Results of operations, financial position and net assets

Property and casualty reinsurance

- Property and casualty reinsurance remains fiercely competitive
- Combined ratio improves to 95%
- Very pleasing operating profit

In worldwide property and casualty reinsurance the market continues to be intensely competitive, with reinsurance capacity comfortably outstripping demand. Additional capacities originating from the ILS market are also putting prices and conditions under sustained pressure. While profitability for primary insurers and reinsurers is generally good despite the prevailing low interest rates, it has been supported by the fact that losses from natural catastrophes in recent years have been below the longer-term average. The difficult business conditions have therefore only impacted underwriting profits to a lesser degree so far, although they have also been reflected to some extent in the results posted by reinsurers.

In this challenging environment it is especially important for Hannover Re to continue systematically with its margin-oriented underwriting. This approach similarly shaped our strategy in the treaty renewals as at 1 July 2016, the outcome of which was broadly positive for our company. In North America the trend observed in preceding renewals was confirmed. The absence of large losses from natural disasters and individual risks continued to make itself felt in rate decreases. Nevertheless, the rate reductions were smaller than anticipated in some cases and there were further indications of a bottoming out in prices, both in the property and casualty lines. Even though most casualty lines are still fiercely competitive, we were able to act on new business opportunities – including for example in the coverage of cyber risks. In US property catastrophe business the pressure on prices eased in comparison with the previous year's renewals. We rigorously maintained our pricing discipline and focused on target customers. Hannover Re further underweighted its share of US catastrophe business. On the whole, the treaty renewals in Latin America and the Caribbean as at 1 July 2016 typically saw price reductions. The losses from the earthquake in Ecuador brought about rate improvements, albeit only in the impacted region. We responded to the rate erosion in agricultural risks by scaling back our share of the business.

Gross written premium for our total portfolio contracted by 2.7% as at 30 September 2016 to EUR 7.1 billion (EUR 7.3 billion). At constant exchange rates the decrease would have been 1.5%. The level of retained premium was slightly lower than in the previous year's period at 88.3% (88.8%). Net premium earned fell by a modest 0.7% to EUR 5.9 billion (EUR 6.0 billion); adjusted for exchange rate effects, it would have grown by 0.9%.

Following the heavier-than-anticipated burden of large losses incurred in the second quarter of 2016, the situation in the third quarter was thoroughly moderate. Expenditure on major losses came in at EUR 40.5 million, well under our budget of EUR 265 million for the third quarter. In keeping with our prudent reserving policy, we allocated the bulk of the unused large loss budget to the loss reserves. Aside from the usual positive run-off, no other reserves were written back in the third quarter. Total net expenditure on large losses for the first three quarters amounted to EUR 393.2 million (EUR 436.4 million). The underwriting result for total property and casualty reinsurance increased sharply by 9.6% to EUR 275.5 million (EUR 251.4 million). The combined ratio remains positive at 95.0% (95.5%) and is in line with our goal of staying below 96% for the full year. Looking at the third quarter in isolation, it was even as low as 94.4%.

The investment income booked for property and casualty reinsurance from assets under own management retreated slightly as expected to EUR 623.8 million (EUR 656.5 million).

The operating profit (EBIT) for the Property & Casualty reinsurance business group totalled EUR 893.0 million as at 30 September 2016; this figure is 4.6% lower than in the comparable period (EUR 936.3 million). The EBIT margin of 15.1% (15.7%) was again comfortably in excess of our minimum target of 10%. Group net income in property and casualty reinsurance contracted by 5.8% to EUR 613.5 million (EUR 651.0 million). Earnings per share amounted to EUR 5.09 (EUR 5.40).

