Hannover Rueck SE 1 January Property & Casualty Treaty Renewals Call

Company Participants

- JÃ¼rgen GrÃ¤ber, Member of the Executive Board
- Ulrich Wallin, Chairman of the Executive Board and CEO

Other Participants

- Andrew James Ritchie, Partner, Insurance
- Frank Kopfinger, Research Analyst
- Guilhem Horvath, Research Analyst
- Ivan Bokhmat, CEEMEA Banks Analyst
- Kamran Hossain, Analyst
- Thomas Seidl, Senior Analyst
- Unidentified Participant, Analyst
- Vinit Malhotra, Banca di credito finanziario S.p.A., Research Division

Presentation

Operator

Ladies and gentlemen, welcome to today's Hannover Re International conference call on the 1st of January 2018 PNC treaty renewals and guidance update 2017 and 2018. For your information, this conference is being recorded.

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

Ulrich Wallin {BIO 4863401 <GO>}

Yes. Good morning. Thank you for dialing into our conference call on the renewal at 1st of January for the 1st of January 2018, as well as updated guidance on the 2017 calendar year which is based on the current status of our book-closing activity.

Important note to start with, figures are based unless otherwise stated, on underwriting-year basis. Details are based on our portfolio and may not be indicative for the market development. Price changes are on a risk-adjusted basis. And all changes are based on constant foreign exchange rates.

Coming to the reinsurance market, 2017 was of course dominated by the natural catastrophe losses which reached levels well over above $100 billion for the insured losses because you'll remember the hurricanes Harvey, Irma. And Maria. Then we had large fires in California in the Fourth Quarter. And an earthquake in Mexico. And also a typhoon in -- or cyclone in Australia. The overall loss load was very comparable to what we had seen in 2005 and 2011. And therefore of course it was expected that we would see similar reactions on the reinsurance market as we had seen at 1/1/2006 and 1/1/2012.

Directionally that actually was happening in fact. However, the capacity of the reinsurance market remained at a very high level because none of the participants in the market reduced their capacity, if anything people were looking to apply larger capacities. As a result, there was no dislocation in the market. And the market remained quite comparative. This meant that the rate increases were a little bit below what some observers might have expected.

However, due to the reported results after nine months, which for the reinsurance industry were not all that great, the market was quite disciplined. So we saw rate increases on loss-affected programs, some of them double-digit and as before for most of the business was actually the floor. Some loss-free business also saw modest rate increases. However, taking it all together, the pricing quality of the reinsurance business as a result of that increased as compared to 2017.

As I already said, the capacity was still there. If you look at the ILS market, of course it participated in the 2017 losses. Therefore some of the invested funds were lost. Other were tracked on programs which potentially are hit by the losses, therefore the collateral could not be released. But the investors replenished the funds and even the ILS market got more money than it had in 2016 which meant that right at the end of the renewal season, the ILS market became quite aggressive because we needed to invest all those money.

Also the traditional re-insurer whilst being hit by the losses and one might say that the overall results may be somewhat disappointing if you compare to previous years, nonetheless most traditional re-insurers pretty much stayed in profitable territory. Therefore there was no immediate need for significant changes in the market.

Demand for reinsurance has gradually increased, which was positive, in particular aggregate excess of losses. But also multi-line, multi-territory, multi-year coverage were in demand and that of course (inaudible) the launch of re-insurers that are active in all lines of business on a global basis.

If you look at our results of the 1/1 renewal season, we were quite pleased with the outcome. We felt that in a market condition that showed modest improvement with our competitive position, we were quite well-placed to take advantage of that. This is based on our very strong client relationships, some of them dating back for many decades. Also our client relationship activities paid off. And our slight competitive advantage due to our low expense ratio and our good security ratings actually played also a positive role.

Overall, we saw good growth of our business at improved pricing. And we also saw quite number of new businesses, not only launch individual contracts. But also the bread and butter business saw some satisfying increases.

As far as natural catastrophe (inaudible) we only slightly increased our risk appetite because it was an area of continued competition. Therefore, in some areas of the natural catastrophe excess of loss business, the pricing development was not fully satisfying for us.

On the other side, the fear that the retro capacity would dry up for us was actually not true, quite to the contrary there was more capacity available to Hannover Re than there was before and as a result the risk-return profile of our retro sessions did not deteriorate, if anything one might even argue it did improve a little bit.

But this chart reminds you that the development on an underwriting-year basis is not equal to the development on a fiscal year basis. What can be said that on an underwriting-year basis, 2018 pricing quality provided that the remainder of the year follows the same trend as the 1/1 renewals, will be better than 2016 and '17. But on a fiscal year '18 will be better than '17. But not quite as good as '16 and far away from '15.

With those remarks, I would hand over to JÃ¼rgen GrÃ¤ber, our Chief Operating Officer for our P&C business.

JÃ¼rgen GrÃ¤ber

Yes. Well thank you very much. Uli and I will now go into details on our P&C 1/1/2018 renewal. You can see that out of the EUR 10.1 billion P&C premium, round about EUR 4.6 billion was up for renewal. And we usually report only about the treaty renewals on the traditional business and as we introduced it last year, we will also have a short report on the structured reinsurance as this has been a growth driver in the last years.

So basically 65% is up for renewal at 1/1 of for traditional business. And the highest share is in the specialty lines worldwide. Here, 79% are up for renewal and the lowest share is in the global reinsurance, the EUR 967 million represents only 46% of the total global reinsurance.

If we then look at the remainder of the year, what is yet to come, we have the important one for renewal. But also the very important 1/6, 1/7 renewals. We have 11% during the months of January to April to renew and another 16% to renew from April to July. But it is not an even picture. For example, if we take continental Europe and Germany, the lion's share actually renews at 1/1 and there is less to come throughout the year, whereas if you look at the U.S., we still have a meaningful part to come at 1/4 and 1/6, 1/7 renewals. So as far as the U.S. is concerned, we report roughly about 50% of the treaty renewals at the 1/1 renewed call.

