very benign first quarter. The second quarter losses almost exactly hit our budget of €137 million. And although some of these losses actually occurred in the first quarter and only made it over the large loss hurdle during the second quarter.

After six months, 12 major losses are showing up on the large loss list. The impact from natural catastrophes rather benign, and more than half of the net losses are result of manmade losses. Here, the biggest part is coming from the Marine, with three out of these four claims being damages from oil platforms that is dominated by the Pemex loss of €33 million net in our account.

Overall, close to €100 million of unused budget, as already mentioned, is carried forward for the remainder of the year. The topline development of the Life & Health, very favorable with currency adjusted growth of around 9%. As in previous periods, emerging markets especially Asia have been a driver of that growth. We also took advantage of opportunities in improved markets in Australia, as well as from additional longevity transactions especially also here in the UK.

With the EBIT number of €200 million, the overall profitability improved by almost 30% as compared to last year, because the result is particularly driven by the financial solutions business, where we even adjusted for the one-off effect of the first quarter. You may remember the termination fee of one of the contracts accounted for some €39 million. But, even if we back that out, the first quarter EBIT margin – or the EBIT margin would account for an excellent 17.1%.

And additionally, with 3.5% EBIT margin, our longevity business contributed well. This is the result, I should not repeat the reasons which Uli had already mentioned, the unfavorable development of the mortality experience, as well as the lower-than-expected income from France, which all in all also can be seen as an investment in the future. Overall, we've seen quite a volatile development in our Life & Health business over the first half year, with an extraordinarily good first quarter, and a rather weak second quarter.

Neither the first nor the second quarter should be seen as a guidance for the full year. We do expect normalized results for the full year over and above the 2014 numbers, as we had expected. Aside from the one-off effect, net investment income was very much in line with our expectations. Just as an information, the effect from our ModCo derivatives was a minus €6.4 million in the first half year.

Looking at the investments, I'm quite satisfied with the result of the first six months. Ordinary investment income came in at 3.3% on an annualized basis. The Life & Health financial solutions termination fee agreement accounted for around 20 basis points. That still leaves 3.1%, which still beats the hurdle. If we look at the number overall and back out of the inflation swaps in the ModCo number is, all-in-all, 3.4%.

We only moderately realized gains below last year's level, leaving valuation reserves on a very comfortable level despite the increase in interest rates. This result was achieved with the help of an increased exposure to real estate, as well as the overall increased asset volumes. The increase of the impairment line is a result of ordinary depreciation on real estate, with actual impairments again being on a negligible level.

At the bottom of that slide, you can see the effect that increasing yields in the second quarter had on our valuation reserves. The absolute amount slightly decreased compared to the end of the last year and decreased significantly to the end of the first quarter. However, with still almost €2 billion in unrealized gains and especially viewed from an economic perspective, this development doesn't concern me too much. On the contrary, it is actually positive for our returns going forward.

I think this concludes my remarks, and I'll leave the rest to Uli as usual.

Ulrich Wallin {BIO 4863401 <GO>}

Thank you, Roland. Well, the target matrix that you see here shows almost ticks on all targets, which is the result of a rather favorable development of our business. So far, in 2015, that it. I will move on directly to provide further insights and our expectation for the remainder of the year. This shows you the development of the renewals of our P&C business over the years. It excludes facultative and structured insurance, also excludes our ILS activities.

As you can see in the second quarter, 17% of our traditional non-life treaty book came up for renewal. The outcome of this renewal launch in 1/6, 1/7 – or if you are American, 6/1, 7/1 -- have actually been quite positive for us. While – I mean, the renewals on some of our North American business and some of our agricultural business, good portion of our Latin American business and our Australian business. And as I said, overall, we saw a positive development. In Australia, in particular, we were able to increase our market share.

Despite significant capacities in the natural catastrophe market, both actually for treaties on a proportional as well as on a non-proportional basis, due to our extensive product range, we are able to offer our clients, we saw new opportunities in Latin America and the Caribbean. And we were able also to further diversify our agricultural book of business with actually quite significantly new additions to our business.

While this is in particular some Indian business, but also some business from the US. North American rates and conditions remain under pressure. So, rate reductions were somewhat smaller than anticipated by some. Further demand driven by improved state of the economy was a key factor here. Despite below average natural catastrophe expenditure and relatively modest fire losses, the renewal for US property business passed off favorably.

Based on our good rating and market standing, ceding companies largely consider us as a preferred partner, and we see the entire spectrum of the outgoing reinsurance business for underwriting. As a result, we were able to expand our proportion of business with conditions remaining largely stable. Rates on the non-proportional loss reinsurance programs show declines of around 5%.

In US, property cat business had a pressure on price eased somewhat because the rate reductions in 1/6 and 1/7 were a little bit smaller than in previous renewal periods. But, don't forget, it's the third consecutive renewal on this business where rates are reduced. Nevertheless, we were able to increase our business slightly on business that's still fulfilling our margin requirements. This is largely due to additional demand of cat covers.

Casualty business in the US remained competitive. Nevertheless, we were able to write some new opportunities. We in particular saw increased demand for insurance and reinsurance in respect of cyber risk. Overall, this means that our premium volume on the renewals in the second quarter increased by 8% on – from exchange rate adjusted basis.

In view of the good results of the first-half year, as we already said, we are raising our profit target to €950 million. We also raise our growth target, where we set stable to moderate growth, we now think that we will achieve growth between 5% and 10% on a currency adjusted basis. And this is rather prudent because the new business that we have written so far this year both on the Property & Casualty business, as well as on the Life & Health side, does secure that growth.

