Q2 2018 Earnings Call

Company Participants

- Roland Helmut Vogel, CFO & Member of the Executive Board
- Ulrich Wallin, Chairman of the Executive Board & CEO

Other Participants

- Andrew James Ritchie, Partner, Insurance
- Frank Kopfinger, Research Analyst
- Guilhem Horvath, Research Analyst
- Ivan Bokhmat, CEEMEA Banks Analyst
- Jonathan Peter Phillip Urwin, Director and Equity Research Insurance Analyst
- Kamran Hossain, Analyst
- Paris Hadjiantonis, Research Analyst
- Roland PfÃ¤nder, Research Analyst
- Sami Taipalus, Research Analyst
- Thomas Fossard, Co
- Vinit Malhotra, Banca di credito finanziario S.p.A., Research Division
- William Hawkins, MD, Head of European Insurance Research and Senior Analyst

Presentation

Ulrich Wallin {BIO 4863401 <GO>}

Yes. Good morning, ladies and gentlemen. I'd like to welcome you to our conference call presenting the results for the first half year of 2018. As always, I'm joined by our CFO, Roland Vogel.

Our business developed rather favorable in the first half year of 2018, driven by a significantly improved underwriting result. Our EBIT grew by 13.5% to EUR 907 million. The EBIT, therefore, grew even faster than our premium income, which increased by 11%.

Foreign exchange rate adjusted, the increase for this (it) have been 18%, predominantly stemming from our P&C business. Due to some one-off negative tax effects, the tax ratio for the half year increased to 31.4%. And thus, the net income only increased by 3.8% to $555 million (sic) (EUR 555 million). The tax effect mentioned mainly refers to the restructuring of our U.S. life business following the U.S. tax reform, which became effective towards the end of last year. This effect was already recorded in respect of our Life & Health business in the First Quarter.

The book value per share decreased slightly as a result of the dividend payment in the Second Quarter. This is in line with our capital management goal to manage the growth of our IFRS capital by payment of special dividends. We can do this because of our very comfortable Solvency II ratio, which stands at 256% at the end of the Second Quarter. And therefore remains significantly above our 200% threshold, which we want to maintain in line with our risk appetite. It is expected that this number will remain largely stable at the end of the Second Quarter.

Our return on equity increased to 13.2% and is well above our minimum target of 900 basis points above the risk-free rate. Our P&C reinsurance business saw a significant increase in the underwriting result based on an improved combined ratio compared to the first half year of 2017 and continued strong premium growth. The large losses in the first half year were well below the expected levels, however, due to our conservative unchanged reserving policy. This is largely not reflected in our underwriting result.

On our Life & Health business, we saw a significant improvement in the results of our legacy U.S. mortality business. But the results remain negative on that business. The losses were less than half of those we saw in the first half year of 2017 and came in well below expectations. As a result of the significant reduced loss burden from that business, the underlying profitability of our Life & Health business became more visible. And therefore, the EBIT increased by 32.8% to EUR 290 million.

The premium grew -- the premiums grew adjusted for foreign exchange rate movement by 3.7%, in line with our targets as put down in our target matrix. The performance of our investment continued to exceed our target of more than 2.7%. Based on a stable ordinary investment income, the return on investment from assets under own management were 3.1% on an annualized basis.

On this note, I would like to hand over to Roland, who will explain these figures to you in more detail.

Roland Helmut Vogel {BIO 16342285 <GO>}

Good morning. And thank you, Uli. Maybe one short remark before I start. For those interested in analyzing our reserve situation in even more detail, we have published the P&C loss reserve triangles as of December 2017 on our website today.

Here on the second slide, you see that the remarkable growth of 18.1% adjusted for currency exchange rates in the first half year of 2018 is largely driven by our P&C business, as we continued to see ongoing high demand from our clients. Net premium earned developed overall in line with the gross premium. And here, looking at the underlying details, the change in unearned premium had a dampening effect on the earned premium, which is natural in a growth environment, whereas the retention increased slightly compared to the previous year.

Other income and expenses decreased mainly due to lower positive currency effects. The increase in group net income was a little bit less pronounced, Uli mentioned that already, compared to the rise in EBIT, reflecting a higher tax rate. This is mainly the result of the extraordinary tax burden in connection with the U.S. tax reform and the necessary restructuring of our internal repossessions of our U.S. Life & Health business in the First Quarter. Moreover, we had a few smaller effects, which we do not expect to repeat themselves in the second half of the year so that our expectation for the full year is a tax ratio below 30% again.

On the next slide, the operating cash flow continued to be very positive in the first half year, increasing by more than 10% compared to the previous years. Besides this and not part of the operating cash flow, we issued our first senior bond to the volume of EUR 750 million in the Second Quarter of 2018 and experienced some currency movements, in particular, the strengthening of the U.S. dollar against the euro, which had a positive effect of around EUR 800 million. Altogether, this was partially mitigated by a decrease in variation reserve of almost EUR 500 million and the payout of last year's dividend so that the overall assets under own management increase was only slightly -- or the increase was only a slight decrease by 2.1%.

