Q1 2017 Earnings Call

Company Participants

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

Other Participants

- Andrew J. Ritchie, Analyst
- Frank Kopfinger, Analyst
- Guilhem Horvath, Analyst
- Ivan Bokhmat, Analyst
- Jonny Urwin, Analyst
- Kamran Hossain, Analyst
- Vinit Malhotra, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen, and welcome to today's Hannover Re Interim Results for the First Quarter of 2017 International Conference Call. For your information, this conference is being recorded.

At this time, I'd like to hand you over to your host for today, Mr. Ulrich Wallin, Chief Executive Officer. Please go ahead, sir.

Ulrich Wallin {BIO 4863401 <GO>}

Thank you very much and good morning, ladies and gentlemen also from the Hannover team. I'd like to welcome you on our conference call presenting our results for the first quarter 2017. As always, I'm joined by our CFO, Roland Vogel. Given that today we also have our Annual General Meeting for shareholders, we are holding this call rather early in the morning. But we do hope that this will not cause too much inconvenience for you.

I'm pleased to report that Hannover Re shows results in the first quarter of this year which are fully supportive of our guidance for the entire year 2017. The top line grew for – adjusted for foreign exchange rate by 5.9%, which was entirely driven by our P&C business and here in particular by the structured reinsurance business written by our advanced solution practice.

The net income and EBIT figure broadly in line with the figures recorded a year ago for the fourth quarter of 2016 and, therefore, are supportive of our expectation to reach a group net income in excess of €1 billion for the entire year. The book value per share further increased by 3.6%. And nevertheless, the return on equity remains well above our minimum target and stands at 11.6% on an annualized basis. To put these figures in perspective, I would like to mention the following aspects which are significant for the development of our business in the first quarter.

Firstly, received an excellent result from our investments, which is 7.3% higher than for the first quarter 2016, and this is based on the development of our ordinary investment income and not of the development of the realized gain.

Second, our property and casualty business was significantly impacted by the step change in the so-called Ogden tables in the UK. This change meant that, on lump sum settlements on bodily injury claims, the discount rate used for future cash flows have been changed from 2.5% to a minus of 0.75%. If this change is also applicable to outstanding claims from previous year, it means that these claims increased significantly and, as a result of this, the loss reserves have to be increased accordingly.

At Hannover Re, we have booked additional loss reserves to take these changes into account of €126 million in the first quarter. In the course of the year, we do, however, expect this number to increase if additional changes in reserves are received from our clients and also the reserves on new claims, it will also increase to the extent that they are in respect of lump sum settlements for bodily injury claims. We have these claims mostly on our UK motor excess of loss business (04:30) business excess of £5 million and enjoy a market share of 15% on those layers only. We have no involvement in any lower layer.

Developments such as the changes in the Ogden rate are, on the other hand, one of the main motivations for holding reserves which are above the actuarial best estimate which are based on past claims experience. We will, therefore into position to offset the impact from the Ogden rate changes by releasing reserves which are redundant according to the various actuarial calculations. Considering the high level of reserves we are holding on our UK motor excess of loss portfolio, we feel that we would be able to do the same with the expected further increases in the claims due to the Ogden rate changes.

On our life and health business, we recorded an excellent result on our financial solution business, which is partly recorded on the other income and expenses line because the treaties are deposit accounted.

On the other hand, we saw again a negative impact from our legacy U.S. mortality business. The result of the first quarter for our life and health business is, therefore, a little below our expectations. Nevertheless, it is still supportive of an EBIT in excess of €350 million for the entire year.

On this note, I would like to hand over to Roland, our CFO, who will explain this figure to you in more detail.

Roland Vogel {BIO 16342285 <GO>}

Hey. Good morning and thank you, Uli. As usual, I will try to keep my comments brief. This would be rather easy this time as the Q1 results do not include too many material one-off effects worth mentioning. I would also like to take this occasion to point out that, together with our Q1 results, we have also published our SFCR reports for the full year 2016 for the first time, which provides a lot of additional qualitative as well as quantitative information on top of the solvency ratios which we have already published together with our year-end results. You will find them on the company website where we have published the two mandatory reports for the German entities, Hannover Rück SE, the parent company, and our German subsidiary, E+S Rück.

As a subgroup of Talanx – or as a bonus subgroup of Talanx, we are not required to prepare an SFCR report for the Hannover Re Group. Nevertheless, we voluntarily decided to compile and publish the report for the group as well since we think it's a valuable source for information for our shareholders and it also provides added transparency to facilitate any comparison with our peers.