Key figures for property and casualty reinsurance

in EUR million	2016					2015	
	1.1.–30.6.	1.7.–30.9.	+/– previous year	1.1.–30.9.	+/– previous year	1.7.–30.9.	1.1.–30.9.
Gross written premium	4,627.4	2,493.1	+6.2%	7,120.5	-2.7%	2,347.1	7,319.4
Net premium earned	3,838.4	2,086.8	+0.8%	5,925.3	-0.7%	2,071.2	5,965.4
Underwriting result	166.4	109.1	+35.6%	275.5	+9.6%	80.5	251.4
Net investment income	416.1	226.4	-8.6%	642.5	-4.5%	247.7	672.8
Operating result (EBIT)	560.9	332.0	-5.8%	893.0	-4.6%	352.6	936.3
Group net income	376.2	237.3	+2.0%	613.5	-5.8%	232.6	651.0
Earnings per share in EUR	3.12	1.97	+2.0%	5.09	-5.8%	1.93	5.40
EBIT margin [1]	14.6%	15.9%		15.1%		17.0%	15.7%
Combined ratio [2]	95.4%	94.4%		95.0%		95.8%	95.5%
Retention	88.2%	88.5%		88.3%		87.3%	88.8%

1 Operating result (EBIT)/net premium earned
2 Including funds withheld

Life and health reinsurance

- General business developments in line with expectations
- Substantially increased contribution to Group net income

In the period under review our worldwide business in life and health reinsurance developed in line with expectations and generated an increased contribution to Group net income.

In large parts of Europe life and health reinsurance developed as expected, while in Germany it even performed somewhat better. Eastern European markets continued to offer promising business opportunities, driven inter alia by increasing regulatory requirements. The effects on traditional endowment life insurance products are likely to be particularly marked.

Following the implementation of Solvency II at the beginning of the year it has been evident that primary insurers in many European countries are heavily preoccupied with the challenges posed by the high capital requirements resulting from longevity business. Particularly in the United Kingdom, demand for corresponding longevity protection is exceptionally strong. Along with the challenges of Solvency II, it is evident that in the United Kingdom the initial uncertainty among policyholders has abated: after the annuity requirement was almost entirely abolished by the reform of the UK Pensions Act in April 2015 and the volume of new immediate annuities more than halved, there are now indications that demand is picking up again. All in all, these developments played a positive part in the overall performance of life and health reinsurance.

In US mortality business the measures that we have implemented in some areas of our existing portfolio are starting to bear fruit. In addition, the development of new mortality business has been pleasing. As we had anticipated, the profit contribution generated in the area of financial solutions as well as in the health and special risk portfolio was once again very positive.

Gross premium for life and health reinsurance amounted to EUR 5.3 billion (EUR 5.6 billion) as at 30 September 2016, equivalent to a decline of 5.2%. The decrease would have been 2.0% adjusted for exchange rate effects. The level of retained premium rose from 86.8% to 91.5%, as a consequence of which net premium fell only slightly by 0.5%. At constant exchange rates, growth of 2.8% would have been booked.

Investment income including income from securities deposited with ceding companies totalled EUR 494.7 million (EUR 542.9 million) in the period under review. The performance of the securities held for our account by US cedants stood at -EUR 0.3 million, a reduction compared to the same period of the previous year. Provided they develop as planned until maturity, however, the performance of the so-called ModCo derivatives will have no effect on income.

The operating profit (EBIT) in life and health reinsurance climbed by a very pleasing 17.9% as at 30 September 2016 to EUR 290.4 million (EUR 246.3 million). The EBIT margins for the reporting categories at the end of the period under review were as follows: financial solutions business emphatically beat the 2% target with a gratifying 19.7%. The EBIT margin in longevity solutions similarly surpassed the target margin of 2% to reach 2.4%. Mortality and morbidity fell short of the targeted 6% at 4.3%. Group net income grew by a pleasing 17.5% to EUR 208.9 million (EUR 177.8 million). Earnings per share amounted to EUR 1.73 (EUR 1.47).