Looking at the capital position. We see the same effects with the dividend payment, is, to a large extent, covered by the profits from the first half year of 2018. Rising interest rates, especially in the U.S. dollar, resulted in a decrease in unrealized gains on the other hand. And positive currency effects on the other abate to a lesser extent. Therefore, the overall negative development of the OCI led to a decrease in shareholders' equity of 2.4%. Here, on the left-hand side of this slide, you can see that the newly-issued senior bond did not change the hybrid bucket. And we still have an unchanged high degree of flexibility in this regard to manage our capital.

On the next slide, the P&C gross written premium increased by a remarkable 27.6% on an FX-adjusted basis. The main driver for this growth continues to be new business written on our structured reinsurance team. Additionally, a few larger transactions in our traditional business lines contributed as well to this development, especially here in Australia and China.

Asset retention increased by 2percentage points. The gross net premium earned was slightly higher compared to the gross premium.

Major losses in the first half year were significantly below budget. As in previous years, we stuck to our reserving practice and kept a large loss expectation as part of our IBNR reserves. Nevertheless, a combined ratio of 95.7% is below the full year's maximum of 96%. Looking at the underwriting results, it's gratifying to see that the increase of 46.5% clearly outperforms the high premium growth, which is even more impressive in light of the competitive market environment.

As always, the underwriting results here includes the funds withheld. In this context, it's worth mentioning that the interest from funds withheld this time actually contributed some EUR 16 million, which also reflects the increase in structured transactions and was not so material in the recent past.

The run-off of loss reserves in the first half year was in line with our expectations. And as we have not changed our approach to setting the initial loss reserves, we do not expect material changes to the confidence level.

Ordinary investment income was stable. Other income and expenses decreased, mainly because of the very positive currency effects seen last year, which did not recur at -- to the same extent this year.

The operating profit increased by 8.6% compared to a slight decrease in net income. The higher tax ratio was mainly due to the fact that last year benefited from tax-reduced disposals, gains and dividends. As already mentioned, a few small items accumulated. But we expect the tax ratio to come down for the full year as mentioned earlier.

On the next slide, major losses were significantly below the expected level and even lower than the already benign first half year of 2017. This leaves us with a comfortable cushion of around EUR 730 million to absorb large losses in the remainder of the year, including the unused nearly EUR 260 million carried forward from the first half year. That said, I think the loss development in the second half of 2017 was a strong reminder for us of what can happen in reinsurance.

The large loss list on the next slide is rather short after the first half of 2018, with Storm Friederike being the costliest event for our book. Normally, this reporting is focused on losses occurring in the current period given that the development of the Harvey, Irma and Maria losses is a bit of a hot topic of the recent past. I would add that Hannover Re experienced a slight increase in the HIM losses on a gross basis in the Second Quarter. However, in U.S., the fact that Irma and Maria are covered by our whole account protection, our net position was not materially affected at all.

Moreover, there had been discussions around the loss from a Colombian dam. Here, we expect a low double-digit million impact if the loss makes it to the large loss list at all.

On the next slide, you can see that most lines of business showed healthy underwriting profitability. Several regions and lines contributed strong to the underwriting reserve here, namely Continental Europe, marine, credit and surety. And actually all 3 lines within our global reinsurance segment.

North America was impacted by a negative -- one negative reserve development from some of the previous years here, especially the California wildfires developed a little bit negatively. Within the U.K. business, we expanded our nonproportional motor business, which comes in with very high initial loss ratio assumptions. So we are not that much concerned here from those results.

On Slide #9, in Life & Health, the gross written premium increased by 3.7% adjusted for FX effects, which is fully in line with our expectations for the entire year. The main driver for this development was our U.K. longevity business.

Uli already commented on the development in U.S. mortality. And I think he will come back to that as part of his outlook. Also, outside the U.S. mortality, the business development was favorable. Our morbidity business performed particularly well, with significantly improved profitability compared to the previous years. Our U.S. financial solutions business continues to deliver excellent results. This is also visible in the other income and expense line where the profits from treaties which are accounted or according to deposit accounting are recognized.

Ordinary investment income was stable, realized gains and losses lower as compared to last year, partly driven by the increase in interest rates in the U.S. and our current portfolio restructuring. Consequently, net income from assets under own management decreased to EUR 142 million.

As already mentioned, we had a one-off effect of around EUR 22 million from the U.S. tax -- or negative EUR 22 million from the U.S. tax reform already in Q1 2018. This effect will not go away over the course of the year. But of course, also not repeat itself. But as a one-off, the impact should be diluted. This is already visible in the tax rate for the first six months.

Looking at the investments. The development in the first six months of 2018 was very satisfactory, with investment income remarkably above the return expectations for the full year. In light of the strong contribution from private equity and real estate, the ordinary investment income remained stable despite the fact that we sold our listed equity portfolio last year and therefore, did not benefit from the dividend season this year.

Realized gains and losses decreased compared to last year. This development reflects the fact that as part of the portfolio restructuring activities owing to the steeper yield curve, we realized also some losses, particularly in the Second Quarter.

Impairments and depreciations still consist mainly of regular depreciation for real estate. Overall, the ROI of 3.1% makes us very confident of achieving the full year's target of at least 2.7%.

As a result of increased interest rates and widened spreads, the valuation reserve decreased as compares to year-end 2017. Although on the other hand, this is associated with a higher reinvestment yield.