The favorable top line development in the first quarter of 2017 is entirely driven by our P&C business group, whereas life and health showed a small decline in gross premium. Overall, the premium development is in the range we have been expecting for the full year. Net premium increased by 4.3%, adjusted for the currency effects. The retention, overall, was rather stable compared with previous years.

As already mentioned, we are highly satisfied with the investment income, especially because the increase compared to last year is driven by the strong ordinary income. Other income expenses increased mainly due to the strong profit contribution from our life and health business solution segment. FAS 113, the U.S. GAAP rule, requires a significant part of these treaties to be booked according to the deposit accounting method. Due to the insufficient and limited risk transfer and the profits from these contracts, therefore, show up in the other income lines of the P&L. Just for the sake of complete this year of (09:32) the tax rate is in line with the expected range.

On the next slide, cash flow continues to be very positive, driven mainly by good results on the underwriting, as well as on the investment side. Assets under own management increased to roughly €42 billion. In the first quarter, FX effect had a positive impact of almost €170 million, rising valuation reserves of around €230 million and on top of the positive cash flow.

On slide 4, if we look at the capital side, we feel very comfortable with the low level of outstanding hybrids also because it gives us significant flexibility to issue more. We have explained that before. The shareholders' equity increased by 3.6%. On the right-hand side of this slide, you can see that the change is driven by the asset valuations and the currency translation partly offset each other on balance in the first quarter of 2017. Therefore, the increase is mainly driven by the positive earnings contribution.

For the P&C segment on slide 5, P&C gross premium increased by a remarkable 11.3%. On an FX adjusted basis, this is mainly driven by the successful new business written by our structured reinsurance team and fully in line with our reporting on this year's January renewals.

Additionally, we have enjoyed healthy demand in property lines in several regions around the world, also leading to a further diversified growth, that was partly offset by reduced premium income here in our home market in Germany. Net premium earned increased favorably by 8.8% adjusted for currency effect on that basis.

At 6.2% of net premium income, the major losses were again below the budget in the first quarter. The underwriting result is on a good level as the combined ratio of 95.6% comes in below the full year maximum target of 96%. As in the previous years, we stuck to our standard practice and did not release the major part of the unused large loss budgets and kept it as IBNR for the remainder of the year.

One should bear in mind that the increase in structured reinsurance business generally leads to higher combined ratios as the lower risk transfer justifies also lower margins. Moreover, profit recognition happens conservatively, usually back-loaded, which is the reason that the initial combined ratios for the new contracts are booked remarkably above our 96% target. And so, this inflates a little bit the combined ratios.

Regarding the Ogden rate change, Uli has already commented on this rather extensively. Overall, based on the fact that we absorbed the effect from Ogden within our existing IBNR, the confidence levels of our reserves should be slightly down compared to year-end 2016 but definitely still on a very comfortable level. Apart from the Ogden, the run-off reserves on balance did not include any other major effects and came in, as usual, slightly positive.

Ordinary investment income was slightly above expectations, mainly driven by a strong contribution from private equity and real estate, realized gains rather low, and the result of normal portfolio maintenance, which means that, as in the past, we did not actively harvest unrealized gains from our fixed income portfolio.

Other income expenses decreased to minus 24%, mainly driven by negative currency effects this time. Altogether, net income for P&C segment at €215 million, up by 5% compared to an already good first quarter in the previous year. Major losses were significantly higher than in the very benign first quarter of the previous year. However, the net loss from large catastrophe and manmade events in the first quarter was still below the expected level. Therefore, roughly €30 million in unused budget will be carried forward for the remainder of the year.

Five losses made it onto our large loss list in Q1, the most significant event being Cyclone Debbie in Australia at the very end of the quarter. As Debbie occurred only just before the closing of the books, the €50 million net loss is an early estimate and, therefore, especially by the time when we set it up, included a remarkable level on uncertainty. Nevertheless, we feel still comfortable with this estimate especially as any increase should be covered by unused Q1 budget and would hence not affect the Q2 budget. Just to make that sure, we don't foresee that right now.

You might also be wondering why the relief from retrocession seems to be rather low for U/W (16:22). This due to the fact that a significant part of this loss originates from proportional treaties and our facultative book, and these are not covered by our K quota share vehicle.

On the next slide, you can see that most lines of business showed a healthy underwriting profitability. The main contributor to the good underwriting result in the first quarter was Continental Europe where we did not record any sizable large losses. Additionally, the combined ratio of our global cat business, as well as the specialty lines in our facultative book, favorably below the MtCR.

North America impacted by a series of tornadoes and a rather large property loss. Worldwide treaty business also affected by large losses, namely, the wildfires in China and Cyclone Debbie. This slide also demonstrates what I already mentioned earlier. The structured reinsurance block has a high MtCR so that the growth of the business lines of that business impacts the combined ratio without affecting the economic profitability.