Key figures for life and health reinsurance

in EUR million	2016					2015	
	1.1.–30.6.	1.7.–30.9.	+/– previous year	1.1.–30.9.	+/– previous year	1.7.–30.9.	1.1.–30.9.
Gross written premium	3,656.4	1,677.1	-16.6%	5,333.5	-5.2%	2,012.1	5,626.6
Net premium earned	3,328.1	1,513.0	-13.0%	4,841.1	-0.5%	1,739.3	4,864.1
Investment income	322.2	172.5	-2.1%	494.7	-8.9%	176.3	542.9
Operating result (EBIT)	179.1	111.3	+140.6%	290.4	+17.9%	46.2	246.3
Net income after tax	130.6	78.3	+143.5%	208.9	+17.5%	32.1	177.8
Earnings per share in EUR	1.08	0.65	+143.5%	1.73	+17.5%	0.27	1.47
Retention	91.8%	90.8%		91.5%		87.2%	86.8%
EBIT margin [1]	5.4%	7.4%		6.0%		2.7%	5.1%

[1] Operating result (EBIT)/net premium earned

Investments

- High-quality diversified investment portfolio maintained
- Ordinary investment income lower owing to special effect in the previous year and difficult interest rate environment
- Return on investment at 3.0% slightly higher than expected level of 2.9%

The investment climate was once again challenging in the period under review and notable for considerable uncertainty, which was further exacerbated by the decision of the British people to leave the European Union ("Brexit"). Following the referendum at the end of June the uncertainty surrounding the outcome of this vote gave way to political and legal doubts over how exactly the process of leaving the EU will take place. On the whole, this situation led to sustained volatility and a generally low level of interest rates in most Western nations, and particularly in the United Kingdom, the European Union and the United States. In the United Kingdom further very sharp declines in yields were observed across all durations as a consequence of support buying by the Bank of England. Significant yield drops were, however, also recorded on German and US government bonds during the reporting period. German government bonds are at times being sold at clearly negative returns right through to the ten-year maturity segment.

Credit spreads on European and US corporate bonds also narrowed in most rating classes and remained on a low level overall relative to the historical mean. In total, the unrealised gains on our fixed-income securities increased sharply to EUR 2,048.6 million (EUR 1,046.7 million). After the already significant growth recorded in 2015, our portfolio of assets under own management increased again to EUR 40.7 billion (31 December 2015: EUR 39.3 billion). We adjusted the allocation of our assets to the individual classes of securities in the period under review such that we further expanded our holding of fixed-income instruments rated BBB or lower while at the same time enlarging the proportion of government bonds in our portfolio. In this way we are able to increase the liquidity of our portfolio while maintaining the overall risk level of our fixed-income holdings virtually unchanged and continuing to generate comparatively stable returns. In addition, we had already streamlined our private equity portfolio in the first quarter by selling older investments. The modified duration of our portfolio of fixed-income securities is guided by the duration of the insurance portfolio and increased slightly to 4.8 (4.4).

Our ordinary investment income developed in line with our expectations and decreased to EUR 852.0 million (EUR 912.5 million). While the difficult interest rate environment was a factor here too, this reflects in particular the elimination of the positive special effect recognised in the previous year from life and health reinsurance. We were nevertheless able to partially offset the diminished return potentials associated with the protracted low level of interest rates through stronger income from dividends and real estate. Interest on funds withheld and contract deposits fell to EUR 249.9 million (EUR 292.9 million).

Impairments of altogether EUR 61.0 million (EUR 24.1 million) were taken. This includes an amount of EUR 27.6 million (EUR 1.0 million) attributable to equities – principally as a consequence of lower spot prices following the Brexit decision. Impairments of EUR 9.7 million (EUR 3.0 million) were taken on alternative investments. The impairments on fixed-income securities amounted to just EUR 0.7 million (EUR 2.4 million). Scheduled depreciation on directly held real estate increased to EUR 21.2 million (EUR 16.8 million), a reflection of our growing involvement in this area.