Looking at the individual areas of our Property & Casualty business, you can see that overall, we still expect profitability above the cost of capital. That's true for most lines. But, you can also see, as Roland already mentioned, that – I mean it's getting a bit tighter, and this is not surprising due to the continued soft market.

We still see growth in that business. Here, of course, on a non-adjusted basis for foreign exchange rates, all the arrows are basically turning upwards. But well, for the current year, I mean as we already alluded to, we expect on the Property & Casualty side good growth at acceptable profitability. Life & Health, we also see further growth. It doesn't look like growth on the financial solutions business. However, this business -- large part of the business is actually not really topline accretive because it's either deposit accounting or even showing up as an investment like the business where we saw the extraordinary positive effect in the first quarter.

Therefore, here, if you talk of growth you have to look at the bottom rather than the topline, and we expect good growth here. Otherwise, I mean, we expect profitability also in our longevity business coupled with growth and a return to, I mean, profitability above the hurdle rate, particularly on our mortality business for the entire year.

This slide may look familiar to you because we show it continuously at occasions like this one for the last two years. It summarizes the rationale behind our confidence to be in the position to deliver attractive results also in the currently prevailing difficult market, both from a competitive point of view, as well as from the view of the continued low interest rates. We feel that these factors of our business should hold true also for the coming years, in particular 2016 and 2017.

We continue to be on track with increased profits on our Life & Health business of the current year compared to previous years. As Roland already alluded to, we do not believe that the rather low profitability in the second quarter on a standalone business signals a negative trend for the future development of our Life & Health business. We feel this is just a reminder of the quarterly volatility of the quarterly profitability of the business, and hence, as we've said all along, looking at Life & Health business on a quarterly basis is not all that meaningful. The volatility, of course, is significantly less on an annual basis where we feel that the positive trend is fully intact.

On the Property & Casualty side, the half yearly results demonstrate the resilience of the technical profitability of our business. It is in particular gratifying that due to our market position and good rating from the rating agencies, we are able to secure our renewal portfolio, and in addition, see a good flow of new business. This allows us to continue with our selective underwriting activities.

On the other hand, we clearly are not isolated from the rate reductions that are prevailing in the majority of the Property & Casualty reinsurance business. This had meant that our initial loss ratio fix on the newest underwriting years will most likely not increase to the overall confidence level of our loss reserves as it has been done in the years, say, for example 2012 and 2013. Nevertheless, it would appear that, at this point in time, the buffers on our loss reserves is maintained, but probably not added to.

Regarding the investment income, the current development supports our expectations that this will be stable in absolute terms despite the continued low interest rate environment. We continue to strictly control the development of our administrative expenses. And coupled with the growth of the business, this has led to a reduction of our admin expense ratio rather than an increase. In addition, this was helped by the weakening euro, so expenses are heavier weighted towards euro than our profit streams.

This brings me to the end of the presentation. We feel that Hannover Re should be well positioned to continue to deliver attractive returns to its shareholders. One good news at the end, which is actually hot off the press and came brand new, as you know, we were engaged with our regulator to get our group model for Hannover Re Group as a subgroup of HDI Group, approved by our regulatory, the BaFin. And actually, we today received a letter that this internal model has actually been approved by the BaFin. It's our own internal model on all quantitative issues and the standard model for the operational risk. On this basis, our solvency level stands at 265%, which can be seen as true Solvency II solvency level now.

On this note, ladies and gentlemen, we come to the end of our presentation, and we will be very happy to answer your questions. Thank you.

Q&A

Operator

Thank you. We will now begin our question-and-answer session. Our first question comes from In-Yong Hwang of Goldman Sachs. Go ahead, sir. Your line is open.

Q - In-Yong Hwang {BIO 18784369 <GO>}

Good morning. This is In-Yong Hwang from Goldman Sachs. Just two questions from me. Firstly, on the combined ratio, Roland, I know you mentioned that the robust result was roughly in line with what you were expecting. Does that mean that you had around €50 million run rate that you guided to previously for the second quarter, or does that mean €100 million for the first half because I think there was no reserve release in the first quarter? So, a bit around that would be useful.

And secondly, on – I'm just looking at the M&A actually that's going on around you, how much opportunity do you see from, I guess, the premium leakage that will emerge from the merger of your peers and how much of that have you seen – how much of that boosted your premium growth for this year? Thank you.

A - Roland Vogel {BIO 16342285 <GO>}

If I may come back to that reserve run-off, I think I tried to explain last year at the occasion of the Investors Day that it is really not too easy to analyze that just without going into the details. But I can say, overall, that it is the usual run-off, which should be in line with the €50 million per quarter. And in that regards, the around €100 million should be the number, which we have seen for the first half year.

You mentioned that we didn't have any, I think we had only less than usual. We also had a positive run-off already in Q1, not to the full €50 million, so obviously, this has made up within the first half year.

A - Ulrich Wallin {BIO 4863401 <GO>}

If I may comment on the M&A opportunities, opportunities arising from M&A, in general it is positive for us to generating new business if we have mergers between reinsurance companies because that normally opens up some opportunities. However, if you look at the merger activity so far this year, the majority has come actually from mergers of insurance companies.

Most notably, if you look at – I mean, ACE and Chubb, and also XL and Catlin, was more geared to the insurance rather than the reinsurance industry. So, I mean, that is more negative for us because it normally takes out a client. So far, we have fared well actually in both of these situations, but it's pretty new. So, I would say this merger and acquisition activity, if not not opening up that significant opportunities to us, but we have been through things like that before, and I don't think it should create a problem for us either particular with the ones that have happened recently.

Q - In-Yong Hwang {BIO 18784369 <GO>}

Great. Thank you.

Operator

Okay. Our next question comes from Andy Broadfield of Barclays Capital. Go ahead, sir. Your line is open.

