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Investment Symposium
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Opening General Session

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Swiss Re

Global economic and life insurance outlook

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Agenda

- Global economic outlook
- Economic indicators
- Outlook for interest rates, credit and equity markets
- Life insurance industry outlook
- Implications of the financial crisis
- Conclusions

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Summary

- The economic recovery continues, but growth will remain moderate
- Markets, though no longer in crisis-mode, are still volatile
  - In US, government bond yields 3.5% - 4.0% this year and rise next year closer to 4.5%
  - Corporate bond spreads continue to narrow
  - Equity markets rise
- Banks are recapitalising, but credit will be constrained this year, slowing growth
- Scenarios: Upside and Downside risks are balanced (15% each, baseline at 70% probability)
- Implications for the insurance industry: Recapitalisation is manageable, pricing power minimal, but with low investment yields, underwriting discipline is essential

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What is driving the recovery?

- Substantial Central Bank easing, low interest rates
- Fiscal stimulus
- Moderate inflation
- Global markets improving, exports rising
- Cost reductions → profits up, business investment prospects are improving
- US consumer – important for global growth – has joined the recovery. Now just need sustained job growth!

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Global overview: Modest recovery in 2010

		2008	2009	2010F	2011F
Real GDP growth					
	Euroland	0.5	-3.9	1.4	1.5
	UK	0.5	-4.8	1.3	1.6
	Japan	-1.2	-5.1	1.3	1.5
	China	9.6	8.7	9.4	8.7
Inflation					
	Euroland	3.3	0.3	1.2	1.7
	UK	3.6	2.2	2.5	1.7
	Japan	1.4	-1.3	-0.4	0.8
	China	5.9	-0.7	3.1	3.0
Policy rates (eop)					
	Euroland	2.50	1.00	1.50	3.50
	UK	1.50	0.50	1.00	3.50
	Japan	0.10	0.09	0.25	0.75
	China	5.31	5.31	n/a	n/a
Yields 10-yr govt bond (eop)					
	Euroland	2.9	3.4	3.7	4.2
	UK	3.1	4.1	4.3	5.0
	Japan	1.2	1.3	1.6	2.0
	China	n/a	n/a	n/a	n/a

Sources: Swiss Re Economic Research & Consulting

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U.S. Economic Outlook

	2007	2008	2009	2010F	2011F
Annual Averages:					
Real GDP	2.1	0.4	-2.4	3.1	3.7
Consensus	2.1	0.4	-2.4	3.0	3.1
CPI	2.9	3.8	-0.3	2.0	2.0
Core CPI	2.3	2.3	1.7	1.3	1.5
End-of-Period:					
Fed Funds	4.25	0.25	0.25	0.25	3.0
5-yr T-note	3.5	1.6	2.7	3.0	4.5
10-yr T-note	4.0	2.3	3.8	3.9	4.8
Baa bond, spread, bp	206	492	181	160	135

Sources: Blue Chips Economic Indicators, Moody's, Federal Reserve Board, Swiss Re ER&C

The alphabet soup of scenarios

- Baseline is **"U" recovery** (70% probability)
  - Moderate: growth, inflation, and interest rates, but fiscal deficit remains an issue
- Upside scenario – Strong global growth in 2010 is a **"V" recovery** (15% probability)
  - Strong growth, increased inflation risk, higher interest rates, fiscal deficits fall
- Downside scenarios (15% probability)
  - **"L" recovery**, Japan-like minimal growth recovery (low growth, inflation, and interest rates; high deficits)
  - **"W" recovery**, a recovery, followed by second recession because, eg, pandemic or central banks tighten (high growth, followed by negative growth, high volatility, high uncertainty)
  - **Stagflation** = "L" recovery with inflation (unlikely with such high unemployment)

What does it mean for the insurance industry?

