Challenges facing the (re-)insurance industry in Europe today

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Chairman of the Executive Board

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CSFI/PwC Banana Skins Poll 2007:

OVERREGULATION AS THE HIGHEST RISK WORLDWIDE

Top 7 Insurance Banana Skins 2007	Comment Hannover Re:
1) Too much regulation	Especially U.S., UK
2) Natural catastrophes	Short term problem/U.S. focus
3) Management quality	Not an issue for Hannover Re
4) Climate change	Prices can be adjusted/demand increases
5) Managing the cycle	Crucial for profitability
6) Distribution channels	Not an issue for Hannover Re
7) Long-tail liabilities	Underreserving being the most important reason for bankruptcy in reinsurance

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Banana Skin No. 1: Regulation

CREATING A LEVEL PLAYING FIELD INTERNATIONALLY

Collateral requirements: the most unacceptable trade barrier

→ According to NAIC:

- domestic reinsurers are good reinsurers → no collateral required
- non-domestic ("alien") reinsurers are poor reinsurers → have to provide 100% collateral for all their obligations (premium, loss reserves incl. IBNR)

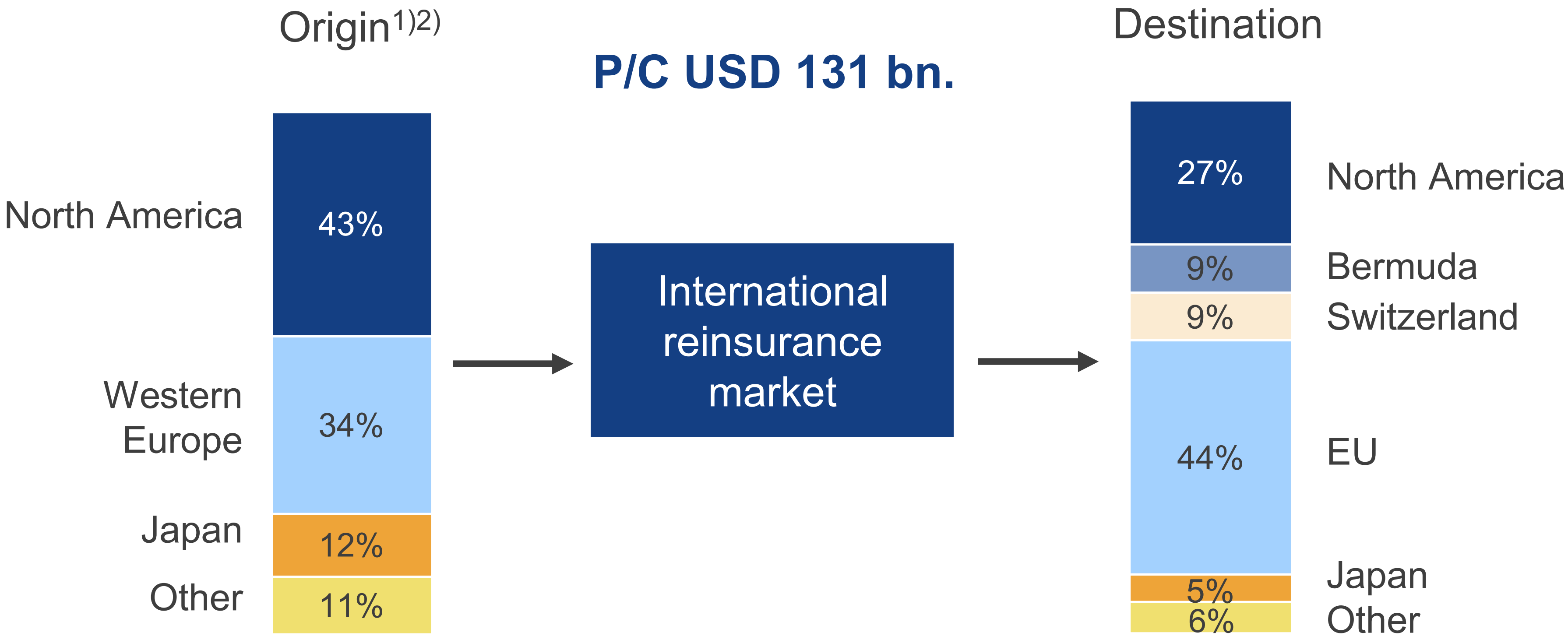
→ EU has shown the way with its Reinsurance Directive:

- mutual recognition within the EU
- establishing framework for recognition of equivalent jurisdictions outside EU

→ IAIS: Mutual Recognition Guidance Paper

Banana Skin No. 1: Regulation

WORLDWIDE DISTRIBUTION OF REINSURANCE



International level playing field is crucial under Solvency II

1) Property/Casualty business premium figure: Swiss Re
2) Source: Guy Carpenter European Reinsurance Market Report 2005

Banana Skin No. 1: Regulation

ARGUMENTS FOR U.S. PROTECTION LACK SUBSTANCE

In fact:

- → according to A.M. Best no P/C insolvencies occurred due to reinsurer failure between 1993 and 2002
- → according to NAIC Reinsurance Collateral White Paper 2005 foreign reinsurers have a better payment record than U.S. domestics
- → EU reinsurers discussing reform have been operating in the U.S. for decades and have branches, subsidiaries or major assets in the U.S.