Q - Andy D. Broadfield {BIO 7273415 <GO>}

Good morning. Yes, Andy Broadfield from Barclays. I want to ask two questions, please. The first one is, again, just coming back to the reserves, I'm getting a little confused now, because I think in the opening comments in your (40:31) you talk about that you expect the underlying reserve strength to slightly weaken, yet you say both you and Roland this morning on the call that you think it's probably where it was.

So, I'm little confused whether we're weakening or whether we are where we are - where we were, should I say. And if you can quantify that in terms of what difference do you think that would have made the combined ratio this year versus last year, given last two years it was strengthening a little, and that would be helpful.

And the second question, just a small thing actually, I noticed that you shifted quite a lot of assets out of held-to-maturity category in the quarter. Just wondering whether you could give us a little bit more clarity about what you're doing on the investment side in terms of shifts in asset allocation. Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

Okay. Well, I'll take the one on the loss reserves. I mean, the loss reserves from the older underwriting years, say, 2013 and before, they're of course running off and running off those loss reserves. Of course, some number of claims have closed. And in this case, if we have over-reserved them, we see the normal release of loss reserves that go to the bottom line.

However, overall, I would say that has not been a major factor in the combined ratio as we have seen. Where we say that the loss reserves are weaker, also have a major effect on the combined ratio, it's on the new underwriting years, because -- I mean, we kept our loss ratio picks, say, in the current year and also I'd say in 2014 quite stable, despite the fact that rates were coming down. And we did that because we have clear evidence by the development of the redundancy that in previous years, when the rates were better, the initial loss reserves that we booked were significantly over-reserving. And this, of course - this newer loss ratio picks, say, on underwriting year 2014 and 2015 is to a much lesser extent the case.

You would not necessarily see that on the combined ratio, because the combined ratio, of course, is the same for the newest underwriting years, as we have shown it, say, in 2012 and 2013, now maybe even 2011. However, the underlying rates are less if ever there's (43:26) a quality. I mean, that's basically the reason behind why Roland and I cautioned you a little bit regarding the development of the roster (43:36) redundancies.

A - Roland Vogel {BIO 16342285 <GO>}

But on a pure technical note, Andrew, the runoff of reserves as compared to last year should be on the same level. And the confidence level should at least not have been weakened as compared. So, there was not a weakening, but as we had indicated, the strengthening might on the basis what Uli had explained might not have occurred as in previous years. But there was no weakening at all. Again, runoff on the same level as last year. And the current year, at least, a confidence level which we have in the reserves already.

When it comes to the investments, I'm not exactly sure what you were driving at. But the composition has broadly stayed on the same level. If you look at the numbers in the appendix, you will see that we have increased our investments on the GAVI side a little bit. That is in line with the strategy to increase the liquidity of the portfolio a little bit and to take less risk on the GAVI side to reduce risk here and increase it on the perhaps lower commodity credit side, leading the overall risk appetite and the overall return expectation on the same level, that is the background why the GAVI portion increased slightly.

Moreover, we continue to increase our real estate portfolio, which has paid off in the last year, remarkable. You see that the overall volume is increasing, so just to keep the level of the real estate on the same level as compared, it needs that - it means that we have to invest more here. But we have also an initiative to increase that.

So, these are the major issues, a little bit what we internally call the barbell strategy to take more risk on the lower credits and increase liquidity on the GAVI side. That is the driver. If you ask me where the reinvestment yield is today, for the first half year, we have reinvested at slightly over and above 2%, if the pure reinvestment yield, as I usually show it, is a little bit over 1.8%, which would be on the basis of the current investments.

Q - Andy D. Broadfield {BIO 7273415 <GO>}

Thank you. I mean, the thing I'm referencing, but maybe we could take it offline, is health and maturity lines come down maybe €0.5 billion quarter on quarter in the accounts, which given enough mark-to-market, I thought that looks like there was a shift to other end.

A - Roland Vogel {BIO 16342285 <GO>}

No, that is - that, Andrew, is more on the technical note. The old hold-to-maturities are running off, and we did not change the portfolio. We've just not added those new investments to the hold-to-maturity bucket.

Q - Andy D. Broadfield {BIO 7273415 <GO>}

Okay. Thanks very much. Thank you.

Operator

Okay. Our next question comes from Kamran Hossain of RBC. Go ahead, sir. Your line is open.

Q - Kamran Hossain {BIO 17666412 <GO>}

Good morning. Two questions. First one, I guess, congratulations on getting approval for the Solvency II model. I just had some thoughts. You seem to report a 285% or 286% ratio at the full year results. Just explain kind of what the differences are between that ratio and the 265% ratio you've kind of mentioned this morning. So, what was changed there? And secondly, just on the US mortality in kind of flat issue in the quarter, is this the end of that issue or should we expect kind of more impact to come through over the following quarters? Thanks.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, firstly on the difference in the solvency ratio, that has almost exclusively to do with the fact that, when we showed our internal model results, we had the operational risks at our own operational model. Whilst in the approved model, the operational risk is on the standard formula, because we couldn't agree with our regulator how to approach the operational risk. So, in the official Solvency II number, on that, we use the standard formula. And only on the quantitative issues we use, actually, our full own internal model.

On the mortality from the US, it will be an optimistic view, I think, if we assume that we will have no negative effect in the future. That is not from our new business that has actually performed very well, it's still from the acquired ING block.

There is in-force management underway. I mean, we have been a little bit delayed with our efforts to reduce the collateral costs, but we now expect that to come onboard anytime soon in this quarter. This is also a part of below expectation result. And of course, we expect it to be enforced for the entire next year, and the coming years, so which is actually a low-double-digit improvement of the result, I could say around €26 million per year.