In life and health, gross written premium decreased slightly by 1.7%, adjusted for currency effects. New business production was favorable in most areas and only the discontinuation of larger volume, single premium business in the UK, enhanced annuities, as well as some financing business in China is also masking this positive trend. Overall, the premium development is within the range which we are expecting for the full year.

The result of our legacy U.S. mortality business is below expectations. Uli mentioned that already. Apart from this, profitability is good and particularly this is true for the financial solutions business. Given that the underwriting result of this slide also includes the income from funds withheld, it's worth mentioning that income from funds withheld declined by €12 million due to the discontinuation of the already mentioned financing fees.

As explained earlier, the significant improvement in the other income and expenses can be explained by the increased results from treaties recognized according to the deposit accounting method with a contribution of nearly €50 million in the first quarter of 2017 compared to around €15 million in the previous year. Currency effects in the first quarter were rather negligible both in this and the previous year.

Looking at the EBIT margins by reporting category, only mortality and morbidity did not meet the target, which is obviously driven by the U.S. mortality. The development in financial solutions continues to be very positive. Net investment income was in line with our expectations. And just for the sake of completeness, the effect from our ModCo derivatives was a plus €1.3 million in the first quarter.

Looking at the investments, the development in the first three months is very satisfactory with investment income above our return expectations for the year. Despite the lower yielding fixed income portfolio, ordinary investment income increased favorably.

This was predominantly driven by the strong contribution from our private equity portfolio, where some distributions - or redistributions are generally not allocated equally throughout the year. This time, we received some significant amount in the first quarter. Additionally, the return from our real estate investments was, again, helpful in the low yield environment.

Realized gains, on a normal lower level as we continued our policy of maintaining unrealized gains instead of actively harvesting them. The development of impairments and depreciations, as well as the change in the fair value of financial instruments, did not include any effects that I should be commenting on. Overall, the return on investments was 3.1%. And even if that includes some one-off effects, this is making us very confident that we will or should achieve the full year target of 2.7%.

As the development of interest rate and spreads was rather moderate in the first quarter, variation reserves moved only slightly. Compared to the year-end, an increase to almost €2 billion which was mainly driven by the listed equity portfolio.

The next slide shows the usual overview of how the different asset classes contributed to the ordinary investment income compared to where we are invested. On the right-hand side, you can see that we kept our asset allocation more or less stable in the first quarter. And the left-hand side illustrates the very strong performance of our private equity portfolio and the continued positive contributions from real estate.

As I have just explained, the 14% from private equity is expected to trend down towards a more normal level over the course of the year. And I think that concludes my remarks, and as usual, the target matrix is for you, Uli.

Ulrich Wallin {BIO 4863401 <GO>}

Thank you very much, Roland. If the target matrix I think confirms a good start into 2017 financial year, most profit targets being achieved, also, it's noteworthy again that the return on equity target is well outperformed and particular also the return on investments is significantly higher than we have expected. Also quite notable that, again, we have hit the growth target on the property and casualty line, so there is some growth back in the business after 2016 where the top line was developing more sideways.

If we then come to the treaty renewal at 1st of April or, to be more precise, January 2nd to 1st of April 2017, you can see that we have up for renewal €964 million of premium, which dropped by 4.9% to €917 million. The main reason for this drop is basically twofold. One, we had relatively large motor quota share in Japan, which was purchased for solvency relief necessities and no longer necessary that was discontinued.

And secondly, on the U.S., we had a treaty that was rolled into another broader treaty, which, on balance, we didn't lose any premium income there. But, of course, with this rolling in, this treaty was not renewing at 1st of April and, hence, it's not recorded here. It's recorded as discontinued here.

Otherwise, I mean, treaty renewals 1st of April reflected prevailing competitive market. Business renewed is traditionally, in particular, our Japanese business, but also some business from other territories such as Australia, New Zealand, Korea and North America. In North America, we have pretty much seen a continuation from what we have seen at 1/1. so market is still competitive. Particularly on the property side, some modest further rate decreases. However, stabilizing trend clearly visible.

In Japan, outside the motor treaty I already mentioned, we saw a moderate softening on the property side. But we saw some significant rate increases on the liability excess of loss programs, and this is due to the fact that the Japanese liability market has suffered in the past some pharmaceutical liability losses which came to notice and, for the reinsurers, basically over the last two years, and this has resulted in some significant rate increases. So that, in Japan, outside that motor treaty, we have been able to record some satisfying growth of our business.