- "Downside scenarios" (15%)
  - Positives: Government bond yields lower, prolonged low inflation, insurance prices firm → P&C insurers particularly have some benefits
  - Negatives: All other asset classes do very poorly, any interest rate or equity market guarantee products do very poorly → risk for L&H insurers especially
  - Rating downgrades and insolvencies up, M&A activity delayed
- Upside scenario – strong growth in 2010 and 2011 (15%):
  - Positives: Values of non-government bond asset rise
  - Negatives: Government bond prices fall, risk of inflation is higher, any hardening in the market ends quickly
  - Life insurance sector probably would do well, M&A up

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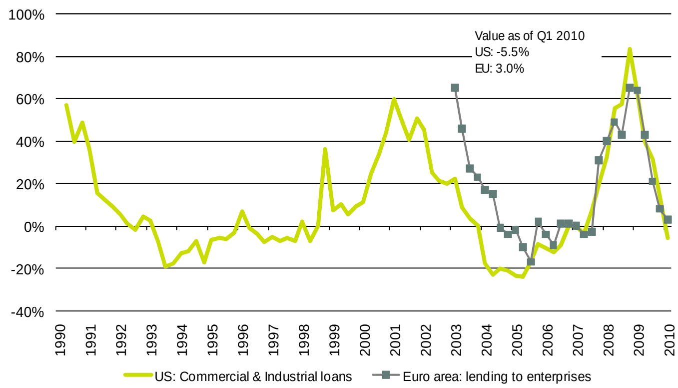
Banks have stopped tightening lending standards

Federal Reserve Loan Survey/ECB bank lending survey

(Net percentage of domestic respondents tightening standards)



Source: Federal Reserve Board, ECB bank lending, survey

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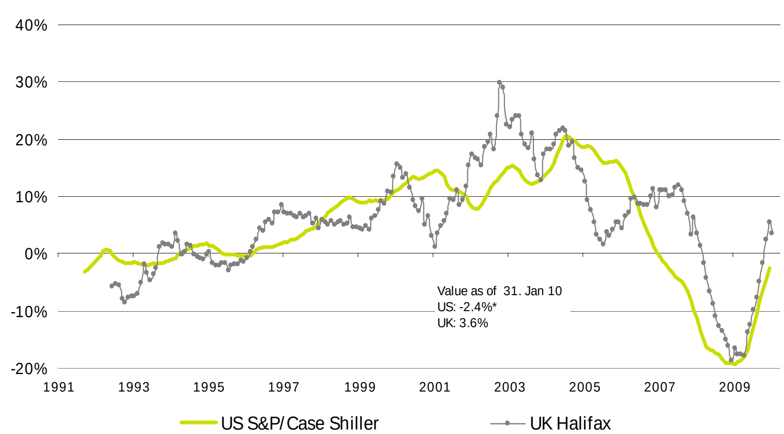
House prices have rebounded

House prices, %-change year-on-year



Source: Bloomberg

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Purchasing Managers Indices in manufacturing have recovered

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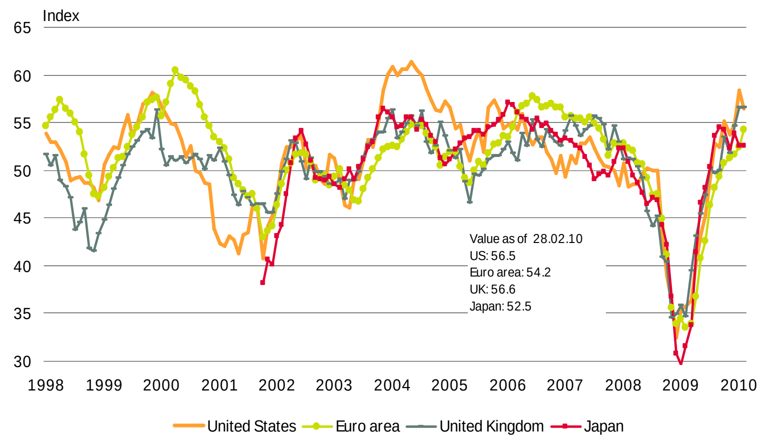
Purchasing Managers Indices