Collateral needs to be abolished for:

- → well-regulated reinsurers, i.e. from equivalent jurisdictions (e.g. EU)
- → companies in good standing with equivalent supervisory authorities
- → companies rated well by nationally recognised rating agencies

U.S. Treasury now takes initiative:

- → long-term goal: Optional Federal Charter (OFC)
- → short-term goal: Federal solution for international issues incl. collateral

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Banana Skins No. 2, 4, 5 and 7: Risk Management

REGULATORS RECOGNISE THE IMPORTANCE

One of three pillars: Risk Management

Solvency II

Pillar I	Pillar II	Pillar III
Quantitative Requirements • Solvency Capital Requirement (SCR) • Minimum Capital Requirement (MCR)	**Qualitative Requirements** Risk Management	**Supervisory reporting and disclosure**
• European Standard Formula • Firms' own internal model	New area of supervisory activity	Increased disclosure towards: • the public • supervisors

OUR RISK-MANAGEMENT STRATEGY: CAPITAL PROTECTION

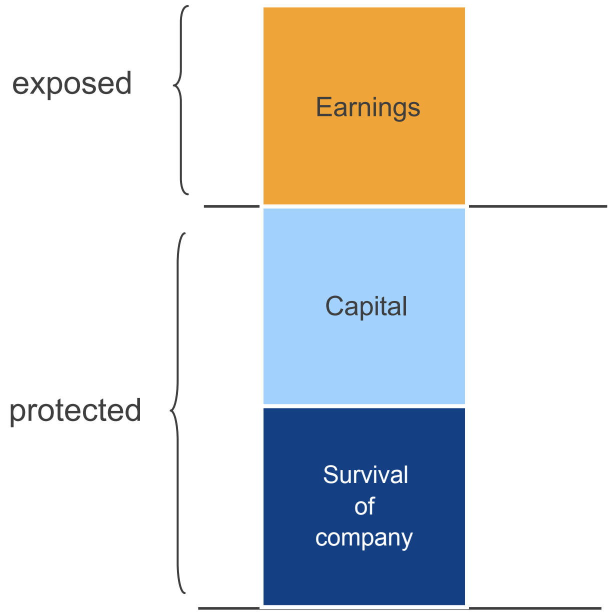
→ Our risk management is **not** meant to

- protect any given year's earnings
- Merely protect the survival of the company (incl. new capital to be raised etc.)

→ Our risk management is meant to

- protect our capital
- stabilise and optimise results
- allow us to profit fully from hard markets (e.g. after a major loss in the R/I market)