The next slide shows the usual overview of how the different asset classes contributed to the investment income compared to where we are invested. In course of our -- or in the course of our portfolio restructuring, we have reduced our share of non-investment-grade profits. And on the other hand, have increased the portion of government bonds. Additionally, we have modified the nature of our government bond holdings and expanded our portfolio of instrument with inflation-linked coupons and redemption amounts to counteract potentially rising inflation risks.

The left-hand side illustrates the favorable performance of our private equity and real estate portfolio. The contribution from government bonds is increasing compared to the previous periods, driven by a mix of higher volumes and increasing interest rates, especially in the U.S.

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

Ulrich Wallin {BIO 4863401 <GO>}

Thank you, Roland. The target matrix reflects good performance of our business in the first half year, with almost all targets being reached. This is particularly gratifying as the first half year 2017 also had shown results which were largely in line with our targets.

The renewal of our traditional property/casualty business during the Second Quarter went quite well for us. The market conditions remained quite competitive. However, in line with the renewals at 1st of January and during the First Quarter, we saw overall modest improvement of the pricing quality of the business.

In particular, for those programs that were hit by losses in 2017 due to the hurricanes in the Caribbean and North America, rate increases could be achieved. In the Caribbean, these were rather significant, ranging from about 10% to 40%. But in North America, even on loss-affected business, rate increases were largely contained to single-digit percentages. This was particularly true for the natural catastrophe business in Florida, which renewed at June 1. Due to abundant capacity, in particular, also from the ILS markets, the increases here were rather modest despite the fact that the Hurricane Irma losses in Florida continued to rise. Based on those market conditions, we were able to grow our business in North America by 15%. We, however, continued our rather cautious approach to the Floridian business.

Besides the North American business at 1/7, significant portions of our Australian business renewed as well as business in Latin America. In both areas, we were able to achieve meaningful growth at improved terms compared to last year. Overall, our premium grew by 16% to just over EUR 1.5 billion.

Based on the highly diversified portfolio, we expect for 2018 to achieve an overall profitability above the cost of capital. We also expect double-digit growth of our premium income. This is true for most parts of our portfolio. But we see particular positive developments of our North American, Continental Europe. And credit and surety business. Also, of course, our structured reinsurance business continues to grow, with results in line with expectations.

In respect of our Life & Health business, Roland already commented on the excellent results of our financial solution business, which we expect to continue for the entire year. In addition, our growing mobility business, in particular from Asia and the Middle East, shows clearly improved results, which should comfortably satisfy the cost of capital.

Particular in the U.K., the longevity business is becoming increasingly competitive, which is clearly eating into the margins. This means that our volume on this business will remain rather stable and driven by the in-force book.

On our mortality business, we expect a significant negative development in the second half of 2018 from our U.S. legacy mortality business from the United States. Due to the continued negative results of this business, which we had acquired in a large block transaction (SRA procession) at the beginning of 2009, we have exercised our rights to increase the reinsurance rate.

The announcement to our clients happened with a letter of May 1, which means that most of the rate increases will become effected at the beginning of August. As a result of the rate increases, the ceding companies have the option to either implement the rate increases or recapture the business. This resulted in significant recapture effective beginning of August, which in turn has already resulted in a negative impact on our IFRS results in the Third Quarter to the tune of USD 264 million.

As we have not heard back from all of our ceding companies, we have to expect that this number will further increase during the second half year, which may reduce the EBIT from our Life & Health business below the anticipated around EUR 200 million. At the same time, we consider these recaptures to be positive because, in each and every case, they mean that future losses from our U.S. legacy mortality business will reduce so that the result of our Life & Health business from 2019 onwards will improve.

We have left our guidance largely unchanged, except we have increased the dividend payout ratio to 35% to 45% of our group IFRS net income from the previous 35% to 40%. This should allow us to increase the regular dividend and is a reflection of our comfortable Solvency II ratio.

Based on the information available at this point in time, we would expect to pay a dividend for 2018 at least at the level of last year, which was EUR 5. This would again include a special dividend and would not be dependent on the level of recaptures on our legacy U.S. mortality business, which we may see in the second half year.

Our guidance for premium growth as well as for the investment returns remain unchanged. The development during the first six months suggests that these targets should be achievable. We also confirm our net income guidance of more than EUR 1 billion. We are confident to achieve this as long as the large losses remain within the budget and there is no dislocation on the capital market. This confirmation of our group net income guidance takes into account the expected recaptures from our U.S. legacy mortality business, which I already said are expected to grow above the level of EUR 264 million -- sorry, U.S. dollars currently advised.

This slide gives you the rationale for our short; and midterm outlook of our business. I would particularly highlight our expectation that the IFRS profits of our Life & Health business should increase from 2019 onwards as we see the underlying profitability of this business currently at an EBIT above EUR 400 million.

On this note, ladies and gentlemen, we come to the end of our presentation. And I look forward to your questions.

Questions And Answers

Operator

(Operator Instructions) And the first questions are from the line of Jonathan Urwin at UBS.