And in addition, I mean, we continue to carefully bring some of the rates on the old YRT business, which would also show an improvement in the future. That said, I mean, on the ING block, we still would not see, I mean, I think a profitable future. The overall mortality business, if you include everything, should see a continued improvement from the growth of the new business there.

Q - Kamran Hossain {BIO 17666412 <GO>}

Thanks very much. Very clear.

Operator

Okay. Our next question comes from Michael Huttner of JPMorgan. Go ahead, sir. Your line is open.

Q - Michael I. Huttner {BIO 21417183 <GO>}

My first question was basically a follow-up. So, on the life, given at the half year, you had €140 million, and the aim is to achieve a fee of €46 (51:01) million, how can you be sure, that was my question here, that you can do that? Have you got some, I don't know, just a question.

The other question is the share of equity (51:22). All the other companies I've followed have beaten estimates, so you wouldn't know what my estimates are, so you feel, Michael, that's completely irrelevant, but I noticed you did have – there was quite a large, for me, against my expectations slightly large swing in unrealized gains on realized losses in the second quarter. I just wonder, is this to do with – is your portfolio more sensitive to interest rates maybe than peers, or is there something here that I'm kind of missing a little bit?

And then, the last one and maybe it's also to do with FX. You are growing aviation, but you're saying aviation is negative and I couldn't quite reconcile that. As you know, it's in that lovely slide where you have the arrows and the pluses and minuses. That was all. Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

Taking the aviation first, Michael, this is purely currency. And adjusted for exchange rate, aviation is actually coming down in premium. With the way the rates are going on aviation, I would be hesitant to say it's also going down next quarter, but it's definitely going down in premium.

How can we be sure on the Life & Health that still achieve our full-year target? Well, the reason is that, of course, partly the second quarter was one-off effects and we see continued increase of profits, particularly from our financial solutions business, and I mean, from other new business that we have written newly in the current year, so the profit contributions will of course increase throughout the year. So, from that point of view, we are trying to positive on the further development of our Life & Health business, despite the fact that the second quarter may put some doubts in the observer's mind.

Yes, Roland, I would leave...

A - Roland Vogel {BIO 16342285 <GO>}

Yes. Mike, I didn't quite understand whether you were referring to the unrealized gains and losses in our investment portfolio exclusively, but also the realized – we did realize less than last year. Last year, we had the change in the reporting currency in Bermuda, which has triggered some realizations or some turnover and realizations, so that went down a little bit. We could have done more, but there was no reason to do that. So, we only realized profits very moderately. That is the answer to the realized gains and losses in the P&L.

When it comes to the unrealized gains and the sensitivities, I think we gave them on a pro-forma basis, or we give them on a pro-forma basis for a long, long time. Of course, that is 100 basis points across the board or the forward curve. What has materialized now is exactly what we have seen. We have a rather high US dollar portion, which is 45% or so.

We have modified duration in the fixed income portfolio of a little bit short of 5. And in that regard, the rate increases we have seen, really, that is a mathematical exercise, I would say. I would be surprised if that comes to different result in other portfolios. Still, I think the portion of unrealized gains and losses as compared to the overall portfolio in our case is rather high, as again, we looked at realizations moderately. But, again, to your model and as compared to the competition, I couldn't say more.

Q - Michael I. Huttner {BIO 21417183 <GO>}

Absolutely. That's fantastic. That's very helpful. Thank you.

Operator

Okay. Our next question comes from Thomas Fossard of HSBC. Go ahead, sir. Your line is open.

A - Ulrich Wallin {BIO 4863401 <GO>}

I think, Thomas, you may go ahead if you want.

Q - Thomas Fossard {BIO 1941215 <GO>}

Hello, can you hear me?

A - Ulrich Wallin {BIO 4863401 <GO>}

Hello, we hear you very well.

Q - Thomas Fossard {BIO 1941215 <GO>}

Okay, sorry about that. Just two questions on my side. The first question would be related to your 260% Solvency II ratio. Can you help us to better understand what is your view on the level you should be in Hannover Re at – what you see your shareholders willing you to keep as a Solvency II ratio? 265% looks very high. I mean, how should we look at this ratio going forward?

And the second question would be related to your upcoming business pipeline and especially on the P&C side, I think that your French competitor on the P&C side indicated that the pipeline was pretty attractive and full of what he named as capital management deals or transactions, which all relates to the implementation of new solvency schemes and things like that, so the population of Solvency II in Europe, but not only in Europe. I think on that front, you're more speaking about potential business opportunities for your Life & Health businesses. Is this something that you're expecting, as well, to come for you on the P&C side? Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, if I take the latter, I mean, yes. I've always said all along that the risk-based capital regimes are modestly positive for reinsurance. And that's also borne out by what's happening now, particularly this C-ROSS in China. I mean some of the treaties become less effective, others become more effective. On balance, we see it slightly positive, maybe not quite as positive as our French competitor. But you can see that our advanced solutions business is actually growing quite nicely and will continue to grow, because here we see new opportunities particularly also in the field of industrial captives, where it's pretty new for us. I mean financial solutions for industrial captives, we do for the last couple of years, and we are well on track there to add new business.

So, I mean, I've never been very enthusiastic about the business opportunity from Solvency II, but I would say it's slightly positive. Because, it also has negative effects. For example, if you look at the Chinese motor quota shares are bought for solvency relief, they on the C-ROSS would not be as efficient because the capital allocation to motor business and the C-ROSS is less than on the current kind of solvency run in China. So, it's not all positive.

If you look at the target solvency ratio, it's a mixture of targets that we have to look at because we have to look at the rating agencies as well. On the Solvency II ratio, what we are aiming to have is a confidence level of 1 in 3,000 years. I mean, of course, a pure Solvency II ratio is 1 in 200 years, so 99.5% confidence level.