So what has happened? I mentioned EUR 4.6 billion was up for renewal and we saw canceled and restructured business of 7.8%. This was a drop of EUR 364 million and a very large portion of our business was actually renewed, 92.2%. This shows the stability and the retention rate and the reliability of our account. And in this renewed business, we saw a variety of aspects. Of course our shares increased by 0.5%. So we had a favorable line allocation and also were able to increase our shares, we saw changes in price to the extent of 1.4% and change in volume -- underlying volume changes all leading together to an increase of 5.3% on the renewed business.

In addition. And I will explain that in more detail, we were able to restructure and actually write new business to the extent of 15.3%, all adding up together to 112.7% or EUR 7.7 billion assuming that all the later renewals are unchanged. You will notice that for the first time we do a price change assessment here for the entire portfolio which we haven't done in previous times. And I will explain later what we have changed as far as the proportional price change assessment is concerned. But before I do so let me go into the details a bit more.

We have broken down our universe of P&C business in the traditional blocks of business, you are used to them already and first let me highlight and this is supported by the blue color, the premium changes. And you see that except for aviation, we had positive premium changes at the 1/1 renewal and these premium changes were, again the exception is aviation, higher than the price changes. This highlights the fact that we like and believe we do well in terms of cycle management. So we try to grow the portfolio faster when there are positive price changes. And of course if we don't see price changes, then we should be shrinking the business faster than the negative price changes. The example is aviation here.

In total the premium changes amounted to 12.7%, I mentioned that already, or EUR 570 million around about euro increase in P&C premium. The comprehensive price change across all lines, all types of contracts pro rata and excess of loss is 1.4%. But let me highlight a few of the price changes already. You can see in the marine sector, the price change is 5%, quite meaningful. Many of the marine lines of business of course were affected by the HIM losses, Harvey, Irma and Maria. And the same you can see as far as the excess of loss business is concerned, again 5.2%.

In those segments we grew faster in terms of premium volume than we actually grew just from the price changes. And let me highlight in addition the change in U.K. and Ireland and -- market direct, an increase of 14.4%. This is of course, if I call it like this, Ogden-induced, i.e. the significant increases in U.K. motor business has helped this premium increase significantly. As far as worldwide treaty reinsurance is concerned, the 35.3% is a combination of many impacts, to some extent we grew nicely in continental Europe. But we also had attractive partnership enhancements, if I call it like this, big quarter share deals or agreements to actually grow on blocks of nonproportional treaties with some selected customers. So in total 12.7% with an average premium change of 1.4%.

Now if we go one step deeper and divide the assessment into proportional and nonproportional business, I should mention first why do we feel able to, for the first time, comment on the proportional price changes. In the past, we always said let's not speculate, let's not talk about what is yet to be underwritten as far as primary companies are concerned. But we developed a methodology to establish this price change for proportional business.

We compare the ultimate loss ratio peaks of the year 2017, with the loss ratio peaks of our underwriters and partly modeled of 2018. We are then adding in the change in commission terms and profit commissions, i.e., what has happened as far as the reinsurance terms are concerned. Then we look at the total of the two, i.e., the expense changes and the loss ratio peak changes and the result is then the price change that we indicate here in the proportional segment.

Of course, it includes present value calculations, it takes into account yield changes, it takes into loss cost trend factors and model changes and validation of models. So it's a very comprehensive assessment which is of course open for some subjectivity if I call it like this.

So when you look at the overall change in the proportional business, it is 0.3%, not too much actually. And you can see that as far as North America is concerned we have a negative price change here and as a result the premium actually drops off faster than the price change, i.e., minus 1.4%. Continental Europe proportional, here we have grown into some attractive motor long-tail business opportunities and our underwriters took the -- yes, the opportunity, the business challenge to grow the business. To some extent this is actually -- and I will get more details -- has occurred in Italy and other parts of continental Europe.

U.K.-Ireland you can see proportionate price change 12.6%. This is a combination of many things. It is to some extent property business, to some extent financial lines business and of course also what happened on U.K. motor, i.e., the changes that occurred in the primary business and the conditions that occurred. As far as nonproportional is concerned, the price change is 4% overall. And let me just highlight the top line North America plus 1.9%. We grew by 12.8% by the means of diving deeper into some specialty lines and also carefully and constantly growing our risk-excess book.

So this was very pleasing to know that we were able to penetrate the U.S. North American market carefully and selectively deeper. Also endorsing our cycle management is what you can see on the aviation side, the price change is minus 0.2% and the premium dropped off minus 5.9%, i.e., we dropping off premium faster than the price change, that is what you do when you're not completely satisfied with the changes. As far as U.K. and Ireland is concerned, plus 20% price change, plus 26% premium change.

We had hoped for more premium change. However, not all our expectations were fulfilled as far as required increases on U.K. motor were concerned. And so we decided not to support every motor treaty that we had written before because we felt the price increases were not commensurate on occasions.

As far as the catastrophe business is concerned, cat XL price change plus 5.2%, increased 7%. This was to be expected, it is not an aggressive push for business because top down we have not allocated more capital to this business segment as already highlighted and therefore, the room to aggressively push for increase was limited for our underwriting.

Of course when you look at the bottom line plus 13.8% premium increase versus 10.1% XL, one would have expected more increase on the nonproportionate premium. However, please bear in mind that the proportional increase is skewed by the fact that they are large (order) shares involved and this distorts the figure. Without these order shares, the premium increase on the nonproportional would have been meaningfully bigger than on the proportional.