Q - Jonathan Peter Phillip Urwin {BIO 6126952 <GO>}

Just 2 from me. So in life, what can we expect from the underlying performance improvement from these recaptures? I think they're a bit higher than we were thinking, certainly. Is the main impact just lower volatility going forward? So will we see higher normalized earnings as well? Then secondly, on the dividends, on the increase in the ordinary payout ratio guidance today, I guess, are you signaling a higher total dividend per share potential, including special? It doesn't sound like you are. Or are you signaling that the ordinary dividend component will just make up a larger piece of the pie?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well I mean, the recapture that we have seen are a little bit higher than expected, I must say. But it also shows that the problem area of our legacy U.S. mortality business, we are now able to come to a solution with -- on that. This clearly improves the earnings in 2019 and onwards and just not reduces the volatility. It's a clear improvement in the earnings. Of course, I mean, every losses we take due to the resolution of the negative reserves that we have on that business, it's already an improvement of future earnings because we take the losses forward. At the same time, of course, also the future expected losses decrease to an even higher amount. So this is an additional effect of future profitability of our business because, I mean, the burden of the losses from the legacy U.S. mortality business, which have decreased quite significantly. As far as the dividends is concerned, at this time of the year, of course, we can say that we would pay, provided everything's being equal, a similar dividend than we had paid last year, which would then, of course, mean that the ordinary portion would increase. I mean, considerations of higher dividends, we will, of course, have to wait until year-end when we have a clear picture of the result of the entire year. This is in line which -- with the way we normally look at our dividend payments.

Q - Jonathan Peter Phillip Urwin {BIO 6126952 <GO>}

Just a quick follow-up on life -- on the life side. So you mentioned at the end of your prepared remarks that it was EUR 400 million is the current underlying view of life EBIT. Is that correct?

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes. It's more than EUR 400 million.

Q - Jonathan Peter Phillip Urwin {BIO 6126952 <GO>}

More than EUR 400 million.

A - Ulrich Wallin {BIO 4863401 <GO>}

I mean, if you exclude the negative effects from the legacy mortality business in the U.S., it is actually currently. But I have to say that the first half year went quite well. It's quite a bit more than EUR 400 million.

Q - Jonathan Peter Phillip Urwin {BIO 6126952 <GO>}

Quite a bit more, okay.

Operator

We are now over to the line of William Hawkins at KBW.

Q - William Hawkins {BIO 1822411 <GO>}

Uli, I think you said clearly at the end that your guidance of north of EUR 1 billion profits was good, regardless of the outcome of the U.S. mortality. Given that there's still a pretty wide range of a few hundred million, what exactly is the balancing item that's enabling you to be confident regardless of that outcome? That's my number one. Question number two, can you give us an indication of roughly how many contracts have generated the $264 million and roughly how many more there are to go? I'm not sure if you know. So just the concentration risk between contracts, how that's spread? Then lastly just very briefly, can you just indicate what is currently your binding constraint to any capital distribution decision you might make?

A - Ulrich Wallin {BIO 4863401 <GO>}

Thank you, William, for the questions. Yes. The guidance on the U.S. mortality, the guidance of more than EUR 1 billion is regardless of the losses from the legacy U.S. mortality business. What is the balancing item? I mean, we have continued to buffer on our P&C loss reserves. And I mean, we can now say that this currency adjusted has not shrunk to -- during 2017. So we feel quite comfortably in that respect. We also have to consider that in the run-up to IFRS 17, we have to revisit these redundancies anyhow. Then, I mean, how much the $264 million, how much of the portfolio have been reflected in that? Well I mean, the number of treaties overall is, I think, close to 1,000 treaties. However, I mean, it's, of course, only about 100, I mean, groups of ceding companies that are factored here. And I would say, I mean, the conclusion on that we have seen up to now is around, I would say, 40% of the portfolio by net amount at risk. That should -- might be a pretty good guidance. Then the last question, can you remind me?

Q - William Hawkins {BIO 1822411 <GO>}

Binding constraints on capital distribution.

A - Ulrich Wallin {BIO 4863401 <GO>}

Not that much because our -- I mean, German GAAP figures are developing quite favorably. It's just, of course, that we, as in the past, are interested in an attractive dividend in a given year but also concerned that we want to pay a constant dividend regardless the volatility that, I mean, a reinsurance company may see because, I mean, we are in the risk-taking business, which can be quite volatile.

Q - William Hawkins {BIO 1822411 <GO>}

So there's nothing to flag with regards to rating agencies criteria anywhere?

A - Ulrich Wallin {BIO 4863401 <GO>}

Not really. I mean, we have -- of course, there has been a tightening in the capital model of S&P. But they just had confirmed our AA; rating. We are still, I mean, in a comfortable situation there from our current, I mean, ratio according to their model but also due to the fact that we have, I mean, a very comfortable unused hybrid bucket.

Operator

Our next question's over the line of Kamran Hossain of RBC Capital Markets.