On the property catastrophe business, we saw slight decrease in volume, which again was the reason for that the market has been relatively soft and some streamlining of buying from major clients, which purchasing more global covers and broader covers and also part of their coverages on a multi-year basis. This in general is a more efficient way of reinsurance buying. It's not necessarily only positive for reinsurer, but it helps the larger reinsurers because the larger reinsurers could provide capacity in all territories and basically also all lines of business.

Aviation pricing pressure remains intense even though there is some hesitation of further decreases on the direct airline business. But on the non-proportionate business, which effectively last year pretty good results due to lack of losses, further rate decreases are the norm. On the marine business, overall, we're quite happy with our marine portfolio even though that it continues to reduce some size a little bit due to our very disciplined underwriting policy there.

If we come to the guidance for 2017, it is entirely unchanged. Premium income, we are now expecting growth in the low single digits. We're quite confident that we will actually achieve that. Return on investment, 2.7%, is – I mean, certainly the first quarter is fully supportive of that. Same is true for the group net income.

If it comes to the dividend payout ratio, if things stay calm and we are not seeing any major events either on catastrophe losses or major losses nor in the capital markets so that overall results remain in line with expectation and markets remain competitive and soft, we will most likely also pay a special dividend for the year 2017.

If I look at the individual lines of business, we continue to expect on the target markets, growth in North America and some reduced premiums in Continental Europe. You can also see that we expect on both areas the result to normalize for the entire year to quite profitable results in North America. Whilst due to the competitive nature of the Continental Europe business, unfortunately, it will be optimistic to assume that the 80 (30:00) combined for that business that we have seen in this first quarter will prevail for the entire year.

On marine, aviation and credit, surety, overall, results should be all right. I mean, we expect to earn the cost of capital for the most part. Same is true for UK, London market and Ireland, that's, however, on the provisor that the Ogden impact is being absorbed by reducing the redundant loss reserves for the year. That will, of course, not be limited to redundant loss reserves from the UK, but we will also probably, I mean, have to look at some loss reserves from other areas which are, in particular, redundant as the actuaries calculate.

Facultative, there has been some relocation of some business from facultative to our direct business. Therefore, we see a reduced income but we expect, like we have seen in the first quarter, good profitability.

Worldwide treaty and structured reinsurance both earned the cost of capital. We put here negative profitability on the property cat business. This is based on the model and expected losses which would probably be combined ratio in the high 70s which would not be sufficient to cover the cost of capital. However, if losses developed as we have seen in the last five years, of course, the actual combined ratio here will be very favorable, but that will not go on forever.

If I then go to the life and health business, you can see that we expect a flat premium income and that the profitability will be driven by the financial solutions business. That continues to show new business on a quite regular basis. However, the majority of these transactions are not recorded as premiums under IFRS accounting standard and therefore the volume here is not a very good indicator of the new business developed.

Longevity, we expect to earn the cost of capital, I mean, this business line is pretty new. I mean, it's probably written over the last seven years or so, particularly when it comes to the pension block, and only the oldest ones are getting really in the period where the risks can actually materialize.

The mortality business, we, unfortunately, also for the entire year, have to expect an IFRS to see further negative impacts. Nonetheless, we expect that, for mortality, the overall EBIT margin for the entire year will be significantly higher than what we have seen in the first quarter. And morbidity is the kind of a right, (33:39) even though it will be a challenged, to come to the 6% EBIT margins.

Coming to the final slide, you can see that we are still very confident that we will at least safeguard the level of profitability above €1 billion in the short term. And that in the medium term, we expect that we will be able to increase the profitability of our business on the P&C side. This is largely based on the expectation that, as results gradually get worse and/or a major catastrophe may occur, we will see some changes in the market, which we feel we are well positioned to profit from.

In the short term, the high level of loss reserves should help us to maintain acceptable and stable underwriting earnings. And also, I mean, we have some tailwind from the terms and conditions of our retrocessional covers.

On life and health, due to the positive development on our financial solution business, we expect that already in 2017 the EBIT should be excess of €350 million, and we have seen very positive trends here on our new business evaluations.

Investments, in absolute terms, we see rather stable development. In fact, I mean, some in-depth analysis into our investment has shown that, following 2018, we can expect that the yield of the investments will not drop any further. On the medium term, there is some glimmer of hope here that, actually, the increased volumes that we expect to see will also result in a gradually increasing investment income.

This brings us to the end of our presentation and we'll be very happy to answer your questions. Thank you very much.