If we look at the price change over the last renewal seasons, we have given you information what has happened at the last 1/1 renewals, this is 1/1 renewals only and you can see that we moved up 4% here which brings us back to 97.6% of the levels which we had in 2011. 2011 if you strip out the spill overall of the large catastrophe losses was a decent premium volume and this is why we are very satisfied with the outcome of the XL pricing at this renewal. Also when you check it where are we today, we are somewhere between 2016 and 2015 underwriting-year levels on our excess of loss book. This again is acceptable. However, in all fairness, we had hoped to reach the 2015 levels and this was not completely fulfilled.

Looking at the overall portfolio in terms of numbers of treaties, let me remark first the numbers have not changed much on the proportional. On the nonproportional side, they are slightly down actually. But what we can see is on the proportional side we measure here the change in the commission and profit commission terms.

We basically had most renewals unchanged and as many increases of commission terms as we had decreases of commission terms on the proportional side. As far as the nonproportional increases are concerned, we had 27% more increases than decreases. And this is exactly the same figure what we had in 2012. So Ulrich highlighted already the fact that also the loss patterns -- even though the losses occurred in different parts of the world, the loss patterns were not dissimilar, yet the reaction is also very similar in terms of what happened at 2012 and what has happened now in 2018.

Now let's have a look at North America. And you will see this picture in the greenish chart on a regular basis we are now dividing the changes on the renewal portfolio into changes in shares, changes in price and in volume. The shares are down, we did not too aggressively push for business, it's a more conservative capital underwriting approach.

Price impact 0.6% and volume impact 2.8% and of course the new and canceled restructured business gave us some tailwinds too. So we are up in total by 5.9%. The key driver is nonproportional business. Proportional business has come down. We were able to further strengthen our position as a preferred business partners with many of our business partners through the fact of active traveling, regular contacts with our customers. And there was also a lift in the organic growth, i.e., our partners actually grew and seeded more reinsurance premium.

The U.S. property book saw a mixed picture. We had some losses of business. But it was compensated for by restructure programs and new purchases. So in total we are satisfied with the changes of the U.S. property business. And again, this business is exclusively written by our brokers. The signed line allocations were very much in our favor.

The U.S. casualty premium increased mainly due to new business. This has been in various sectors, be it worker's comp, be it special casualty, some personal umbrella business and also we were able to actually maintain and increase our position in the MedMal business.

Canada for the second year now saw increases following the Fort McMurray losses, also a pleasing development. In total, as we said, plus 5.9%. Please bear in mind this is only half of our North American portfolio. The other half is yet to renew throughout the year. In terms of the numbers again, you can see that on the proportional side we had more improvement than deteriorations of commissions and the change of the nonproportional treaty as measured by the rate online, 40% more improvements than deteriorations.

This is much stronger than it was in 2012. But 2012 there were no events in the U.S., there were as you recall in Thailand and New Zealand, in Japan and therefore the increase was an indirect one in 2012 as far as the North American portfolio is concerned.

Moving on to continental Europe, again a conservative strategy. The share is down 0.2%, we did not push aggressively for shares. Positive price impacts and even more positive price impacts on the volume side and tailwinds on the restructured business too. Most pleasing to note, Germany, you know Hannover Re is quite active in motor business in Germany and also has lots of proportional business. Price increases, my colleague in-charge Michael Pickel highlighted to me the fact that the motor price in Germany in the primary business increased by 3.5% and on the background of this the excess of loss rates stood stable. So we also saw increases in terms of premium on the nonproportional motor business in Germany. Hannover is not a big writer of higher industrial business. But this was surely a pleasing outcome as far as motor business is concerned.

In Continental Europe, again, strong developments. I referred to Italy already. We saw an increase in our portfolio in Italy. But also in Western Europe, in particular France, the business development was pleasing and a stabilization of pricing in Eastern Europe has helped to show an overall significant increase in Continental Europe plus 8.7%. Again to highlight the fact shares are down, we did not aggressively grow in continental Europe.

Marine, probably, the most pleasing outcome in terms of prices, plus 5%. And whilst Europe and Asia stood largely flat, the London market with no claims activity was up 5% and those businesses in the London market that saw some claims activity were up to 20%-plus. Nonetheless, we discontinued some small accounts. You see here again a decline in the shares. So slightly down. But overall plus 6.2%, mostly price driven on the marine side.

Going on to aviation, this account is by no means as large as it used to be in 2002, 2003. It has declined significantly over the last decade and we are reporting about a relatively small portfolio these days. We cut back a number of shares, 1.5%. The price in total was flat and the volume impact was negative 2.6% mostly because of lower estimated premium on the proportional treaties. So in total, we saw a reduction of 3.3% mostly because of volume and reduced shares, once again supporting our underwriting stands as far as cycle management is concerned.

Moving on to credit and surety and political risk, these days the business distribution in our portfolio is round about 65% credit. That used to be lower. It's 21% surety. And it's 14% political risk. That has changed over time. Surety used to be higher, political risk used to be lower and credit used to be lower too. Again, we are not aggressively moving towards higher premium, shares down 3.3%, price increase 1.1%, volume increase 4.3%. This is largely driven by one particular partner out of the large organizations worldwide and that has fueled the volume increase significantly.

We saw new business opportunities, very pleasing development in Asia in particular. More and more companies are opening up towards this line of business and that has allowed us to grow with these new business opportunities in total plus 4%. So again we were able to retain our significant position as an important player in credit and surety business.

U.K. London market and direct; now you see the difference, here we have a push in the shares plus 2.3%. So we felt that in particular there are meaningful opportunities in the London market in the property business. But of course subject to price increases also in the U.K. motor business. So we moved our shares up, we had a price increase of 2.8% and volume driven increases of 7.8%. So a very meaningful movement.

The rates on U.K. motor in our portfolio are up between 60% to 70% and it would be incorrect if I would say we are completely pleased with this. We had hoped for an increase of round about 100%. However, the 60% to 70% is meaningful enough to basically satisfy ourselves in terms of the pricing quality as far as the settlements of bodily injury claims in the U.K. motor are concerned following the Ogden changes. So we think that if the settlements take place around a discount rate of 0% or plus 0.25%, these rates will support with an adequate profit margin the overall BI claims settlements.