Source: Bloomberg

Long-term inflation expectations remain close to central banks' targets

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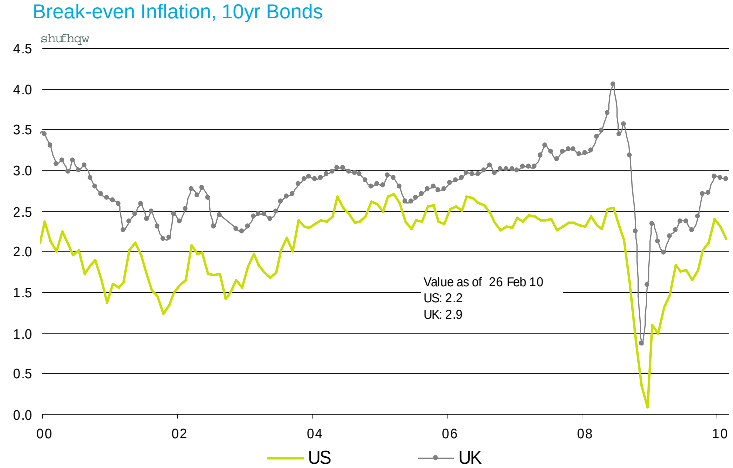
Break-even Inflation, 10yr Bonds



Break-even inflation is calculated as the difference between the nominal bond yield and the yield of an inflation-protected bond1

Source: Bloomberg

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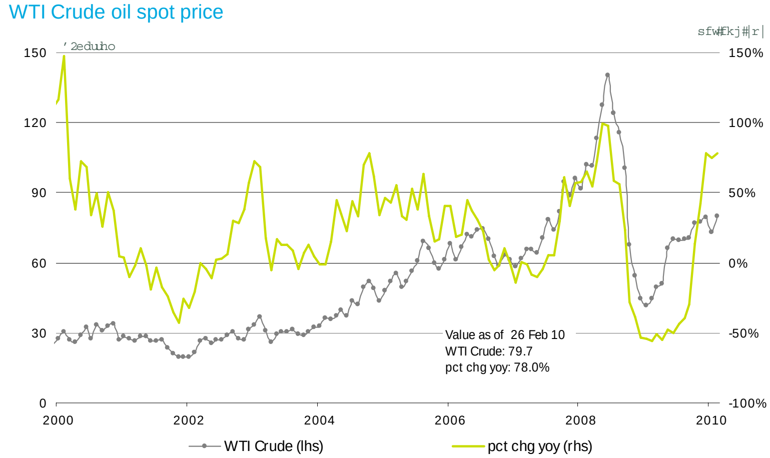
Oil prices have rebounded from their lows

WTI Crude oil spot price



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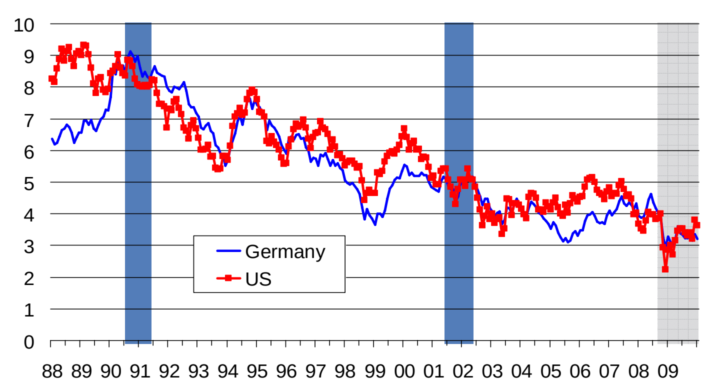
10 yr long-term bond yields (since 1988), monthly eop



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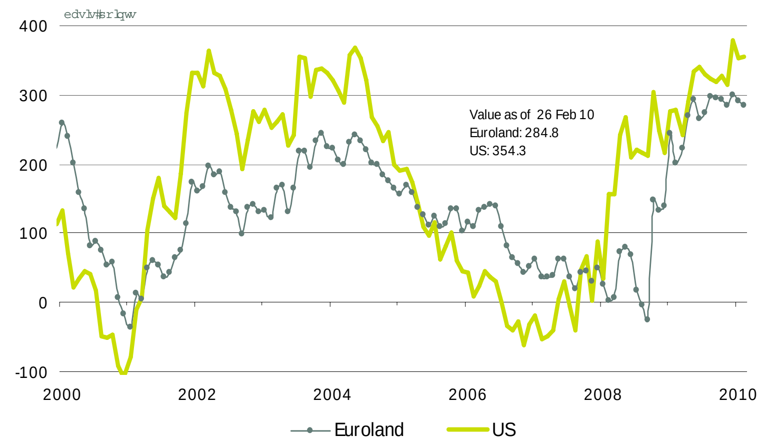
Yield curves remain steep, implying future growth

