

Monte Carlo Press Breakfast

13 September 2010

Current status of the p/c reinsurance markets and expected changes for the upcoming January 2011 renewals

Prices and conditions are for the most part still acceptable and commensurate with the risks, despite a trend towards gradual softening on the markets. Whereas prices for loss-free programmes were weaker, the market retained its ability to increase prices for loss-affected programmes. The 1 July renewals confirmed this trend. Compared to the late 90s, the reinsurance industry is showing far greater underwriting discipline in our market environment, which is once again seeing considerable overcapacity for most lines of business. The widespread use of actuarial-based pricing tools such as natural catastrophe models may be an important factor in this positive development. Additionally, the prevailing low interest rates do not allow reinsurers to offset the results of sloppy underwriting through investment returns.

Catastrophe business is dominated by a significant frequency of non-US cat. losses. Although the severe earthquake in Chile led to price increases in the affected region, it did not bring a general turnaround in global catastrophe pricing. With the latest severe Canterbury earthquake we expect a worldwide upward pressure on cat. rates for the 1 January 2011 renewals. In the event of a major hurricane we should see an even more positive turnaround with respect to rates.

Following the “Deepwater Horizon” oil rig disaster in the Gulf of Mexico, further positive effects on prices for offshore energy risks are to be expected. In credit and surety reinsurance prices have remained on their current high level.

All in all, we expect to see stable rates in the upcoming January 2011 renewals in non-life reinsurance. Details of the current status of the individual markets and our expectations for them going forward are provided in the following.

I. Target markets:

- **North America**

Property business: The primary markets show a mixed picture with decreasing rates for commercial business and increasing rates for personal lines business. For the most part, reinsurance structures and pricing in per-risk business

are expected to remain stable at a profitable level. Further pressure on reinsurance rates is expected if the hurricane season passes off without any severe events.

Casualty business: Casualty pricing has not improved on an overall level, but early positive signs can be detected on commercial accounts. However, heavy industrial accounts and some professional liability lines are still subject to continued pressure. On a short-term basis we do not expect any major shift in the market.

- **Germany**

Industrial property business: Continued pressure on premium level. The competitive environment compels market players to write business very selectively and to ensure the quality of underwriting standards. The economic crisis is reflected in the lower business volumes of the insured industry, leading to a reduced premium income – especially in business interruption insurance.

Industrial casualty business: Unchanged competitive climate on the primary level; limited capacity available for heavy casualty business; terms and conditions will continue to be commensurate with the risks.

Motor business: Environment remains competitive. In the light of a deterioration in premium quality and an unusually harsh winter, which led to an unfavourable claims experience, marked increases in primary insurance rates are expected.

Cat. business: Due to several disasters, e.g. winter storm “Xynthia” and flood events in line with the claims experience of prior years, distinct hardening of prices for catastrophe cover is expected.

- **Hannover Re’s positioning**

We are well positioned in our target markets. In the US we are a strict broker market and the best performing reinsurer according to the most recent Flaspöehler survey. In Germany, where we operate under the trade name E+S Rück, we are the second-largest reinsurer. In both markets it is our assumption that rates will be fairly stable in view of the prevailing low level of investment income.

In the US we pursue a strict cycle management and do not seek to expand our market share unless we see favourable market conditions. We feel that the current pricing levels call for a cautious approach. We therefore concentrate our writing more toward our renewal business and are not making aggressive efforts to increase our market share.

The end of the economic crisis should, however, result in some organic growth as well as business opportunities for us.

In Germany we cultivate our business segment of mutual and medium-sized companies, where we see opportunities deriving from Solvency II. In motor business we see positive signals for a (slow) market recovery. Additional positive stimuli for our business will derive from catastrophe business as well as from our personal accident initiative, under which we help clients to further develop profitable personal accident business. Overall, we expect the market and premium volumes to remain largely stable.

II. Specialty lines:

- **Aviation**

After last year's "Air France" loss, the primary and reinsurance market saw increases in premium and rates. Due to the current overcapacity levels on the primary and reinsurance side, we expect stabilisation.