In total up 14.4%, this is a clear reaction that the London market has responded positively to the opportunities and challenges. Also pleasing to note that cyber has gotten bigger over time. Our cyber portfolio in the U.K. moved from EUR 31 million to EUR 92 million and for the total of the Hannover Re group from EUR 122 million to EUR 193 million. So a meaningful development on the cyber business and I remember we had hoped one day this account will be as big as the D&O and we're moving towards this particular development. So we are very comfortable with this.

As far as the worldwide treaty reinsurance is concerned, again, a push for shares, plus 3.9%, based on positive price movements and supported by positive volume movements up 35%. We do have more partnerships in Australia, we have an increasing number of relationships with Chinese customers. You will recall that about two years ago we cut back severely on Chinese business, not being completely satisfied with the payback opportunities following the Tianjin loss. But we saw some promising reaction in terms of price movements. But also margins movements so that we have decided with preferred customers to move our business relationship upwards and the Chinese business expansion has supported our worldwide treaty reinsurance quite meaningfully.

As far as the Caribbean islands are concerned, we saw good improvements here. We have not significantly expanded our writings in the Caribbean islands because there was sufficient capacity around by the ILS markets. But also by the traditional reinsurance markets. So any premium increase we saw in the Caribbean islands actually enhances the margins, i.e., the profit margins because we did not deploy meaningfully higher aggregates. And we're looking at a margin quality or price level quality between 2010 and 2012 as far as the Caribbean islands are concerned.

Middle East and North Africa, still a high competition and we discontinued a few sizable accounts because these markets are regarded as diversifying markets and there's an oversupply of capacity, still pushing hard on improved terms, not all these terms did satisfy us. In total we are up 35.3%.

Going on to the cat business, again a careful push for higher shares on those businesses that, yes, satisfied us in terms of cost of capital margins, price increases plus 5.2%. This is a bit an assessment figure because it was not that easy to calculate this price increase because between 2017 and 2018 there had been lots of model changes and lots of validation adjustments as far as some of the peak zones in the world are concerned and we tried to assess that as much as we could. But it was not like-for-like -- an easy like-for-like assessment to figure out these price increases. Volume increases negative here.

Expectations not completely fulfilled, that is what Uli said before that's why the board of Hannover Re did not grant a larger budget for writings of cat business. And the growth is a combination of underlying portfolio growth, change of program structures and some positive movements on global programs. Our risk appetite, i.e., the capital we deployed very much the way we like to deploy it.

Let me now report on structured business. We started that last year because it fuels our top line quite severely. The structured business encompasses of surplus relief contract, aggregate multi-year, multi-line contracts and of course cat excess of loss treaties to a limited extent with special features. We were able to grow this business again, mostly in North America and Europe. And in Europe, Germany and the U.K.. So nothing has changed to the drivers of the growth compared to last year.

And it was again driven by capital cost optimization and capital optimization. So most of the contacts are with CFOs and not (inaudible) managers. And the impact on the Hannover Re combined ratio could be anywhere between 0.6% to 1% up because this business cruises along with combined ratios 97% to 100%. And therefore has a diluted impact on the combined ratio of the traditional P&C business. Yet it is ex RoCA or IVC, cost of capital accretive, it deploys less capital, it positively adds to our diversification because large blocks are quarter shares on a net basis, i.e., they are protected by the reinsurance (inaudible) and it earns above cost of capital returns.

When you now look at the total of our 1/1 renewal, if I solely carve out the 1/1 renewal and look at our treaty business only, i.e., the structured treaty business and the traditional treaty business, we are up altogether by 21.8%. If we assume for the remainder of the year and also for the facultative and the ILS business which is mostly fronting business that there won't be no change, we are up 12.9% on the total. But I'm sure we will later comment on what happens at the later renewals as well.

And with these remarks, I would conclude my detailed summary and pass on to Ulrich for the updated outlook.

Ulrich Wallin {BIO 4863401 <GO>}

Thank you, JÃ¼rgen. To sum up the renewal and what does it do for our 2018 financial year expectations as far as volume and profitability goes, you can see on the volume side that we are up in most areas with the exception of aviation and facultative due to some restructuring of the allocation of business. And we believe that we could -- we will earn the cost of capital in all lines if the large losses behave with the exception of aviation, particular more than the cost of capital we are expecting in North America, continental Europe and our facultative business which continues to be -- to show good profitability.

If you then look at the 2018 guidance, we didn't change that from November. As far as the gross written premium is concerned, we are now pretty certain that we will have double-digit growth on our P&C business. But on the life & health, we see a more stable development so that the expectation of a single-digit growth still holds through even though it will be the upper end of single-digit.

Return on investment 2.7%, this assumes only limited amount of realized gains because prices -- I mean interest rates are moving upwards. So unrealized gains are coming down a bit. But we are pretty confident that this 2.7% should be reachable looking at our current investment portfolio which provides the lion's share of that return plus the expected new investments.

Group net income, we are confident that we should reach more than EUR 1 billion should the larger office remain within budget of EUR 825 million and short -- we see no dislocation in the capital markets.

Dividend payout ratio unchanged. Also we would still consider to pay a special dividend because the capital ratio based on Solvency II remains above our limit and threshold. If we look at the 2017 year, this is based on our current book-closing activities which based on previous year's expectations -- the previous year's experience we would not extract lot changes from that. We see a growth of the premium income of 9% to EUR 17.8 billion, currency-adjusted so that unchanged currency rate, the growth would have been 11.2%.

Return on investment 3.8%. That is on the one hand due to the increase in the ordinary income by -- in excess of 10% which is largely the result of good performance of our real estate as well as private equity portfolios as well as our credit portfolios. But even more pronounced was the growth in the extraordinary income because as you know in the Third

Quarter we sold our quoted equities and that gave it a boost of more than EUR 200 million.