Q - Kamran Hossain {BIO 17666412 <GO>}

Sorry to stick on this topic of life. But I guess, in relation to the recaptures, could you just talk us through the time line? Because the way I understand it, the notification period hasn't been -- I guess, price increase has gone through. It hasn't been a particularly long period so far in the uptakes. It feels like it's a little bit higher than you'd anticipated. So any kind of comments around time line kind of when you started officially that process? Kind of how long do people have to take any decisions relating to that? And the second question, just on the U.S. legacy losses, could you just give us a number year-to-date? I'm not sure if I missed it early.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well you didn't miss that number because I didn't tell it. But I mean, the year-to-date number is around $40 million negative. But that is -- I mean, we expect it according to what we call the reboot assessment just to be more like $100 million. So I mean, we have clearly better performance there, despite the fact that the performance is not in line with what we had anticipated at -- when we bought that big block of business. And those, of course, are the locked-in reserves. And of course, the locked -- the reserves remain locked in because our U.S. mortality continues to have, I mean, a positive value in force. That positive value in force actually increases with every recapture charge because the recapture charge brings the loss into the IFRS profit and loss account. And therefore, in the loss recognition testing, it's out. And therefore, the sufficiency there is actually increasing. Time line, yes, very interesting question. I mean, the time or the period that people have to notify us is basically 90 days. I mean, there are some extensions that we have granted for another month. But it's largely 90 days. And that is the reason why right when we compiled our accounts, all these recapture notices were coming in. We also have some notices that people implement the rate increases. Then, of course, I mean, there's another 60 days, for the most part, for the client that haven't responded to implement the rate increases. So I mean, we expect that we see most of the issues regarding the rate increases and recapture being finalized within the Third Quarter. Some might, I mean, drag on into the Fourth Quarter. Then, of course, I should also say that clients also have the ability to challenge us on the rate increases. Then, we would go into arbitration. That will, of course, take longer. However, our legal advisers tell us that the arbitrations that have been happening in the past on these issues have almost always been won by the reinsurers. That's as far as the time line. I think that pretty much answers your question, does it?

Operator

Okay. We're now over to the line of Paris Hadjiantonis at CrÃ©dit Suisse.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

I have 2. First, going again back to the life insurance division and the recaptures. You are talking about an impact of $264 million so far. I'm not completely clear if that already gives you an EBIT of EUR 400 million. You've talked about underlying EBIT of EUR 400 million right now. But would that take you to the EUR 400 million from 2019 onwards? And if yes, what does any incremental, any additional recaptures do that EUR 400 million going forward? So what happens, for example, if that $264 million goes up to $500 million in terms of upfront recaptures in Q3 and Q4? The second question will be on the investment result. You have a return on investment of 3.1%. You're still guiding for 2.7% or above, which, to an extent, implies a lot of conservatism or maybe a large one-off in H2. Which of the 2 is it? And if you could actually give us your new money yield currently, that would also be helpful.

A - Ulrich Wallin {BIO 4863401 <GO>}

I would leave the second question to Roland because he knows that much better than me. Regarding the $264 million recapture, that was not yet sufficient for the expected -- I mean, all other things being equal, for the expected about EUR 400 million of EBIT. However, if we would have recaptured $500 million, then, of course, the majority of the business that is subject to rate increases would have been recaptured. That would, of course, then mean that the EUR 400 million should definitely be within reach.

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

Okay. And with regards to the investment income, yes, you're right. The current achievement is remarkably above the guidance. But the guidance has at least 2.7%. When we go into the year, we usually look at the ordinary income and leave out the rest. We have said the disposal gains have come down a bit. But we are still well in line. But it was not a reason for us to change the guidance. So if you ask me if I would be very surprised if we still have the 3 as the first digit by the end of the year, I think that is possible. We don't expect anything extraordinary to happen. Still, it will be depending on some realized gains in -- for the rest -- for the remainder of the year as well. With regard to the reinvestment yield, you know that we usually communicate that on a -- on the basis that we sell everything today and would reinvest today, which we don't exactly do. But on that basis, I think the reinvestment yield should be between 2.1%, 2.2%. If we then would include the change or an adjustment of the investments which we invest in, that could increase slightly more than that. But I think this compares to the number of 1.6% or so which we had 1 or two years ago.

Operator

Our next question is over the line of Vinit Malhotra at Mediobanca.