- **Marine**

After the "Deepwater Horizon" incident, the primary and reinsurance market will see considerable hardening for offshore energy physical damage and liability business. In addition, we expect growing demand for coverage in respect of the liability exposures. To a lesser extent, the other marine classes will also experience premium increases. The hardening of the reinsurance market will be more pronounced here than on the primary side.

- **Credit/Surety**

Despite the continued high level of insolvencies, significantly reduced loss ratios can be observed in trade credit as a result of drastic portfolio consolidation on the primary and reinsurance level. Starting out from high levels, primary and reinsurance rates will increase slightly or remain flat. Loss ratios in surety and stand-alone political risk remain on a good level. For 2010 and 2011 clearly improved results are expected.

- **Structured reinsurance**

Worldwide: In the aftermath of the global financial crisis, capital in any form is again readily available and the capital resources of most insurers are back to pre-crisis levels. Demand in structured reinsurance has therefore normalised; continued application of improved regulatory and accounting frameworks as well as the exacting level of compliance standards continue to provide a sound basis for the development of structured reinsurance business.

Europe: Increased awareness of the value of reinsurance solutions in the light of the upcoming Solvency II framework should result in an increased demand for structured reinsurance solutions in the near future. The more sophisticated risk management required of insurance companies by regulators in many countries is prompting stronger demand for multi-year stop loss products.

US: The US insurance industry's capital and surplus situation has recovered to pre-crisis levels, hence causing interest in our surplus relief products to normalise after the demand surge reported last year. We are seeing increased awareness of the value of capital protection products.

- ***Hannover Re's positioning***

Due to our favourable position in specialty lines we expect continued growth based on profit-oriented underwriting. We see grounds for optimism, especially in credit and surety. In aviation we are one of the market leaders; rates in non-proportional business are satisfactory and we are confident of holding our good market position. As a result of the "Deepwater Horizon" loss we expect rate increases in XL marine business. In view of the situation in structured reinsurance – especially due to Solvency II – we see good growth potential in the coming years.

III. Global reinsurance:

- ***Global catastrophe business***

US: After the very good results posted by reinsurers in 2009 more than enough capacity was available. Additionally, the financial markets moved back into the reinsurance sector. After the price reductions recorded in January, pressure on prices increased at the June and July renewals. In general, however, prices should continue to be risk-adequate.

In the absence of major hurricane or earthquake losses in 2010 the current pricing level will remain under pressure at the next renewals. In the event of a moderate hurricane season, ROLs will increase by up to 10%.

Europe: Rates decreased in Europe during the year with the exception of programmes affected by winter storm "Klaus" in 2009. Going forward, only minor rate changes are expected unless programmes suffered a loss in 2010. The CEE primary market is still seeing growing demand for catastrophe protection as a result of increased values, and the flood events of 2010 should lead to price rises in this market.

Japan: At the April renewal cat. pricing decreased to the 2008 level. Stable rates are expected for earthquake and typhoon covers.

Latin and South America: The earthquake in Chile demonstrates that the markets are capable of raising rates following major losses. Rate increases of up to 70% were observed. However, it has to be stated that other non-peak areas, e.g. Columbia or Peru, did not see the desired rate increases.

Australia/New Zealand: Only programmes with losses saw increases in 2010. General price increases are expected in light of the recent severe Canterbury earthquake.

- ***Global treaty business***

Western Europe: Property per-risk covers are stable, while rates for non-proportional motor are increasing slightly. Overall, rates should remain on a stable level.

CEE (Central and Eastern European Countries): Intense competition on the primary side; primary markets will see stronger demand for insurance products in the years ahead; rates on the reinsurance side are expected to hold stable and should continue to be commensurate with the risks; increased demand for reinsurance protection in property/casualty lines is expected in the coming years.