Q&A

Operator

Thank you. Our first question is over the line of Vinit Malhotra of Mediobanca. Please go ahead. Your line is open.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yes. So, thank you, sir. Just one thing, on the outlook on the life side, just if you could remind us, Uli, is today's miss in the – or rather the slight weakness in the ING book continuing? Is it causing you to be a little more concerned or are you still very bullish about the financial solutions coming in very early or earlier than we earlier thought? So, if we just comment a bit more on the life outlook, that will be very good.

Second question, please, on the SFCR, we have noticed in the – so, first of all, thank you for voluntarily providing that. In the underwriting result by line, there is a workers' comp, pretty material loss there. Is that a surprise because I thought at least in the U.S. Hannover Re was very strong in workers' compensation?

And last question, please, if I can one. The last comment you made on the running yield pressure going away next year onwards, is that because of the relisting that was mentioned in the Investor Day or is that just the fact that yields are a little better or what do you think is driving that? Thanks.

A - Ulrich Wallin {BIO 4863401 <GO>}

Vinit, the last question was on the special dividend?

A - Roland Vogel {BIO 16342285 <GO>}

No. That was about the running yield.

(38:28)

A - Ulrich Wallin {BIO 4863401 <GO>}

I leave that to you, Roland.

A - Roland Vogel {BIO 16342285 <GO>}

I will take that, yes.

A - Ulrich Wallin {BIO 4863401 <GO>}

Let's start.

A - Roland Vogel {BIO 16342285 <GO>}

Sorry, sorry. Yeah. I think I can start with that. As we mentioned and we tried to explain before, the reinvestment yields, as we usually present them, are the theoretic reinvestment yields, which result if we would invest the new money exactly where the old money is invested. And the difference between that has become remarkable.

On the other hand, you should also have - bear in mind that 50% of our portfolio is invested U.S. dollars. We have seen increasing yields in the U.S. dollars, so that has an impact. Moreover, we have also continued to invest a little bit more in the alternative asset classes as was presented. So, in our projections, I can say whether it's - one or two years down the road, 2.6% or 2.7%, but - so, overall, the actual and also expected reinvestment yields we are looking forward do result in the running yields to stabilize where we are.

A - Ulrich Wallin {BIO 4863401 <GO>}

Okay. Then I'll take the question on the life side. I mean, the first quarter, in fact, was a little bit disappointing from the U.S. mortality. But that was the major hit that we have seen there, but we are still quite bullish for the entire year, of course, first and foremost, due to the financial solutions business which for the year seems to be coming in even a little bit stronger than expected. And there are also some new treaties which are close to being finalized.

But also, we have seen a very positive development which also should contribute to the profitability in Asia, particularly in China where we have written some new very traditional treaties, which are quite sizable. That is on the back of the mortality initiatives that we are doing this South African company. Mortality Latin America business is growing very traditional business, actually quite a lot of that is actually annual business. It's growing double digit at this point in time, and also our French business.

So, we expect that those non-U.S. traditional businesses will see an increasing contribution of profitability throughout the year and coupled with the (41:37) financial solution business, which is largely U.S. but not entirely U.S., and the fact that we expect that the remainder of the year on the legacy U.S. mortality business will not be great, but it should be a little bit better than what we have seen in the first quarter. We still believe that we will be comfortable like above €350 million EBIT for the year.

On workers' compensation, while – I mean, workers' compensation, we write on a non-proportionate basis, both within a person limit as well as cap. I mean, this is a line where we just strengthen the loss reserves because we could, because other areas of the U.S. liabilities do not lend itself so much to strengthening of the loss reserves at this point in time because the developments in the triangles are quite positive. So, I mean, it's typical to defend (42:45) the reserves. That's not the case in workers' compensation excess of loss because it's actually quite a long tail line of business.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay. Thank you.

Operator

We are now over to the line of Andrew Ritchie at Autonomous. Please go ahead, Andrew. Your line is open.

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

Hi there. Two quick questions. First of all, during the quarter, you entered the Lloyd's market with your purchase of Argenta. I wondered if you could just give a bit of color around that. Does that complete your long-term-held ambitions to get a presence at Lloyd's? What do you think of the group benefits? Does it – what (43:29) start to materially, if it all, contribute to earnings? Obviously, it's a tricky time in the Lloyd's market as far as pricing is concerned.

The second question is a bit of a technical question, I'm afraid. When I look at the SFCR, the difference between best estimates Solvency II non-life reserves before discounting and your held reserves is something like €4.5 billion. Obviously, that's a larger number than the roughly €2 billion difference between best estimate and held reserves that you talked about in the past. Should I compare the two? Is this just a reflection of the fact that the definition of best estimate is quite different between what you would define as your margin versus how it's defined in Solvency II? Thanks.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, I mean, on Lloyd's, I would say the Argenta acquisition is basically driving (44:26) our endeavor into that market. We feel it's a rather, I mean, low risk entering the Lloyd's market because what we have at our disposal the majority of system capacity of the Argenta Syndicate at this point in time, with the purchase, we're only getting a 21% share in that underwriting capacity.