Q - Vinit Malhotra {BIO 16184491 <GO>}

One on Life Re. One on P&C. On Life Re, one thing I'm curious is, is this -- I mean, is -- the very strong mortality on the legacy side. And you said it's half the result of what you would have expected and then how bad it is. So is it the right thing to do to cancel all these treaties if they are performing very well now? And is that the reason why suddenly there's such a high takeup of this recapture? That's the first question. The second question is just on the P&C re growth, which obviously is very high in the 1H. But in 2Q, was slightly lower, I think maybe 17% compared to 39% in 1Q. Of course, they're lumpy, structured, tailor made, et cetera. But is that meant to taper off a bit at this one point? And the other question linked to that is that when you sold equities, the idea was to put money to work in the reinsurance market, where pricing hasn't happened. But is -- are these structured products actually consuming capital? And if not, then what do you plan to do with that EUR 400 million on the balance sheet?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well on license held, of course, we were relatively pleased to see some better mortality on our U.S. life legacy. But first of all, that doesn't mean that the business has turned into profitable -- into profitability; and secondly, it's only 2 quarters. And I mean, it's a better trend, I would say, than we had seen in 2017. So we take it. But we still -- I mean, we would still, of course, find it's the best solution for our clients that implement the rate increases. But if they decide to recapture, that's fine. I mean, that also might indicate that they are probably, in some cases, able to replace the business with one of our friendly competitors at a lower rate than we have adjusted. I mean, for us, the big question here is really the old age mortality for people over 80, which our view has become rather pessimistic and is probably a little bit more pessimistic than what the market sees here overall. That's the reason why -- I mean, we are happy if these treaties get resolved either with implementing rate increases or, if that's not possible, with a recapture. On P&C growth, yes, you're right. In the Second Quarter, it was tempering off a little bit. One of the reasons is that the structured reinsurance deals, as they are capital relief, a little bit more concentrated on 1/1 and there are less renewals midterm. And therefore, we saw this slight tapering off. We don't expect to see further tapering off through the -- towards the second half. I mean, one is, of course, the 1/7 renewal that we saw new premiums coming in at growth of 16%. Also, that should normally force -- I mean, between the cracks of reporting is the growth in our agricultural business to the tune of about EUR 100 million. And the reason for that is that it's mostly 1/4 renewals, some 1/1 renewals. But the treaties are finalized then within the Second Quarter. So they have missed the reporting of the First Quarter. And if they are First Quarter, they're also missing the reporting of the Second Quarter. So with these effects, I mean, we are quite confident that we will have a very good growth on our P&C business for the overall year of 2017. Yes, I mean, applying capital to underwriting and then the rates haven't risen as much as they should have done. There are some truth in that. But as you see, I mean, we find in this current market environment, also due to our low expense ratio, admin expense ratio, I mean, sufficient opportunities on the P&C side to employ our capital. From that point of view, yes, I mean, it's not quite as good as it should have been. But it's still all right, I would say.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Can I follow up with you on this EUR 400 million? Because this is not the first time we've heard this number. I mean, there was a question, I think, in the full year results call when you had said that you can't be sure of EUR 400 million in '19. But maybe afterwards, because '17 wasn't very good. I'm talking about Life Re EBIT. Could you clarify, when you said it should be over EUR 400 million, you did say not '19. But did you mean somewhere in '20 or some medium term or some later?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well I mean, if all the treaties where we have applied the rate increases get resolved in 2018, then the EUR 400 million for '19 would be quite plausible. I mean, of course, if the treaties continue to be on our books, then the big question is, of course, have we seen the peak in the mortality losses in 2017 and the trend is back to a more, say, the 5-year average, then, of course, it would be fine. But of course, that's rather difficult to say. I mean, if that's the peak or if we see a further deterioration of the losses, to some extent, this depends on the mortality improvements, depends on all the losses that are so much discussed with the (inaudible) the U.S., which might have an effect there. So I mean, as I think we mentioned in previous calls, the problem with our book is that we have a concentration on the older underwriting here. So the average age of the insured is higher. And therefore, this business is more subject to the fluctuations in the old age mortality. That's really not visible on the new underwriting years.

Operator

We now go to Sami Taipalus of Goldman Sachs.

Q - Sami Taipalus {BIO 17452234 <GO>}

So my first question, just coming back to the Life & Health reinsurance business. It's really -- it's only Solvency II impact from the sort of recaptures that you're doing? Then my second question is on IFRS 17. You commented about the change or potential change to the reserves. Could you just add a little bit more color there? I guess, we're moving from a regime, which is a prudent-based regime without discounting to one where you're going to have a best estimate or discounting best estimate liabilities with a risk adjustment. So how should we see that change playing out over the next couple of years?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well I didn't quite catch your first question on the recapture. What did you want to (inaudible)?

Q - Sami Taipalus {BIO 17452234 <GO>}

Yes. I was just wondering if -- I was wondering if there's any impact on the Solvency II numbers from these recaptures.

A - Ulrich Wallin {BIO 4863401 <GO>}

On the Solvency II numbers, it was -- on the Solvency II numbers, the impact is rather limited because the higher-than-expected mortality is, of course, in the technical -- in the Solvency II technical provisions because, on Solvency II, of course, we haven't got a lock-in. So the effects on solvency ratio will not be very large. And so I mean...

Q - Sami Taipalus {BIO 17452234 <GO>}

The sentiments you've been getting have been in line with sort of the assumptions that you have in your technical provisions at the moment?

A - Ulrich Wallin {BIO 4863401 <GO>}

Oh, yes, absolutely. And on IFRS 17, I would hand over to Roland because he's the expert in that.

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

Yes, Sami. I think to -- this is, of course, a hot topic. And we are all -- we are trying -- in the middle of doing our analysis of our first simulations and whatever. You mentioned that we are going from a prudent to a best estimate, which I don't see exactly because we are in the best estimate environment and everything we have here is part of our best estimate ranges, which -- where you can see the result. Of course, we will see how this cash flow based accounting will really end up. Also, here, we might have possibilities to look at cash flows, to look at -- you mentioned risk margins, the CSM, the potentially different borders. So where there are options, we would, of course, try to maintain what we feel is the right approach and has been the right approach. It might also be affected to some extent. But it's very, very difficult to say that already today as we are, again, in the middle of the first quantitative analysis in that regard. Plus, we have to be aware that the respective bodies are still discussing. There is a EFRAG statement. There had been approaches to the IASB. And there are still different discussions a little bit up in the air, the different definition of the unit of account. So there are lots of technicality -- technicalities to be sorted out, especially in practice. And again, we feel that what we do today makes a lot of sense. And if possible, we will try to maintain that.

A - Ulrich Wallin {BIO 4863401 <GO>}

And I would say that IFRS 17, in the finer details, it's still a little bit a moving target.

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

Yes.