It turns out that at Moody's, the confidence level for 1 in 3,000, which is kind of a AA level, say, in S&P terms, is about twice the capital you'll need for confidence level of 1 in 200 years. So, I mean, I think we would always want to maintain Solvency II ratio quite ahead of 200%, I would say, because, I mean we want to depict ourselves as at least a AA credit. So, I mean, that is – but there's still some headroom on that as well, also in the rating agencies' models.

Does that answer your question?

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes.

A - Ulrich Wallin {BIO 4863401 <GO>}

Thank you.

Operator

Okay. Our next question comes from Vinit Malhotra of Mediobanca. Go ahead, sir. Your line is open.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Hi. Vinit from Mediobanca. Just maybe two or three questions, if I can. First is on the non-life combined ratio of 95% reported in second quarter. Could you update on the – what is the thinking on the MtCR? Because normally, I understand that that's how the IBNR has been – that's how -- usually that's a good guide to what the number could be. I understand you've beaten that number. I'm just trying to understand if there's something more between linking the MtCR in this quarter to either first (01:01:44), and if there's any change to the MtCR levels that you think about.

Second thing is, please, can I request for a premium split, some idea between the three products in the financial – in the life reinsurance because that seems to be provided sometimes but not all the time, just if you could guide us a bit there. And lastly, I remember already was some presented at the Investor Day on the hybrid capacity from Solvency II. Would – and you had also, I think, mentioned that you're not necessarily going to ramp it up, because investors might demand higher cost of capital for more leverage? Is there a change in – do you see them – there's a need to do some more leveraging up at Hannover, if it is around? Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

I guess – I mean, on the combined ratio in the second quarter of 95%, it's still a little bit higher than our peers, I would say. But, I mean, it's a little bit lower than we normally have seen it, because really, I mean, we had a rather quiet quarter when it comes to past year's loss development where sometimes, we always have something that develops in the wrong way. Nothing in the second quarter, and therefore, the combined ratio is a little bit more favorable.

MtCR's coming down gradually, but we are not reserving to the MtCR, Vinit. Then, our actuaries – our reserving actuaries calculate their best estimate. They're not taking care of the MtCR. I mean, because we are reserving on a purely non-discounted basis.

And on the premium split on the Life & Health, I haven't got it with me now. I mean, we can give you that in detail, but still the largest volume is clearly on the mortality side followed by longevity and the smallest on the financial solutions. But, Roland has just given that split, so I hand over to him.

A - Roland Vogel {BIO 16342285 <GO>}

I'm not sure, Vinit, did you ask for just the financial solution product or the overall split?

Q - Vinit Malhotra {BIO 16184491 <GO>}

I mean, the overall just so that we understand, I mean if you are trying to – if there are so many differences in the various lines, it just makes it a little easier to model. Just a request, okay. Because in the past, you used to provide – I mean, provide on and off piece on these premium levels, whatever you can provide?

A - Roland Vogel {BIO 16342285 <GO>}

I'm sorry. The composition of the half year premium was €1.6 billion. Mortality and financial solutions, €560 million. Here, you should bear in mind what we said before that a lot of these transactions are deposit accounting and do not produce accounting at all. Index solutions longevity accounted for €720 million and the mobility solutions another €700 million.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay.

A - Roland Vogel {BIO 16342285 <GO>}

I hope that helps. If I can come back to your leverage and hybrid discussion, yes, I mentioned already last year that Solvency II will ease our considerations remarkably, especially in combination with the rating agencies' rules. That means that, as from next year onwards, we have headroom, as I mentioned, that is between €1 billion and €1.5 billion. Such an amount would be accepted as capital credit in all of our solvency models, being the internal or the various rating agencies and what you have. So, that increases our financial flexibility. We could use that.

We also mentioned that leverage is, of course, a potential measure to improve cost of capital and improve ROEs. Right now, we see that as financial flexibility to do things, and it gives us also the opportunity to potentially look at redundancies or comfort levels in our straightforward capital a little bit more flexibly. Right now, we have not - we have no plans to really increase it, but we have the means and ways and the headroom to do it from one day to the other, which to me as a CFO is a positive.

Q - Vinit Malhotra {BIO 16184491 <GO>}

All right. Thank you.

Operator

Okay. Our next question comes from Andrew Ritchie of Autonomous. Go ahead, sir. Your line is open.

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

Hi there. First of all, I wonder if you could just give us, Roland, the P&L effect of FX in the first half? Or another way of putting it, how much of the increase in guidance for the full year is reflecting the FX effect that has gone to the P&L, I guess it's mostly in the other income line, but maybe just clarify the overall FX effect, that would be helpful.

Secondly, what is the expected benefit from the French restructuring with the clients? And you talked about the impact in Q2 and when does that come through the P&L. And the third point, just a clarification, I assume - I mean you're talking about how you've got increased capital flexibility now you've got the model approved. Presumably, I mean the rating agency remains a binding constraint. Is there any reason why your surplus on the rating agency models should have changed materially over the first half? Thanks.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, I mean the P&L effect on forex, I will leave it to Roland, because it's really a difficult question. The expected profitability from the French business - from the business written by French branch that had large client, we expect that to I mean be visible, even though we will not point it out separately maybe from next year, because there are new opportunities that we have from that.

And I mean, rating agency capital ratios, yes, they have been quite stable actually. However, I mean, the flexibility as Roland has just mentioned, increases because - I mean, if we come under constraints there, we now can use a hybrid to make up for it, which in the past due to the -- particularly this run rating agencies, due to the hybrid allowed under Solvency I in Germany was restricted, which is now not restricted to anywhere close to that extent.