It will contribute most likely from the third quarter onwards because that's when we're expecting the closing of the transaction. And on the FSCR (sic) [SFCR] (45:08) I would hand over to Roland.

A - Roland Vogel {BIO 16342285 <GO>}

Yeah. There is a – I expected that (45:15) I must admit I think we have prepared here the presentation of our IFRS quarterly results. We are not fully prepared to comment on every potential questions on our presentation of the Solvency reporting. The reserves you mentioned, I think you mentioned the €4 billion, it's a bit speculation on my side. You should, of course, bear in mind that the best estimate liability will include also discounting as well as redundant reserves. But we are not fully prepared to answer that question now and I would ask you that we come back to that offline.

A - Ulrich Wallin {BIO 4863401 <GO>}

Yeah. The only thing I would say is the difference between the reserves recognized under Solvency II and the IFRS, it's not only the redundancy but it is also the discounting, because on IFRS, of course, you are not discounting loss reserves, they are entirely nominal, it's not discounted.

A - Roland Vogel {BIO 16342285 <GO>}

Yeah.

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

It is separately disclosed so – on page 64. But I anyway we can return back to that. Just on Argenta, you have the right in any future underwriting year to increase your participation. Is that the case? You could go up to 100% if you wish?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, not quite 100%. I mean, there are some things that have tenancy rights. So, I mean, we would have to buy them out in the option.

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

Okay.

A - Ulrich Wallin {BIO 4863401 <GO>}

But we could get to the – I mean, to around 70% if it's not too much of a problem, which gives us great flexibility. I mean, of course, we can also set up a special purpose vehicle or syndicate if we want. But those are widely bought to gain those options.

In the short term, I mean, Argenta is largely a short-tail business. So, the risk of under-reserving is not at all that high and that attracted us to the syndicate.

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

Okay. Thank you.

Operator

Okay. We're now over to the line of Kamran Hossain of RBC. Please go ahead. Your line is now open.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi. Two questions. The first one just on life business, we've seen, I guess, mortality improvement in the UK begin to deteriorate. Can you talk about whether you factor this into numbers here or whether we should see this in your numbers at all? So, that's the first question.

And the second question, just on the Ogden reserves, when we think about the – your overall reserve buffer, should we simply strip that €126 million plus the remainder out of that reserve buffer and what impact does this have on the capital? Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, I think the entire effect that we have on the redundant reserves is of course then subject to the calculation at the end of the year by the actuaries. But if you just base it on the calculation at the end of 2016, then, yes, that's the answer. I mean, you should strip out then the €26 million (sic) [€126 million] (48:44).

As far as the UK mortality business is concerned, we are not very heavily involved in that, I must say, because we feel that the market in the UK is very, very competitive, and therefore, we have only some business outside one or two direct areas which we support. We only have some run-off business which actually has a benefit of higher rate obviously.

In recent years, we haven't written new mortality business in the UK mainly because of the competitive nature of that business, and some of the treaties are placed for 100% and we are not very keen on doing that because we'd like to have the seeding company having skin in the game and have retention.

Q - Kamran Hossain {BIO 17666412 <GO>}

Sorry. I probably phrased my question quite badly. I was actually trying to guess out is there any positive for your longevity business in the UK...

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, on the longevity.

Q - Kamran Hossain {BIO 17666412 <GO>}

So with a little bit mortality improvements deteriorating, does that benefit your longevity business in the UK? Sorry, badly phrased question for me.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, on the longevity, of course, it should have a positive impact. As I said, the result of that is not seen in the short term because, as I explained on previous calls, I mean, if you write one of those pension blocks, in the first, say, seven, eight years, we expect that we will pay out the pensions on most of the pensioners but only if you go like 10 years down the line, when if the average age stayed at (50:32) 70 when we wrote the business, at 80, I mean, we will not pay out the pension on some of the pensioners. And that's, of course, when the risks really start.

We are not yet in that phase, and so we would not take any benefit in our reserving on those kind of trends at this point in time nor – and probably I shouldn't say it because it's a little bit of a competitive question here, not this point in time we take any of the reduced mortality improvement into account when we price the business.

Q - Kamran Hossain {BIO 17666412 <GO>}

Okay. That's perfect. Thanks very much.

Operator

Okay. We are now over to the line of Jonny Urwin at UBS. Please go ahead, Jonny. Your line is open.