Asia: Strong growth in Asia's emerging primary markets but continuous fierce competition among insurers. On the reinsurance side pricing is generally rather soft with the exception of loss-affected markets/programmes. In more mature markets, e.g. Japan, reinsurance demand is decreasing as a result of recent merger activities but markets as a whole remain profitable. Terms and conditions should be fairly stable on both the primary and reinsurance side. In China tremendous primary growth is generating stronger demand for reinsurance. Intense competition prevails among reinsurers.

Australia: High catastrophe loss frequency not adequately reflected in reinsurance pricing. Primary rate increases visible, but kept mainly in the retentions of insurers. Reinsurance conditions will continue to range from stable to improving.

Agriculture: Rates and conditions are in general holding stable. Further development of public-private partnership schemes (premium subsidies), especially in emerging markets with considerable agricultural potential, offers new

business opportunities. The growing world population with rising demand for food prompts additional investment in the agricultural sector and hence increased demand for insurance and reinsurance.

- ***Global facultative business***

Demand is growing in facultative business (with the exception of property); in particular, we see good growth opportunities in specialty lines such as engineering, offshore energy, professional indemnity and D&O business. Provided that reinsurers have the necessary expertise, these segments deliver good profitability.

Property business is suffering from a softening trend in the primary market, while rates and demand in facultative casualty are fairly stable.

- ***Hannover Re's positioning***

In our "Global Reinsurance" sector we see further good demand in agricultural business, where we expect continued growth. In Europe – on account of Solvency II – and in facultative business we are well positioned to benefit from the available growth potential. The same is true of Asia, particularly China. Through our non-life branch in Shanghai we are well positioned to benefit from growth opportunities. Our well-spread emerging markets book of business should provide us with scope for organic growth. Even though the market is competitive, rates are mostly at sufficient levels. Our Bahrain operation is well on track with 20% growth in retakaful business. With regard to the global catastrophe market, the impact of the hurricane season remains to be seen. In regions where we observe strong competition, it is not our aim to gain market shares.

Hannover Re's stance on the upcoming renewals

Hannover Re is well prepared for the currently prevailing market conditions. According to our strategy, we focus on underwriting discipline and active cycle management and only emphasise those parts of the business which offer us good profitability. Overall, we see risk-adequate prices in most business lines as well as opportunities in specific segments. In business lines that offer adequate prices and meet our profitability requirements, we shall maintain or increase our share. Thanks especially to our top-quality rating, we are in a position to act accordingly.

A top rating is still a prerequisite for a reinsurer. With our very good ratings ("AA–" from Standard & Poor's and "A" from A.M. Best) we are one of the reinsurers to satisfy this condition.

In view of the market conditions, which are characterised by softening tendencies, we shall place a special emphasis on renewals – in which we expect to be able to retain a high level of our clients' business. We shall further strengthen our writings of agricultural reinsurance and in emerging markets. We can see growing opportunities for insurance-linked securities solutions and therefore expect more business in this area. Due to the strong frequency of high severity nat. cat. claims worldwide we expect a general increase in prices for cat.-exposed business. Consequently, we shall most likely see further expansion of our business in 2011.

On the retrocession market we anticipate stable conditions, provided there are no losses to the programme. Interest in "K6" remains at a high level, but at this moment we do not intend to increase the volume of the "K6" transaction. Overall, we expect to buy a similar amount of retrocessions in 2011 compared with our current purchased volume.

With our strong capitalisation and very good ratings we are well positioned to benefit from the available opportunities in the year ahead. Our capital adequacy is on its highest level ever – within 18 months our shareholders' equity improved by more than EUR 1.4 billion to reach EUR 4.2 billion, which puts our total policyholders' surplus (including minorities and hybrid capital) at EUR 6.2 billion. This enables us to assume more risks when opportunities arise.

Our adherence to profitability as our main goal remains unchanged. For the current year, we are increasingly confident of achieving our earnings target. Based on our expectations for the upcoming renewals, we are optimistic that we shall again maintain our high level of profitability in 2011.

In the years to come we shall strive to further improve the stability of our earnings. In the case of non-life reinsurance this means that we shall focus on disciplined underwriting and a well balanced and diversified portfolio.