Operator

We now go to Guilhem Horvath at Exane BNP Paribas.

Q - Guilhem Horvath {BIO 18460437 <GO>}

The first question is on P&C re combined ratio. I'm a bit surprised to see the mix between the loss ratio and the expense ratio this quarter because usually when you write structured reinsurance, the loss ratio is higher and the expense ratio is substantially different. But this time, you have a quite high expense ratio and a quite low loss ratio. So I would like you to elaborate a little bit on this breakdown. And the second question is a bit -- is a follow-up on the life topics. And it's just for checking purpose. I mean, it looks like you're quite confident in 2019. Maybe you weren't in the past. Are you completely confident that these issues and all the recapture process will be finished at the end of 2018? Or is there any chance that you have further issues with this business going forward?

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes. I mean, regarding the P&C combined ratio between -- the mix between loss ratio and expense ratio, I mean, on the fact that reinsurance business on some of the larger transactions, the loss ratio has actually come in better than expected due to the structure of these treaties. That would then increase the commission ratio. That is one of the effects, which is relatively gratifying because it, of course, has an even better buffer on the expected margin of that business. The other thing is that also the mix of our business is moving a little bit towards the proportional side. Life, the non-proportional business is growing at a lower pace. This partly has to do with the demand of our clients. There is more demand for proportional and less for nonproportional. It's not that much to our liking and then, of course, has an effect because on a proportional basis -- business, the commissions, of course, are a lot higher than on excess of the loss business. I mean, it's not that much to our liking. But there's not a lot we can do about it because we clearly prefer the nonproportional business to the proportional. But of course, I mean, we have to serve the clients according to their needs. That's the thing on the loss ratio and the combined ratio. Confidence on the life, I mean, I would say the problem should be largely solved within 2018. Of course, I mean, if there are more recaptures than implementations, the further development of the old age mortality would be less -- I mean, a source of volatility. But of course, inevitably, we expect that there will be 1 or 2 arbitrations at the end of 2019, which may then -- I mean, that normally takes 2.5 years. So that will still mean that there will be some uncertainty. But the majority of the portfolio will be sorted out.

Operator

We now go to the line of Ivan Bokhmat at Barclays.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

I've got a question on the reserving side. You mentioned that, that was all in line with expectations for the Second Quarter. I have a question, perhaps a bit broader in scope. For the structured reinsurance business that you write, is it the same reserving approach? Or considering that it's a higher combined ratio business, the margin is a little bit smaller and therefore, we should expect smaller releases in the future? Then second perhaps on the -- also in the P&C, could you comment why your earnout pattern was a little bit different for the first half, why the earned premiums grew faster? And what should we expect in the future?

A - Ulrich Wallin {BIO 4863401 <GO>}

Okay. I would then take the question on the reserving approach on the structured reinsurance business. It's actually somewhat different to what we see in the P&C side. It's also relatively conservative because the way we account for the margins is that we defer the margin recognition as we would normally have a margin recognition reserve. And the other thing also is that we only, I mean, earn the full margin that is in the treaty once the treaty is finalized. That's largely then once the underwriting year is commuted. So I mean, the conservatism on the structured reinsurance is more that we recognize the margins later. But of course, the overall amount of conservatism as percentage of the premiums there is less because also the volatility of the results are significantly less. And on the earnout pattern, I would defer to you, Roland, because I think it's a really difficult question.

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

Yes. Thank you. I must admit we haven't really analyzed that. The -- of course, if you grow remarkably, especially with proportional business at the beginning of the year, a lot of what you had underwritten and what you see as a gross premium written will be reserved and then reduces the earned. The earnings pattern differ to some extent line by line in that there was no change whatsoever. And in that regard it is -- if you have observed a change in earnings pattern, that must be really driven by the lines of business. Other than that, I'd say we have not changed anything here. And of course, in a growth environment, you always see the unearned portion growing as well.

Operator

Our next question is over the line of Thomas Fossard at HSBC.

Q - Thomas Fossard {BIO 1941215 <GO>}

Two additional questions remaining on the life side. First one will be on what you've got at the present time in terms of reprice from your client base. Are you able to say how much of the amount at risk are coming as recapture, how much you believe actually clients will opt for price increases? And how much is going for arbitration? So kind of speak in the terms of feedback you've been getting from clients so far. Or potentially, what are your expectations by the end of the year? And the second questions would be related to that. The (100) clients, which have decided to recapture the business, how are you confident that you can keep forward the new -- the commercial relation when it comes to securing new business on new treaties?

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes. I mean, firstly on the mix between recapture and implementation and arbitration. Of course, we haven't got any notice of arbitration so far. From the notices we have got, I would say it's around a little bit more than 80% that have decided to recapture. And the remainder has implemented. It's really difficult to say how that will turn out. But I will give you a very precise answer on that at the end of the Third Quarter. The actual -- sorry.

Q - Thomas Fossard {BIO 1941215 <GO>}

And the 80-20 is on 40%...

A - Ulrich Wallin {BIO 4863401 <GO>}

Off the net amount of (IFRS).

Q - Thomas Fossard {BIO 1941215 <GO>}

Off the net amount of (IFRS). Okay. So you're still waiting for the 60% to come in the coming weeks?