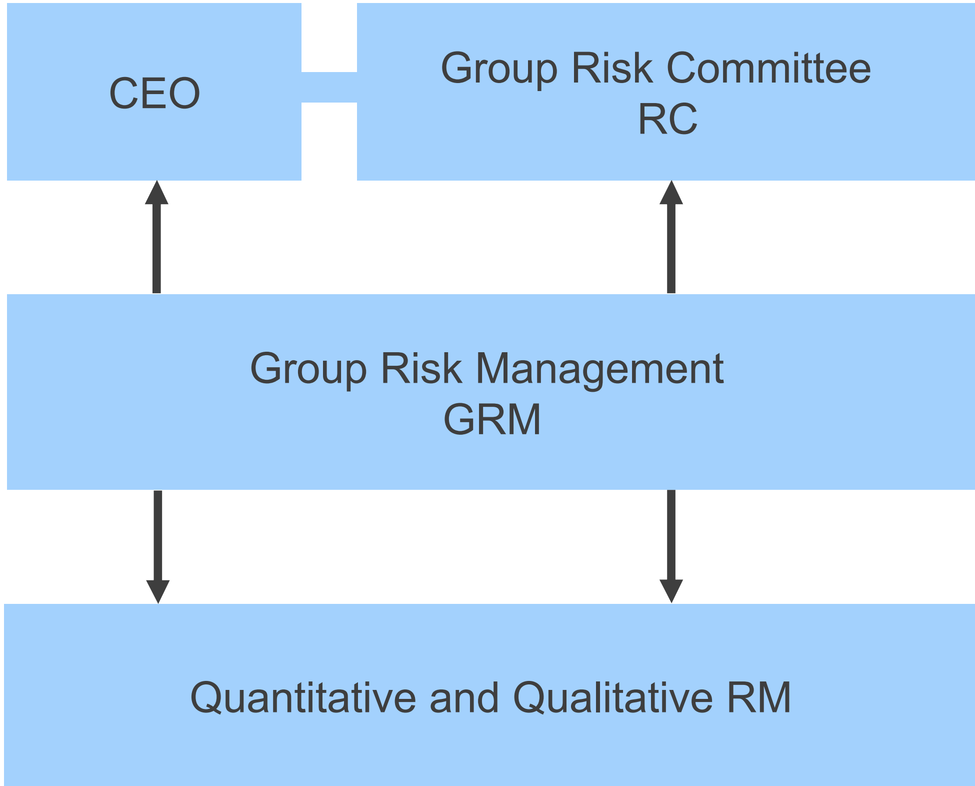
Approaches to risk management



Example: Hannover Re

CENTRALISED GROUP RISK MANAGEMENT

Reporting to CEO



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GROUP RISK MANAGEMENT
Overarching tools

Chief Risk Officer

Quantitative RM

DFA

Main operating unit:
GRM DFA

Qualitative RM

Risk Cockpit

Main operating unit:
GRM ORR

Risk hierarchy:

1. Reserve risk
2. Exposure risk
3. Mispricing risk
4. Investment risks
5. Other balance sheet risks

Banana Skin No. 2: Exposures

ORGANISATION OF EXPOSURE MANAGEMENT

Roles

→ Executive Board
- Determines the overall nat. cat. risk appetite

→ Group Risk Committee
- Supervision of the overall risk measures and implementation of escalation processes

→ Non-Life Executive Committee
- Implementation of the defined risk measures into the underwriting
- Defines capacity limits by scenario and department/business centre

→ Group Risk Management – Aggregate Control Department
- Develops and maintains tools for reliable aggregate control
- Runs the aggregate control process and assists in capacity management with special attention to profitability aspects

→ Group Protections (Retrocession)
- Informs and consults Aggregate Control Department with respect to all retrocessions

Banana Skin No. 2: Exposures

DATA QUALITY IS KEY TO CATASTROPHE MODELLING

Consistency

- → Detection of accounts that are not part of any portfolio
- → Detection of locations that have no location coverage
- → No line of business defined
- → Unknown currencies

Geocoding

- → Individual locations with high coverage not geocoded
- → Loading necessary for geocoding less than 95%

Completeness

- → Not all perils encoded in exposure
- → Construction/occupancy classes set to default
- → Treaty settings specified by cedant may be incorrect
- → Structure of exposure