The net balance of gains realised on disposals stood at EUR 153.6 million (EUR 124.2 million) and was in large measure attributable to regrouping activities as part of regular portfolio maintenance, the streamlining of our private equity portfolio through the sale of older investments and internal capitalisation and financing measures within the Group.

We recognise a derivative for the credit risk associated with special life reinsurance treaties (ModCo) under which securities deposits are held by cedants for our account; the performance of this derivative in the period under review gave rise to fair value changes of -EUR 0.3 million (-EUR 18.9 million) recognised in investment income. In economic terms we assume a neutral development for this item over time, and hence the volatility that can occur in specific quarters is of minimal relevance. Altogether, the positive fair value changes in our assets recognised at fair value through profit or loss amounted to EUR 29.2 million. This contrasted with negative fair value changes of EUR 9.2 million in the corresponding period of the previous year. The increase can be attributed principally to fair value changes in a derivative contract component of a reinsurance treaty recognised separately under investments. This development occurred principally as a consequence of repercussions of the Brexit vote on pound sterling interest rates.

Our investment income of EUR 1,146.4 million came in below the comparable period (EUR 1,224.7 million). In view of the low level of interest rates and the elimination of positive effects recorded in the previous year, the result is nevertheless pleasing and consistent with our expectations. Income from assets under own management accounted for an amount of EUR 896.5 million (EUR 931.8 million), producing an annualised average return of 3.0%; this is slightly higher than our target of 2.9%.

Net investment income

in EUR million	2016					2015	
	1.1.–30.6.	1.7.–30.9.	+/– previous year	1.1.–30.9.	+/– previous year	1.7.–30.9.	1.1.–30.9.
Ordinary investment income[1]	568.0	284.0	-9.5%	852.0	-6.6%	313.8	912.5
Result from participations in associated companies	1.7	0.9	-78.1%	2.6	-70.9%	4.2	8.8
Realised gains/losses	79.5	74.1	+28.7%	153.6	+23.7%	57.5	124.2
Depreciation[2]	48.1	12.9	+37.4%	61.0	+153.0%	9.4	24.1
Change in fair value of financial instruments[3]	20.5	8.7		29.2		(7.6)	(9.2)
Investment expenses	52.5	27.4	-2.5%	79.9	-0.6%	28.1	80.4
Net investment income from assets under own management	569.2	327.3	-1.0%	896.5	-3.8%	330.5	931.8
Net investment income from funds withheld	175.6	74.3	-22.2%	249.9	-14.7%	95.5	292.9
Total investment income	**744.8**	**401.6**	**-5.7%**	**1,146.4**	**-6.4%**	**426.0**	**1,224.7**

1 Excluding expenses on funds withheld and contract deposits
2 Including depreciation/impairments on real estate
3 Portfolio at fair value through profit or loss and trading

Rating structure of our fixed-income securities[1]

Rating classes	Government bonds		Securities issued by semi-governmental entities[2]		Corporate bonds		Covered bonds/asset-backed securities	
	in %	in EUR million	in %	in EUR million	in %	in EUR million	in %	in EUR million
AAA	76.1	8,501.5	65.2	4,597.7	1.2	147.1	67.2	2,435.1
AA	11.6	1,295.4	28.2	1,988.7	13.6	1,701.0	15.1	548.4
A	6.6	733.0	2.5	173.1	37.2	4,674.6	5.3	190.8
BBB	4.4	486.2	1.2	84.5	40.0	5,022.3	8.7	317.0
< BBB	1.3	148.6	2.9	204.1	8.0	999.4	3.7	132.4
Total	**100.0**	**11,164.7**	**100.0**	**7,048.1**	**100.0**	**12,544.3**	**100.0**	**3,623.7**

1 Securities held through investment funds are recognised pro rata with their corresponding individual ratings.
2 Including government-guaranteed corporate bonds