Group net income is around $950 million which is below last year, it's also below our initial expectation. But considering the natural catastrophe losses that we saw in third and Fourth Quarters, it's still an acceptable result in our few, it's also slightly higher than our revised guidance of $800 million which we provided you with when we knew about the hurricane losses and earthquake losses in the Third Quarter.

Dividend payout EUR 5, will be the recommendation of the executive board to the supervisory board and the AGM and the split will be again 3.5% ordinary dividend and 1.5% special dividend.

With that, that concludes our presentation and we look forward to your questions. Thank you very much.

Questions And Answers

Operator

(Operator Instructions) Our first question comes Johnny (technical difficulty).

Q - Unidentified Participant

Just 2 for me please. So firstly on the renewals, I mean, just looking at the sort of early reports so far from the U.S. and from Europe, it looks like a lot of the more traditional established carriers have taken market share, you guys included a little bit today. Has there been a flight to quality do you think from (inaudible) to sort of the better established traditional carriers after the losses of 2017? Any color there will be great. Secondly on just thinking about FX, could you give us a steer on how we should be thinking about dollar weakness for the P&L and the balance sheet?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well if I may take the second question first and then if you can answer on the more complicated one being your first question. Well of course we have seen a significant weakening of the U.S. dollar in particular compared to the beginning of 2017 which of course has kind of a negative effect on all the profits we generate in the U.S. dollar currency. But overall I would say the -- I mean the exchange rate that we have is not too different from what we had some years ago. In fact if you look at the long-term average, it's probably there or thereabouts and therefore we feel that the influence in the extra profitability that we are able to report will be rather (inaudible) will be -- maybe small double-digit millions in euro terms. But we feel that that should not have a significant impact on the expected earnings in euro terms.

A - JÃ¼rgen GrÃ¤ber

As to your question flight to quality, of course when you go back the last five years you can see that the large traditional carriers are gaining market share as do the smaller carriers, whereas the middle segment has not gained market share worldwide. We believe that this is due to the fact that when you are very large and when you are specialized, you can offer deep highly selected service quality and that of course creates glue and retains the customer. So yes, there is a flight towards quality and that has continued. And the second aspect of course is that more and more companies also induced by the capital regimes do measure the capital allocation towards the quality of the reinsurance, i.e., the credit counterparty risk charge and this also supports the flight to quality as the larger carriers tend to have on average, tend to have the higher ratings and still enough headroom to allocate larger shares. So yes, we have this observation that this trend is continuing.

Operator

Our next question comes from Andrew Ritchie.

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

So Uli, you talked about having renewed your retro program, maybe you could just clarify the broad outline of that program, is it similar to previous years? I noticed related to that you haven't increased or so far at least your net large loss budget 2018, I appreciate you haven't increased your cat business. But your overall large loss exposure must have increased because the books increased. So maybe clarify why that hasn't changed in relation to any change in the retro program? Second question, broader question really, why do you think demand has increased because it's not what we've seen distressed at this location at the primary level either. And you talked and referred to the fact you thought demand has increased. I'm just curious, I mean because the worry would be the recent demands increased is that the primary insurers are trying to lay off problems that they foresee in the underlying book. And I guess just a final question on tax and the tax regime in the U.S. has changed since you last talked to us. How do we think about that in relation to how Hannover structures its business?

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes, Andrew, I would like to leave the first 2 questions to JÃ¼rgen and would then do the tax question myself.

A - JÃ¼rgen GrÃ¤ber

Yes, Andrew then let me start with the retro program. Hannover has basically a couple of retro programs. There is this quarter share covering our nonproportional writings on cat business, aviation and marine. We have slightly increased the placement. In absolute dollar terms the increase is more meaningful. It's about $600 million these days. The placement share is round about 44%. We have renewed our whole account contract which provides round about EUR 280 million of cover. But we have significantly increased a protection on an aggregate basis that protects our large loss budget as far as net cat exposures are concerned. And we moved this up by more than or roundabout EUR 100 million and this is exactly the reason why you don't see an increase in the large loss budget. One could have assumed with somewhat higher sums insured of our primary companies may be slightly higher lines of Hannover Re, the large loss budget should have increased. But the budget is for net account and takes into account the gross model losses minus of course theoretical recoveries from our retro programs. And if you take this all into account and also a trend that actually we had in 2017 what I would call a less severe manmade loss year, we to the best of our capabilities assessed that the large loss budget should not be altered. So it's a combination of what have we written, how does the retros work? And the retro, in particular this protection on the NatCat exposures on an aggregated basis is closer to the risk, which means it kicks in earlier and has a more meaningful impact on the large loss budget than covers that we previously purchased. Then the last hour of our purchases is the specific retros. They are purchased as needed as far as marine and aviation is concerned.

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

I mean, aggregate is normally quite expensive. But I mean you have managed to enlarge the aggregate on reasonable terms on basically.

A - JÃ¼rgen GrÃ¤ber

No. We actually had to take more money out of our pocket. So we had to pay a higher price. But we purposefully did do so because some of the price increases of course paid for it and we believe that the overall mechanics justified to pay a higher price while stabilizing our net risk appetite.

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

And just to be clear on the K-vehicle, it's $600 million of capital -- $600 million of capital in K plus obviously the loss with the premium to get the total loss absorption capacity?

A - Ulrich Wallin {BIO 4863401 <GO>}

Get through.

A - JÃ¼rgen GrÃ¤ber

Yes. Yes.