Sources for underestimating modelled losses

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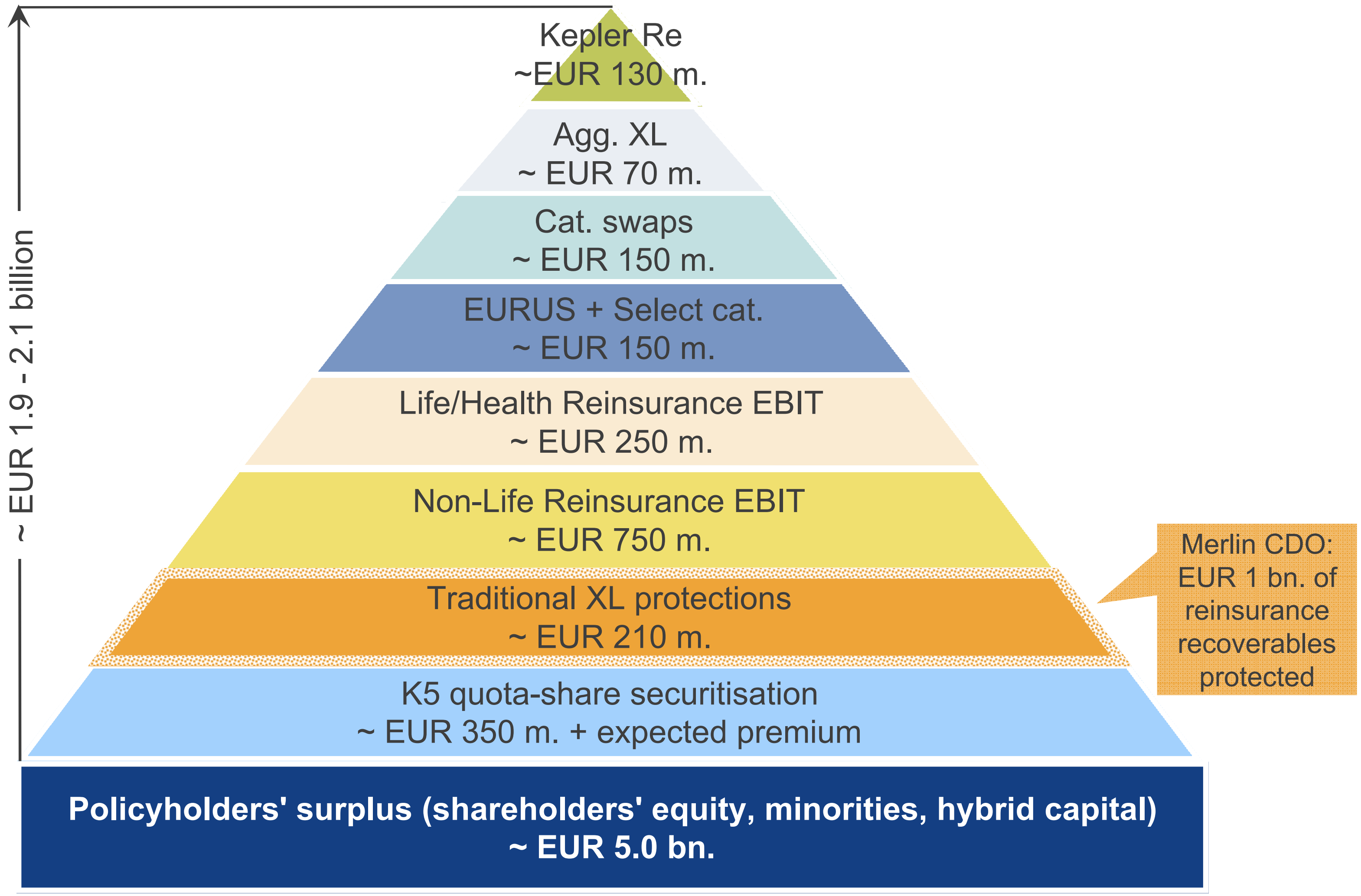
SEVERAL LEVELS OF PROTECTION SAFEGUARD CAPITAL BASE

Our protection has never been better!



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Banana Skin No. 7: Reserving

ACTUARIAL SUPPORT FOR ALL PARTS OF THE GROUP

Various layered controls

Majority shareholder reserve study (annually)
(by external consultant on behalf of parent company)

Group-wide Non-Life reserve study on annual basis
(by external consultant on behalf of Hannover Re)

Recommendations for year-end
(by consultant)

Peer reviews & internal calculations
by Group Risk Management (GRM)

Home office calculations
by GRM reserving actuaries

5 branches/subsidiaries
by external actuaries

6 branches/subsidiaries
by HR Group actuaries

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Banana Skin No. 7: Reserving

RESERVING PROCESS AT HANNOVER RE HOME OFFICE

Strong actuarial controls

- Segment matrix of 53 business segments
  - Line of business
  - Geographical split
  - Type of reinsurance (obligatory vs. facultative, proportional vs. non-proportional)
- Action plan during year
  - Actuarial calculations by group reserving actuaries
  - Actuarial calculations & recommendations by external consultant
  - Discussions with underwriters & board members
  - Close cooperation with technical accounting & claims department
  - Data checks and actions for improvement
  - Reporting to Actuarial Committee
  - Quarterly review by Risk Committee

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Banana Skin No. 7: Reserving

SEVERAL OPINIONS ARE REQURED

Enhanced by peer reviews

→ Role of external actuarial consultants on behalf of Hannover Re

- Recommendations for home office business segments during book closing
- Actuarial certificate for U.S./Bermuda operations
- Complete actuarial report for Hannover Re Group Non-Life after year-end

→ Other external actuaries

- Outsourced for Malaysia, Canada, Australia
- Auditors for branches & subsidiaries
- Second peer reviewer for Australia (as required by APRA since 2006)

TRADEOFF BETWEEN TRANSPARENCY AND PRODUCTIVITY

The market will largely regulate itself

→ Increasing pressure on transparency

- by shareholders/analysts
- by rating agencies
- by supervisors
- by clients/brokers

→ Increasing resources required

- Threat: limited availability (e.g. actuaries)
- Increased "unproductive work" required from underwriters

Today	Tomorrow	The day after tomorrow
Cutting-edge R/M + full transparency	Delighted shareholders	Out of business (no clients)
Black-box R/M, no transparency	Disappointed shareholders	Out of business (no capital)
State-of-the-art R/M + sufficient transparency	Satisfied shareholders	Satisfied clients

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