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

Okay.

A - Roland Vogel {BIO 16342285 <GO>}

Andrew, when it comes to the currency exchange rate effects, we have to distinguish two issues. On the one hand, we tried to have our balance sheet matched as far as possible. And to the extent that this doesn't work here, we have currency exchange rate effects which materialized then in the other income and expense line. So, if I'm on the balance sheet short in dollars or long in dollars, that has an impact.

That is a little bit less than €50 million for the year, but would not be the basis for any increase in our guidance or profit expectations, because usually, we see that as a flat position now for the first year. It is positive to the extent, which I have mentioned, but this would longer term always be seen as neutral.

I don't know whether you remember, I think we did the math together when we spoke at the Investors Day. Apart from that effect, from the pure matching effect of the asset and the liability side, we have an increase in profits this year – or the running profits, for instance, the coupons which we get on our fixed income portfolio, which come in as dollars and are then translated on the P&L into euros. And the weaker the euro is, the higher that amount is. That is difficult to isolate.

Again, I did – we did the math together last year and I think we saw that going forward, an increase of – I don't exactly remember, was it 10% – could result in a €60 million increase in profit. But that was a rule-of-thumb calculation. So, I would say, overall, the increase in guidance has nothing to do with currency exchange rate expectations and assumptions.

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

So by implication, you're assuming those gains reverse in the second half then?

A - Roland Vogel {BIO 16342285 <GO>}

No. We do our math on the basis that the currency exchange rate, so we do our expectation for the year that the currency exchange rate does not change. But, I would not base any guidance assumption really on that remaining, so we see it to stay where it is. But, if it was just the currency exchange rate effect, we would not have increased our guidance.

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

Okay. Thanks.

Operator

Thank you. Our next question comes from Michael Haid of MainFirst Bank. Go ahead. Your line is open.

Q - Michael Haid {BIO 1971310 <GO>}

Thank you very much. Good morning. Three questions, if I may. First question, can you shed a little bit more light on the growth in P&C Re. My understanding is that some of this growth is achieved by an increase in the sales that your clients feed to you and that you take. Can you indicate kind of the nature of these increases in the shares, which they typically have? Is it more that this indicates where you move from the number two position to a number one position, or is it that you increased your share where you had the number one position already before, or is it that you increase your share from 5% to 10%, or 5% to 20%? Just a little bit more light on this.

Second, on the price decline in the July renewals, minus 5% in the non-loss-affected lines. You mentioned that there were some price increases in loss-affected lines. Can you give us an average effect? I have no feeling for how much business was loss affected.

And the third question, on financial solutions, can you give us the EBIT contribution from the Life Re financial solutions business? In connection to that, it may be a stupid question, but calculating an EBIT margin on the group level, when some of the business does not have revenues, does it really make sense?

A - Roland Vogel {BIO 16342285 <GO>}

Yes. I mean, on the last one, I agree. I mean on the financial solutions, probably an EBIT margin is less sensible. But I mean if I talk a little bit where the growth came from, some come from larger shares in particular on the US -- in the US casualty business. However, I mean, the majority of the growth comes actually from new, larger transactions in which -- largely on those, I mean, our lines at a 100%, and we always have a number of those in the pipeline.

I mean, the hit ratio is not overly large. This year, it has been larger. I mean, I say normally, the hit ratio is not overly large, but presently these large transactions, of course, there is – I mean, quite an intense negotiation on the terms and conditions, and we've got to stick to our guns even if large premium volumes are at stake. So only right business that – I mean, fulfils our margin requirements. Just this year, we have been successful with that.

And – but this is different to growth that, for example, we have seen in 2012. The growth was driven by good market conditions, so the growth was from a number of treaties, much broader-based. Now, growth in a soft market has been driven by individual large transactions in specific situations, which we could benefit. That is the majority of it, actually.

And I mean, yes – I mean, we see increases on loss adjusted – on loss-affected business, but I mean, overall, on the loss side, the development has been rather benign. That is of course, I mean, only a small portion of our overall business. And therefore, I mean, we still would say that the overall rating is actually declining, and maybe it's not 5%, but I would say at least 4%, I mean, on average.

Q - Michael Haid {BIO 1971310 <GO>}

Okay. Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

The thing that was – still the question open to the financial solutions on the Life & Health side. Well, if you ask the question, does that make sense to do an EBIT margin also and include business which doesn't produce premium? You could argue, yes. It's hard to deny that. On the other hand, you also – to have lots or sometimes large transaction producing lots of premium, with nearly no risk in there, which then would produce a low EBIT margin but still be very profitable if you compare it to the risk we take. And on average, I think it's still a meaningful number. Now, whether you ask for the number, I think the profit contribution from that line is around €125 million.

A - Roland Vogel {BIO 16342285 <GO>}

(1:18:05).

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes, EBIT.

A - Roland Vogel {BIO 16342285 <GO>}

EBIT-wise.

Q - Michael Haid {BIO 1971310 <GO>}

Financial solutions, EBIT contribution €125 million?

A - Roland Vogel {BIO 16342285 <GO>}

In the first half.

A - Ulrich Wallin {BIO 4863401 <GO>}

In the first half.

Q - Michael Haid {BIO 1971310 <GO>}

In the first half. Okay. Thank you very much.

Operator

Thank you. Our next question comes from Frank Kopfinger of Commerzbank. Go ahead, sir. Your line is open.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Yes. Good morning, everybody. My first question is on your manmade losses. You experienced a high level there on the manmade claims that almost entirely ate up your entire major loss budget. And also, if you take into account that you even have had some improvements on the nat cat side first (01:18:45). So, the question is how do you see your manmade assumptions going forward for the full-year there, and was this also – is the manmade in your nat cat?