A - Ulrich Wallin {BIO 4863401 <GO>}

So this is a very attractive business for our retro session as I would say. If we go to the tax question, U.S. tax reform did not have any significant effect on our P&C business because if you write that cross-border and the cross-border business that is not going to affiliated companies is not affected by the tax reform. The only effect there might be that it becomes slightly more attractive to write the business from the U.S. to the lower tax as compared to Germany. But we are not changing our business more or less this point of time. On the life side it's different because due to XXX and a XXX reserving, historically large part of our U.S. business was ceded to Ireland. This is now subject to (inaudible) and will not be continued. Therefore luckily we have a U.S. taxpayer in Bermuda that is not subject to U.S. regulatory accounting. But it is subject to U.S. taxes and therefore (inaudible) is not applicable to that company and that will take the place of the Irish company on the U.S. life business. So it's cumbersome and makes it all rather complicated. But this U.S. taxpayer in the U.S. which we established some three years ago for other reasons, we are in a pretty good position.

A - JÃ¼rgen GrÃ¤ber

And Andrew, I have to apologize, I forgot to reply on demand of -- for reinsurance. Well various drivers, we highlighted already the fact that there are new inquiries coming into the structured reinsurance solution-driven direction. This is driven by more a deeper usage of capital models, be it Solvency II. But also the rating agency models seeing adjustments on a regular basis. But we also noticed a trend towards some top-up covers and some of the buyers in the States had to realize that they increased their retention too much. So they bought sub-layers or aggregate covers because they maxed out their retention underneath their cat program several times, hitting them on a net account basis more severely than what was budgeted for and that also fueled demand.

Operator

The next question comes from Vinit Malhotra, Mediobanca.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Two questions please. One is on the guidance of 2018 which when it was introduced in November, the idea was that any market hardening is not being built-in and given that the market hard -- or the price increases were not as much as you would have liked, is it still the case and just to hear your thoughts on with this guidance is still viewed as conservative? That's the first question. And second question is I was just curious about the commentary around the shares and I noticed that it's being down a lot in -- even in noncat areas, I mean. So whether we started with North America or continental Europe or even -- I know marine has the cat effect. But could you comment a bit about -- because that's not probably where the ILS was trying to hit you. So if you could comment a bit about the shares, that will be great. And just if I can also add one more on the 2017 Fourth Quarter being such a strong -- close to EUR 400 million net income, is that due to large runoff movements, could you comment on that please?

A - Ulrich Wallin {BIO 4863401 <GO>}

On the guidance for 2018, of course it now includes the expectations of the price increases that we have seen. So it's a little bit more comfortable from a P&C side than it was I would say in November. But I mean it says more than EUR 1 billion. So that allows a little bit of range anyhow. There's still some caution on the life & health side due to our U.S. mortality business where we have continued in-force management which might result into further recap shares from our clients, which could result in some IFRS losses for the year, economically positive for us. So we have catering for that as well. Then on the 2017 Fourth Quarter, yes, it was pretty good. There were positive development on the loss reserves. But the quality -- the confidence level was quite stable. Any further information on that of course we will have it all for you in every detail on the 13th of March.

A - JÃ¼rgen GrÃ¤ber

Vinit, on the shares, I don't have a precise answer right away. But I have certain assumptions, let me put it this way. So if I look into those segments where we have positive share movements, here we think everything is right, we're pushing for larger shares, we're quoting and leading and when we are quoting and leading, we offer our shares, usually higher shares and we insist on full allocation, i.e., line (inaudible). So here the share increases materialize. In the other segments where we are happy with the business. But we don't want to get into a massive increase, we just accept signings as they occur and then sometimes when there is enough capacity, the signing could fade by half a percentage or something and this is my assumption on what happened in these other segments. This is the only explanation because had we been pushing, we would have been allocated always the lines we want. But as I said we're not pushing in these segments and then it happens when there is normal kind of oversupply of capacity as against demand.

A - Ulrich Wallin {BIO 4863401 <GO>}

And if I may add in general, we would never be prepared to decrease the pricing for larger share which some of our competitors do. But we would never do that. I mean if you have a larger share, we want a higher price rather than a lower price.

Operator

The next question comes from Kamran Hossain, RBC.

Q - Kamran Hossain {BIO 17666412 <GO>}

One question for me, just tell me about these renewals. You mentioned back at your Investors Day and there was some last year that you thought pricing would reach 2015 levels, clearly you haven't quite got there. But with momentum continuing into rest of the year especially into the mid-year renewals, do you think we'll reach that 2015 level, any thoughts or color would be really helpful?

A - Ulrich Wallin {BIO 4863401 <GO>}

My answer to that will be a clear no because the overcapacity remains and correct me if I'm wrong, JÃ¼rgen. But I would expect that the midterm renewals, they pretty much follow what we have seen at 1/1/18.

A - JÃ¼rgen GrÃ¤ber

Yes, I agree and disagree at the same time if I may Uli. I'm on the underwriting side. So my hope is towards 2015 and that is still the internal steer. But the market dynamics of course point towards what Uli said and we have to see what the outcome is.

Q - Kamran Hossain {BIO 17666412 <GO>}

So I guess we'll wait and see.

Operator

The next question comes from Guilhem Horvath, Exane BNP Paribas.

Q - Guilhem Horvath {BIO 18460437 <GO>}

First one is on casualty and it looks like you've been growing quite significantly your casualty exposure. What do you see here in terms of claims inflation traits, can you discuss what are the latest signals on that? Then the second question was on return on investments. So you discusssed the fact that you would have quite lower realized gains next year at least. You will not reproduce the listed equity areas gains, that's for sure. But can you discuss the running yield evolution going forward? Are you already reinvesting higher than running yield and do you see somehow an accretion there?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well as far as the investments is concerned, on the U.S. dollar, many other currencies we invest higher than we reinvest the funds. On euro, that's not the case because either it'd be keeps the interest rates low and will most likely continue to do so. For the running yield, it's stabilizing I would say.