Q - Jonny Urwin {BIO 17445508 <GO>}

Hi there. Just a couple of quick ones for me, please. So, just on the Ogden change, thanks for that description, it's very comprehensive. I just wondered if you got any thoughts on how pricing in the XoL reinsurance market will develop in the UK from here?

Also, just a quick follow-up on the workers' comp specific disclosure in the Solvency II enhanced disclosure . So, I was a little surprised you strengthened reserves just given I thought claims inflation trends are very positive in the U.S. Any more color there will be much appreciated. Thanks.

A - Ulrich Wallin {BIO 4863401 <GO>}

What I would say on workers' compensation is the tail of the business is actually long, as I said. And claims are actually developing into the non-proportionate business at probably a rate which is – you can consider a little bit higher than the actuaries believed, I mean, some time ago. That's particular for regional account workers' compensation. And then, of course, it depends what you do with this on the triangles because of, I mean, some of the business have (52:38) period of, say, 30 years. So, a little change in the triangle and the factors that you put in for the further development has a relative significant effect.

And as I said, as on our U.S. casualty business, we always try to make absolute sure that we have the very conservative reserving approach. We used this – observed somewhat higher claims than expected to change the factors, and that really resulted in the change in reserves. And pricing on Ogden, I mean, we have in Hannover Re established, of course, one group on Ogden that looks at the development of the loss reserves and tries to come up with a new best estimate. But we also have, of course, pricing group that works on the pricing going forward.

If I just look at the advised losses that we have seen up to now, and I refer that largely to the underwriting years 2013 to 2017 because those are the ones that are mostly impacted, we already have seen on advised losses more than a doubling due to the Ogden claims. So, what our client advisor has already doubled, I mean, I should say that prior to the Ogden claims arriving, we have the advised loss reserves from our clients and advised pay claims on the underwriting years 2013 and following, we're only 27% of our overall loss reserves. So, 73% were IBNR.

So, in theory, we could just absorb the increased advisers within our IBNR. But you can see this doubling in advised losses may point to a doubling in premium, but this is, of course, a little bit premature to come up with a definitive figure. But clearly on the upper layer, I mean, the loss load is increasing significantly and it wouldn't surprise me if the final analysis would point to expected losses on those layers at least double.

Q - Jonny Urwin {BIO 17445508 <GO>}

Thank you very much. That's great.

Operator

We are now over to the line of Guilhem Horvath at Exane. Please go ahead. Your line is now open.

Q - Guilhem Horvath {BIO 18460437 <GO>}

Yeah. Good morning. Thanks for taking my questions. So, the first one is on the reserve buffer and I think, Roland, you said that, after the Ogden impact, your conservatism was slightly lower than before, still very comfortable, but lower. And I like to understand what's your strategy going forward. Are you going to be able to rebuild this buffer going forward or do you still have constraints in terms of increasing conservatism?

And the second is on credit and surety because I see on your slide that your expected profitability is, I would say, with a plus and minus. But I like to understand what's your view on the claims environment going forward in this particular line of business and what you see after primary insurers cutting a lot of their exposure. Is it improving, in your view, in terms of the claims environment there? Thanks.

A - Roland Vogel {BIO 16342285 <GO>}

If I may comment on the redundancy level, as Uli also mentioned a minute ago, one should assume that the confidence level will be impacted by the Ogden rate triggered use of redundant reserves. So, on the one hand, and we've mentioned that before various times, we are at the upper boarder anyhow. So, there was not too much room for additional conservatism. So, if you now ask, will we be able to kind of restore the previous level, will, of course, also depend a little bit on large losses by the end of the year if that stays very, very low. So, we might be able to restore some of that.

Overall, I think we have added to redundant reserves for quite some years, and it would not be a concern if that is not the case. It would even make our auditors a bit more happy than they were. So – and again, we're talking about a stock of €1.9 billion, and the number we mentioned here is not that high up to now. In that regard, we still feel very comfortable.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, on the credit and surety business, I mean, overall relatively positive. I mean, we had losses in the past years from some of the emerging market credit business that, on those treaties and on the trade credit side, terms have improved for the benefit of the reinsurers. So we are expecting better results here very clearly because, I mean, actions being taken both by seeding companies as well as – on the reinsurance terms, are still cautious on the surety business due to its longer nature of the original policies. I mean, it's basically for the duration of a project.

I would say some of the emerging markets we have seen improvement in the economic conditions which, of course, help here. But also, I would say, I mean, if I compare the terms and conditions on the credit and surety to those that we have enjoyed in 2009 and 2010 and maybe 2011, of course, I mean, they are not nearly as good, therefore, we put the plus, minus.