And my second question is on your new target, the €950 million, can you elaborate a little bit on the drivers, how you came up to this figure? That would be helpful. And some positive drivers, I would say, you have some still despite the major manmade claims are below the budget for the half-year, but also return on investment as usual is a strong 3.4%. Was this your expectation? Your target looks a little bit conservative. So, could you elaborate a little bit on the drivers and why it's at €950 million?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, of course it takes into account that we will use the full budget of large losses. And otherwise, I mean, it also takes into account that there is no extraordinary movement one way or another even on currencies and things like that in the second half. And of course, the basis for us is the bottom up forecast that we do on a quarterly basis following each – the end of each quarter and each quarterly results. So, I mean, that's where it's all coming from. It's not really a top-down number that I have dreamt up, when I couldn't sleep at night. But, it takes into account that bottom-up forecast that we do.

I mean, manmade losses in the first half has been of – yes, I would say, above expectation even though the calculation of the expectation on the manmade losses is less sophisticated than on the cat losses. Because on the cat losses, we use our cat models and calculate the expected losses that way. On the manmade, it is more of a long-term average that we are looking at adjusted for the development of the premium income.

I mean, the losses have been on – I mean, run-off losses really on the offshore energy, the three sizable platform and rig losses. Are those expected or not? It's really difficult to say. I mean, it's probably not that likely that we will have the same kind of run-on from that front in the second half.

On the other hand, if you look at the property losses, they were pretty low. So – but I mean, it is – we do not expect increase or decrease in manmade losses. I mean, the fact is just said we have relatively large positions on some of the large commercial risks, both through facultative, as well as our per risk and pro rata treaties. And therefore, if there's a major market loss, we most likely have a participation in that. That's for the manmade losses.

And there was one other question.

A - Roland Vogel {BIO 16342285 <GO>}

I think that was in my direction, when it comes to the investment returns. We have in the first half year still a positive impact from the termination fees, €39 million. That accounts for the first half year for 20 basis points. If nothing extraordinary happens by the end of the year, it will account for 10 basis points.

In that regard, the 3.4% you mentioned should be 3.3% by the end of the year. That would still be over and above the hurdle. It includes some realizations, although we have decreased those. We do our math, usually only based -- and the definition of the target is based on the ordinary. So, if there are additional components from the realized side, that is an addition or we usually back in or calculate in some, but not to the amount realized by the first half.

So, all in all, you argued that the hurdle might be low. If you look at the low yield environment and the maturing portfolios, plus the reinvestment, we had a good chance to achieve the 3%. And now, we are a little bit over and above. Again, we mentioned that the real estate portfolio is well intact without additional realized losses over a normalized hurdle. We might come out at 3.1%; if we are lucky, 3.2%. That is over and above the hurdle, but not to a large extent. And in that regard, what we expect what we have right now a little bit over and above the 3% hurdle, which we have defined late last year.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Okay. Thank you.

Operator

Okay. Our next question comes from Andreas Schäfer of Bankhaus Lampe. Go ahead. Your line is open.

Q - Andreas Schäfer

Thanks a lot. I have just one question regarding your capital management. I mean, you mentioned that I think a higher payout ratio might be possible given the fact that your growth in 2015 is likely to be much, much stronger than usually expected. Does it have any sort of implications regarding your capital management plans, or is that sort of growth not the bottleneck for higher payout ratios?

A - Roland Vogel {BIO 16342285 <GO>}

Well, I'd say at the current level not, particularly with the higher flexibility that we have as the internal model and Solvency II. So, I don't think that this – we would see that as, I mean, reducing our appetite for dividend payout to our shareholders. It remains that – I mean, if the situation remains largely unchanged as far as capitalization is concerned and market conditions. When we have to decide for 2015, I mean, we will act most likely quite similar than you have seen in 2014. The only difference could be for example, I mean if due to significant volatility appearing in the market through a major loss, for example, that has an effect on the entire market, the market opportunities become very attractive. I mean, then of course, we have to reconsider, say, I mean, a higher dividend payment.

However, I mean, this is currently not foreseen because I mean, the most likely event going forward is that – I mean, it's more likely that we will have no major loss than that we have a major loss. And if that is the case, I mean, we will continue to see a soft market into 2016 and therefore, our dividend policy would remain as it has been for the 2014 year.

Q - Andreas Schäfer

Thank you.

Operator

Okay. And our next question is a follow-up from Michael Huttner of JPMorgan. Go ahead, sir. Your line is open.

Q - Michael I. Huttner {BIO 21417183 <GO>}

Perfect. Just one follow-up. It's just me who doesn't understand, I'm sure you were clear. On the, what I call, excess reserves, which I think you call reserve confidence, you made a number of comments saying that they're at least the same, but maybe not stronger. Is this 2014 relative to 2013 or is this current year?

A - Roland Vogel {BIO 16342285 <GO>}

No. This is – the development within 2015 vis-à-vis the year-end, which will be presented at the occasion of our Investors Day. We have seen the first draft. You should assume that the confidence level has not dropped that much. But, as we had indicated that the additions may not extend to levels, which we have seen before. And if I say that the level should at least be the same that goes for the end of 2014, but this, of course, should not be lower than the level of 2013.

Q - Michael I. Huttner {BIO 21417183 <GO>}

That's very clear. Thank you so much.

Operator

Okay. Our next question comes from Thomas Fossard of HSBC. Go ahead. Your line is open.

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes. One question for Roland, and relating to slide 4, I think that Roland, you have hinted to lower operating cash flows for 2016 and 2017. Could you remind us what is the math behind it, because my understanding is that if you're writing more proportional and maybe more proportional casualty deals, I'm not sure I understand why this will have a negative impact on cash flows? Thank you.