A - Ulrich Wallin {BIO 4863401 <GO>}

That's right. That's right. Then, I mean, the future commercial relationship, I mean, we still continue with those clients' future business, particularly on the financial solutions side. However, I mean, on the mortality solutions new business, we have changed our pricing because, I mean, we have a higher pricing on the, I mean, old age. And this is really a little bit higher than market pricing. So for the renewals, I mean, it's -- at this point in time, it's basically more than 90% term business and very little, if any, permanent business, which is like all of life business or universal life and business like that. So I mean, new business production has been pretty strong. But due to the pricing actions that we took on the mortality solutions business, it's actually coming down. Does that answer the question?

Q - Thomas Fossard {BIO 1941215 <GO>}

Yes.

Operator

Our next question is over to the line of Frank Kopfinger at Deutsche Bank.

Q - Frank Kopfinger {BIO 16342277 <GO>}

I have 2 questions. My first question is on the outlook for P&C reinsurance. Can you comment a little bit on your view on the market environment, especially as you're now entering into the next negotiations? Monte Carlo and Baden-Baden are upcoming. And then we are obviously entering into January renewals. Last time in January, you had a 1.4% price increase. What would be your expectations for January given that we have a normal development for the remainder of the year? Then secondly, just recently, a couple of months ago, you launched a joint venture with your mother company at Talanx. And you put together your specialty insurance initiatives with HDI. Is there any impact going forward as you are obviously losing some business on the different -- within your financials?

A - Ulrich Wallin {BIO 4863401 <GO>}

So as far as the P&C market outlook is concerned, considering that it's in the run-up to Monte Carlo, I'm not going to prejudice my underwriters. I'm, of course, very optimistic that we will see further increases. However, it's also fair to say that the market will continue to be very competitive. I mean, there is still a lot of capacity. There is also an increase in demand. We have seen that. And if you look at the development of the premium volumes, say, of the 10 largest reinsurers or even more than that, all of them report increased premiums. And that clearly signals an increase in demand. But I'm not going to say that we will reduce prices. I mean, that's not the time to do that. But yes, it will be -- it will definitely be competitive. I mean, the joint venture that we have on the specialty business, from our side, it's really motivated that at Hannover Re, we want to be a pure-play reinsurer. And I mean, the influence on the financials will not be that large because also HDI Global is, of course, allocating some of their business to the specialty company. And as -- I mean, that business is really not lost for us because the way the specialty company works is that we get a quota share -- I mean, a guaranteed quota share session on all of that business. And on all of that business, of course, means that it's more than the business that we're currently writing into Hannover. So on that point of view, I mean, the aim is, of course, to see an increased profitability. That's the aim for both joint venture partners. I mean, we might see a little bit of an early drop in the premium volume. But that will not be material. So overall, we think it's very positive because it allows us to concentrate on the reinsurance business. And also on the specialty business from HDI, we will also get that then as a reinsurance and not writing the insurance directly.

Operator

Our next question is over the line of Andrew Ritchie at Autonomous.

Q - Andrew James Ritchie {BIO 18731996 <GO>}

I just have one question. On your slide on renewals, the intriguing sentence, which says casualty pricing is not fully reflecting the continued loss emergence, I mean, casualty -- U.S. casualty has been an area where you've been trying to become more constructive. I think you expect it to grow. So what are you referring to? Are you basically suggesting that the pricing has been disappointing? Is the loss emergence on auto-related lines? Or is it other lines?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well I mean, where we are growing on our casualty business, it's more with our medium-sized clients and it's more like standard business, like standard GL, lead umbrellas on SME type business. So it's not the large account U.S. casualty. I mean, where we are concerned and where we feel it's not fully reflected in the pricing is the developing inflation and the probability of further inflation, which drives loss costs up. I mean, we clearly see that in the commercial auto business. We also see it in parts of the D&O business. And we feel that this is not completely reflected in the pricing. Therefore, we are quite cautious on our U.S. casualty and where we grow. It's with existing clients on business that we already write.

Operator

Okay. We now go to the line of Roland PfÃ¤nder at ODDO BHF.

Q - Roland PfÃ¤nder

Two questions from my side. Do you expect any disposal gain out of the sale of Inter Hannover to Talanx? And does this deal also have a Solvency II impact? And the second question, I saw that you changed your profitability outlook on the facultative reinsurance business in the Second Quarter. Maybe you could shed some light on this -- which triggered the change.

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes. I mean, when it comes to -- we did -- we are not an IFRS. We haven't gotten a disposal gain on the sale of Inter Hannover. The reason is that, I mean, we keep a good part of the profit stream of that business through reinsurance. And Inter Hannover has relatively low net retention anyhow. And that will also continue for the specialty business. Of course, it's not third-party session. It's all in intra-group sessions there. Solvency II impact is minimal on that. Facultative, I mean, we have changed that from a plus to a plus/minus. We still expect to earn the cost of capital. But we have seen some increases in the frequency of medium-sized losses particular on the property side and on the engineering side. And therefore, our underwriters and managers have looked at this a little bit more cautious.

Operator

Okay. Gentlemen, at this stage, there seem to be no further questions in the queue. Can I please pass it back to you?

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes, certainly. Thank you very much. Thank you, all for phoning in and taking an interest in our half year results. And I wish you all a very good and nice day. Thank you very much.