Q - Guilhem Horvath {BIO 18460437 <GO>}

Okay. Thanks very much.

Operator

Okay. We now go over to the line of Ivan Bokhmat at Barclays. Please go ahead. Your line is open.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Hi. Good morning. You've mentioned quite traditionally in your outlook statement that your capital decisions will take into consideration solvency levels. So, my first question would be on whether you can update us on how your first quarter solvency might look like.

And the second question is regarding the investment result outlook. So, you've mentioned that the private equity have contributed something that could be called extraordinary. Could you care to elaborate the total volume of extraordinaries that added to the running yield to the core? Thanks.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, the first is solvency for the first quarter, it should be rather stable. I mean, of course, we have positive development in the IFRS equity, which also fueled through into the solvency ratio. The growth in the P&C business would not require a lot of additional capital because it's in lower risk category being the, I mean, advanced solutions, our structured reinsurance business. So, therefore, my expectation would be it would be rather stable. However, the actuaries are currently working on it and we will report that in due course.

A - Roland Vogel {BIO 16342285 <GO>}

Now, when it comes to the private equity, you have to look at all the various funds we are invested in, and it is somewhat volatile what and if they distribute. If you ask me what the extraordinary portion of this first quarter is, I would estimate it between €20 million and €30 million.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Okay. Great. Thank you.

Operator

Okay. And we'll now go to the line of Frank Kopfinger at Deutsche Bank. Please go ahead. Your line is open.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Yes. Good morning, everybody. I have two questions. And my first question is again on the Ogden rate change, as you said, you expect some more impact to come. Could you shed some light on how much more it's going to come there?

And secondly, again, also on the U.S. life legacy book, and you guided towards this, but it remains an ongoing track on your numbers there. Is there other risks or a chance that at some point we should expect a onetime hit that you're going to restructure this somehow or should we expect that this keeps on an ongoing track and you're simply offsetting this with a stronger financial solutions result?

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, the thing on the U.S. mortality business is that, of course, on the IFRS, you have this locked-in results and - locked-in reserves. And as the overall value unfolds of our U.S. mortality business is still very positive, and that's, of course, based on the new business that we are writing, I mean, there is no unlocking events, so to say, on that business.

That said, I mean, you will see a gradual negative impact from where we negotiate with our clients to recapture some business that often is happening at the same time when we announce rate increases because some clients rather than accepting rate increase they just recapture the business.

In the past years, these recaptures normally benefited our result because we had a more negative view on that business than our clients. And therefore, we could release reserves in those cases. That's not said that that's necessarily the case and we would also accept recaptures if it's a hit to the P&L just to get finality. But it's unlikely that you will see a big hit due to unlocking the reserves overall because, as I said, I mean, it's still a positive value enforced on our U.S. mortality business.

How much on the Ogden rate tables, at this point in time, it's a bit difficult to say because it's a work in progress, I would say. I mean, we would come back, as we said, on our second quarter call where we will have a very clear picture of where we are, but I would just ask you to bear with us up until then. But I mean, as I said, it will be a figure that should be quite manageable decision (01:04:17) our overall reserves. And don't forget, I mean, that – I mean, the current change in the Ogden reserves that we have booked, only the very small portion of the overall loss reserves that we actually set up on our UK motor business.

So, whilst up to now the Ogden impact we have booked in addition to the reserves that we are holding on our motor business, there is also quite a lot of room to book the case reserves and take off the corresponding IBNR reserves. But as I said, more details when we come with the second quarter.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Okay. Thank you.

Operator

Okay. We have a final question and that's back to the line of Vinit Malhotra at Mediobanca. Please go ahead, Your line is re-opened.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Thanks for this opportunity. Just one very minor thing I noticed was that the structured solutions volume. Maybe just semantics, but the bullishness on volume seems to have increased even between the February reporting and now. Is it just because you're getting more demand, or is there something more in the market that you're seeing that you can comment on, please? Thank you.

A - Ulrich Wallin {BIO 4863401 <GO>}

Well, it's just that we continue to write new treaties here largely in Europe. I mean, it's surplus relief treaties in Europe motivated by Solvency II. And, I mean, also the production in the first quarter has actually been quite positive and also second quarter. So, from that point of view, we're a little bit more bullish on the volume there.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay. Thank you.

Operator

Okay. As that was the final question on today's call, may I please pass it back to you for any closing comments.

A - Ulrich Wallin {BIO 4863401 <GO>}

Thank you very much indeed, and thanks for listening into our conference call for the first quarter and look forward to see you soon and, at the latest, at our conference call for the second quarter. Thank you very much.

Operator

This now concludes today's call. So, thank you all very much for attending. And you can now disconnect.