A - Roland Vogel {BIO 16342285 <GO>}

Well, there are two items. So, if for instance, we're no longer at €200 million to redundant reserves, which we had discussed a second ago, then the cash flow should be €200 million less, because this would be the result, but no cash outflow, obviously. So, that is one technical issue. On the other hand, I did mention the quota shares. As you – that is a technical issue in our reinsurance world. If you write non-proportional business, you get your minimum and deposit premium at the beginning and you may pay out your losses later.

For larger quota shares, it takes a while until you get your first account and its premium, less claims, less commissions already then and you might only get the balance and that at a later point in time. So, the cash impact might be limited. These are, for instance, two technical issues why one would assume that cash flow goes down from the peak levels, which we're seeing, but should still be positive.

A - Ulrich Wallin {BIO 4863401 <GO>}

And I would say, I mean, if you look at our pro-rata business where we see increases, it's not on the casualty side. I mean, we haven't written pro-rata opportunities on excess casualty or professional indemnity in the US because we were just not happy with the terms and conditions there.

Where we've increased our pro-rata is on the short-term lines. I mean, it is on property lines in the US and Australia, where of course on a pro-rata, the cash flow is delayed, but it should be positive because these are businesses that have good margins. But then, for example, we also have the increases on our agricultural business on a pro-rata basis. And there, the cash flow is not very exciting at all, because - I mean, even on the primary policies, often the insureds only pay after the harvesting season. Therefore from agricultural business, the cash flow normally is not too much different to the margin. So - I mean, this is not very cash intense in terms of business. And this is - but this is one of the growth areas that we are having.

Therefore, I mean - and then of course if you look at solvency relief type of deals, which we write in our advanced solution business, again, I mean, the risk is quite predictable. But they are, again, you don't see a high cash flow at them. I mean, it's really where you see the best cash flow in the reinsurance world. It's really the bread and butter excess-of-loss business and individual lines facultative business, but not on these larger transactions, unless you are courageous enough to write US excess casualty on a pro-rata basis.

Q - Thomas Fossard {BIO 1941215 <GO>}

Okay. Understood. Thank you.

Operator

Thank you. Our next question is from Xin Mei Wang of Morgan Stanley. Go ahead. Your line is open.

Q - Xin Mei Wang {BIO 20796577 <GO>}

Hi. Thanks. Xin Mei Wang from Morgan Stanley. Just quick questions, quick two questions. First is on the ILS suite, that was very successful in 2Q. I noticed that the slide showing the profitability and the volume has gone up and profitability is now above cost of capital, in the previous couple of quarters, it was meeting the cost of capital. So, was just wondering what's changed in this quarter and where - which regions are you seeing the demand coming from? And then, my second question is just a follow-up on the Casualty line, so you say there's a lot of competition there. And I guess, apart from fiber, are you seeing the Casualty lines trending negatively, and would you consider pulling back there? Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

No. I don't think we are pulling back on Casualty, but we are very selective on what we do. And in our Casualty business, I mean, this is not driven by large single treaty, but it is driven by a wide variety of treaties which are individually smaller, and it's particularly true for our US business where one of the lessons learned in the – a little bit old, so we still have memory. One of the lessons learned from the last soft market at the end of the 1990s was that the very large casualty transactions have not proven to be profitable at the end. And therefore, we have proved on our US Casualty that a single transaction can only have a limited relatively small percentage of the overall US casualty premiums that we write.

As far as the ILS is concerned, I mean, we have been able to act as a transformer of three rather sizable cap bonds in the third quarter. That has given us, I mean, actually a margin, which is well above the cost of capital. And therefore, we have been quite successful there, and we expect that we will have continued pass there (1:35:08) throughout the year. I mean, that's on the cost of capital there. I don't think that the slide was that precise there because there is different ways of calculating it, but I think if you look at it in the internal model, we are well above the cost of capital on our ILS activities.

Q - Xin Mei Wang {BIO 20796577 <GO>}

Okay. Thank you.

Operator

And we have one final question coming through. That's from Vikram Gandhi of Société Générale. Go ahead, sir. Your line is open.

Q - Vikram Gandhi {BIO 6133175 <GO>}

Hi. This is Vikram Gandhi from SocGen. I've got three questions. First of all, given your ROE is above the 12% to 13% threshold level, what does it imply for the capital management actions?

Second, now that your internal model is approved, and the Solvency II issue stands at 265%, would you be willing to share what's the equivalent ratio on 99.97% confidence level? And lastly, if the increase in guidance for this year doesn't come from weaker euro, and if we assume the current forex rates to stay constant, should we expect €950 million as the base for next year, given better expectations from Life & Health business? Thanks.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, on the first one, the ROE at 14% – well, I mean, that is, of course, based on quite good numbers in the first half year and is also helped, I must say, by the increase in yield towards the end of the second quarter. That would not change our approach to capital management, I would say. I mean, we would still, as I have already explained, look at this similar than we have up to now.

On the internal model, 99.97% is around 135% (1:37:24). And the €950 million as the basis for 2016, it's a little bit early to say because – I mean, the crystal ball is a little bit blurred here, but, yes, I mean it should be around that figure, shouldn't it? And we have to – but of course, we have to see how the market develops, but we certainly expect continued increase of our profitability under Life & Health business.

Q - Vikram Gandhi {BIO 6133175 <GO>}

Okay. Thank you. That's very helpful.

Operator

Okay. Okay. There seems to be no further questions on the line, so I'll hand back to our speakers for the closing comments.

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes. Thanks for listening into our conference call for the first half and second quarter of 2015. I hope we could have answered your questions as satisfactory and look forward to seeing you on our Investments Day. And with that, have a nice day.

Operator

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