A - JÃ¼rgen GrÃ¤ber

And as to your question on casualty and claims trends, first let me remark, we are not really overly severely growing on casualty unless you describe motor as casualty. So the key driver of our gross is rather motor than casualty. As far as the claims trends are concerned, there cannot be a straight answer. We divide claims trends by line of business, by country. And in the states even by state, i.e., that is a big metrics with lots of details. An average figure in the U.S. would probably a claims trending off round about 4% for casualty, however the question is not the claims trend. But is the price trend moving ahead of the claims trend. So you have to compare the two. And what we're seeing is in motor business in the U.S. that price is ahead of claims trend, whereas in casualty, it's a very diverse figure and can only be answered state by state. Then the next aspect is of course that claims trends have 2 components, one is the inflation and the other one is what we call social inflation. Internally we separate these 2 trends and we have to realize that there is a negative correlation between the claims trend and the social inflation. So when one is high, the other one is lower and vice versa. Only experience tells us that we are probably on the high side as far as our internal pricing models are concerned as far as the claims trends in general, yes, are looked at. One last remark, in general, I would say they are up around the world because we see developments towards higher wage increases, we see, yes, a good economic development and both these aspects points towards an increase in the claims trends.

A - Ulrich Wallin {BIO 4863401 <GO>}

So there's a -- the reason why we didn't write any of the large U.S. casualty quarter share treaties, particular not if they include components of excess casualty.

Operator

The next question comes from Thomas Seidl, Bernstein.

Q - Thomas Seidl {BIO 17755912 <GO>}

Question on pricing. And I'm puzzled by your comment very satisfactory. If I am not wrong you include interest rate change. If you strip out that your price increase would be probably 0.5% to 1% which on a nominal basis is much less than the average market. So it seems like you have opted to grow and sacrifice a little bit of the average margin (inaudible) January 1. So if you could comment on that. Secondly on retro session, you got significantly hurt last year retro prices are up 5% -- 15% at January 1, yet you say you improved the risk-return margins. How is that possible is my question? Are your retro session was so happy about the last 10 years of profit that they -- happy with flat risk-attractive pricing. And the third one on U.K. motor you say 60%, 70% price increase that is based on an Ogden rate between 0 and 0.5 at midyear we have seen one U.K. company reporting a 30% price increase. And so I wonder basically how much you have to cut back on U.K. motor here?

A - JÃ¼rgen GrÃ¤ber

Well if I may answer first, I can understand your surprise so to say that we speak about a very satisfactory renewal, whereas it appears that the increases don't seem to skyrocket in a sense. But we work and that is correct on a discounted basis, i.e., we take into account the -- what we call risk-free rate of return yield and we include that and have done so. And all the comparisons we did comparing it to 2011, comparing it to 2015, 2016 cycles and the attritional losses there seems to indicate that our technical prices are fairly solid. And therefore we speak about a satisfactory renewal as a combination of prices and top line growth and having said this, Ulrich highlighted in his presentation the fact that we believe we earn our cost of capital, when you look at the respective page, you find lots of plus minus, which means cost of capital, you find 4 plus signals, which is we're earning more than cost of capital and only one minus in the aviation segment. So when you do the math it seems to indicate a fairly reasonable and healthy pricing environment on an underwriting year basis. That's why we speak about a very satisfactory renewal.

A - Ulrich Wallin {BIO 4863401 <GO>}

And if I may add there, I mean of course the nominal increases are larger than what we show here because these are risk-adjusted figure. And normally, due to inflationary trends, the underlying exposure increases from year-to-year, which means that the nominal price, price changes are higher. I mean we even have treaties which we see negative risk-adjusted price changing whether it's a premium growth in the session.

A - JÃ¼rgen GrÃ¤ber

Then on the retro, yes, it looks as if we have accepted a squeeze say higher cost on the retro side as against lower price increases on the primary or on our in-boundary insurance side. This is right at the first glance ignoring how close you are to the risk and I mentioned that one cover that we expanded is very close to the risk and on a risk-adjusted basis we're doing no worse on the retros than we actually do on the inbound business. And indeed our retro sessioners are not unhappy, if I call it like this, because neither did we post unusually high losses to our retro sessioners in 2011 and 2017 will not be a completely unpleasant experience either. So in a way, yes, they take into account the positive balance, the credit balance they have on their dealings with Hannover Re and allowed us on a risk-adjusted basis to find a fair balance in terms of the retro pricing. Talking about

U.K. motor, yes, of course there is a big variety of price increases, there were 100% increases, there were the 30% you mentioned. And I cannot tell you exactly how much we discontinued. But some we reduced significantly, some we discontinued completely. And if someone would only have offered a 30% increase which would lead us having to earn at least a rate of 2.5%, then we surely would have discontinued our participation. I would say as a ballpark figure, we're probably off in terms of sizable accounts 15% to 20% of our U.K. motor writings as far as the renewal business is concerned. But here I'm a bit uncertain, I would have to check that more carefully.

Q - Thomas Seidl {BIO 17755912 <GO>}

And do you -- just a quick follow-up on that one, do you see basically U.K. motor insurance who buy nonproportional going for less purchase because of the higher prices?

A - Ulrich Wallin {BIO 4863401 <GO>}

Not really. I mean they buy unlimited. So on the top this thing, some move a little bit more to pro rata, that's true. But also the retentions have not changed really.

Q - Thomas Seidl {BIO 17755912 <GO>}

So not moving up from the EUR 1 million to the EUR 2 million-EUR 3 million or something?

A - Ulrich Wallin {BIO 4863401 <GO>}

Not to a larger extent.

A - JÃ¼rgen GrÃ¤ber

And there's also a reason for it because the increases are not homogeneous overall these layers. Of course the middle and higher layers had to have more significant increases, whereas to some extent the lower layers, say one over one did not require the same increase like 15 over 10 for arguments sake.

Q - Thomas Seidl {BIO 17755912 <GO>}

And should you not get a nice reserve release if the Ogden rate comes at 0.5 in April?

A - Ulrich Wallin {BIO 4863401 <GO>}

That would be the case. But I mean if you wait and see as and when it happens. We were a little bit disappointed I must say. I mean we had a structure on the program where we gave a price based on minus 0.75% with adjustments reducing the premium in case of increase in the Ogden rate. But the market was prepared to give the client the benefit of the doubt. So clearly according to our calculation did not quote on minus 0.75%. In some cases actually according to our calculation well above 1% and of course we had no option then to discontinue those programs.

Operator

The next question comes from Frank Kopfinger, Deutsche Bank.

Q - Frank Kopfinger {BIO 16342277 <GO>}

First question is also on the renewals and coming back to this 2015 level question. I think, Ulrich, you mentioned that you do not expect the upcoming renewals in respect to price improvements are better than what we saw now in January. Could you confirm this and also whether why we shouldn't expect higher pricing? Is this for the impact of the U.K. motor business, which we obviously have now as a supportive driver for January? What are the reasons behind this? Then secondly also on the renewals, on the price development for the North American business in the proportional business, they show a negative of 0.8%. Can you dig a little bit more on what the drivers are there behind this decline and proportional North America business?

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes, Frank, on your first question, there is still the imbalance of supply and demand. And I mean that will persist most likely throughout the year. And therefore I would love to see as going back to 2015 levels. But I have -- I'm quite cautious there. Of course it will be extremely interesting to see what's happening on the Florida renewal at 1/6 because I mean that has -- we have seen so many redactions on Florida and of course was a most disappointing renewal last year. So it could be very interesting to see what happens there, for us a little bit more observing rather than participating to a larger extent because we are very low on our Florida exposure. And on North American property -- proportional, I would leave that to JÃ¼rgen.

A - JÃ¼rgen GrÃ¤ber

Yes. Well the minus as far as the premium volume is concerned is the result of many things happening at the same time. We had a couple of new additions of new proportional treaties. They are usually in the EUR 10 million to EUR 15 million to EUR 20 million ballpark figures. But we also had withdrawals of similar proportional treaties. They are mostly quoted shares and not surplus treaties and the minus 0.8% is simply the result of these movements. We don't have one very big contract pricing.

A - Ulrich Wallin {BIO 4863401 <GO>}

I mean, you said...

A - JÃ¼rgen GrÃ¤ber

You talk about pricing?

A - Ulrich Wallin {BIO 4863401 <GO>}

Yes.

A - JÃ¼rgen GrÃ¤ber

Sorry, (inaudible) about pricing.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Yes. It was about pricing, the...

A - JÃ¼rgen GrÃ¤ber

Okay. The -- the proportion of pricing. Yes. Well here I probably struggle to give you correct details because we have so many lines of business in the U.S. Yes, I -- probably we have to take that offline so to say and I have to contact the North American treaty department, why exactly minus 0.8% I struggle here to have the details at hand.

Operator

The next question comes from Ivan Bokhmat from Barclays.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

It's related to the structured reinsurance bit. It's now almost a quarter of total P&C volume. I was just wondering if you did any estimates on the overall market size and what's Hannover's share in it. And I'll have few follow-up questions on the same. I was wondering whether the rate on those structured reinsurance, did it in any way benefit from the harder or stabilizing market? And finally you mentioned that there are some diversification benefit, how much more for that do you see considering the already high share in the mix?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well let me start with the market size and try to answer that. The market is not very transparent. Many of these transactions get placed as private transactions and one reinsurer takes 100%. So this is not always that transparent and only with a delay factor you can assess that in the States where it is published in the (Yellow Books) and you find out if you go company by company how much of these transactions were actually placed. Having said that, Hannover has a history of more than 30 years and all the large players are involved. And we of course hear from time to time who are the participants or the competitors. They are usually 2 or 3, not more than this because these treaties don't get offered around the market. And I dare to say with this kind of structure probably one would have to say our shares should be north of 10%. But again this is guesswork since there is no full transparency and the encoding is always different in various companies. Some actually allocated to their traditional business and others carved it out like we do as structured reinsurance. So my best take would be that we have a significantly above Hannover Re worldwide average market share, yes. That is all I can say. Does it benefit from a hard market? No, not really. These kind of structures are driven by other dynamics. The demand gets created by capital models, it of course competes with the pricing of traditional markets. But it also competes with other types of financing, i.e., the spread for corporate bonds. So if the spreads for corporate bonds are high, say for argument's sake 300 base points, 400 base points, 500 base points above risk-free, then the demand is increasing. This though right now is not the driver. So I would dare to say it is optimization of capital costs and it is uncorrelated to the market cycle in the hard or soft traditional market.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

And on the diversification benefit?

A - Ulrich Wallin {BIO 4863401 <GO>}

On the diversification benefit, yes, it adds benefit. It is of course (inaudible) correlated to P&C. But with a factor quite deviating from plus 1 closer to the 0. However -- and what is the driver? The driver is that mostly these covers are net account quoted shares. They have less volatility. But they still have the same volatility like the traditional P&C business. So yes, it adds diversification. But it is not uncorrelated like life business or other types of the business, nor is it negatively correlated. It only has softer positive correlation to the other P&C segments.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

And maybe putting this in the broader context, does the growth of the structured reinsurance means that your 96% combined ratio ambition may change?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well the ambition definitely not, it becomes a little bit more difficult to achieve because it means that on the traditional business we need to be at around 95%. And -- but we think that that's achievable because I mean we continue to have significant amounts lawfully unchanged or if we've done loss reserves. So we expect positive development always from the back years. Taking that all to -- into account, I think we will stay with the goal to be 96% or below.

Operator

As there are currently no further -- speakers, I'm sorry.

A - Ulrich Wallin {BIO 4863401 <GO>}

Any further questions?

Operator

As there are currently no further questions, I will hand back to the speakers now.

A - Ulrich Wallin {BIO 4863401 <GO>}

Okay. Thank you very much. Thanks for dialing in again and have a nice day wherever you are. Thank you very much indeed.

A - JÃ¼rgen GrÃ¤ber

Thank you.

Operator

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