10yr government bond yield – 3m interbank interest rate



Source: Bloomberg

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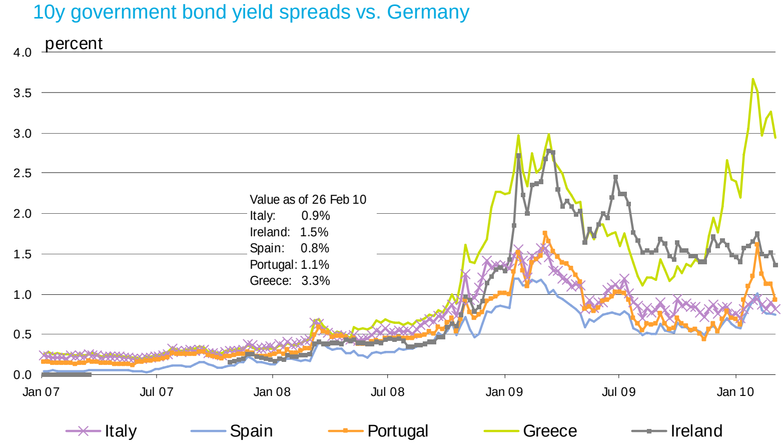
Worries over fiscal sustainability have eased slightly recently

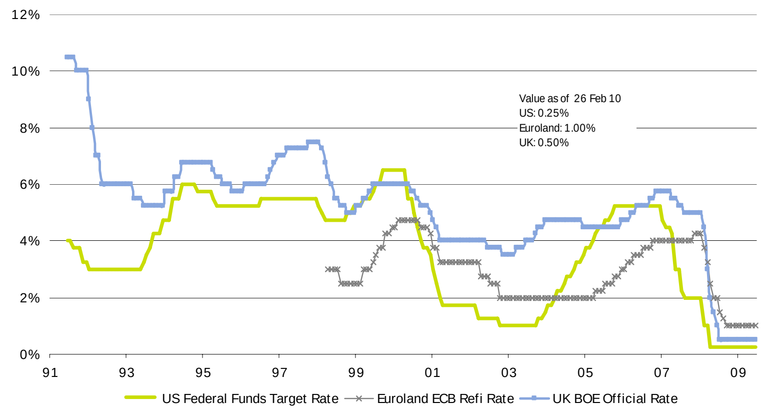
10y government bond yield spreads vs. Germany



Source: Bloomberg

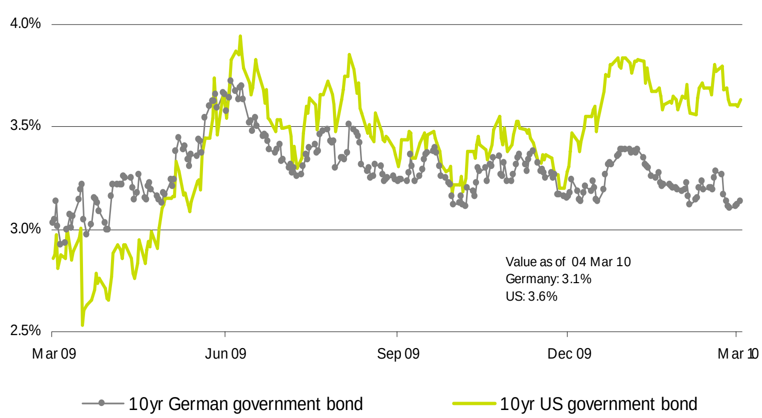
Central bank rates remain at historic lows

Central bank rates



Government bond yields remain range-bound

10yr long-term bond yields, short-term (1-year) horizon, daily data



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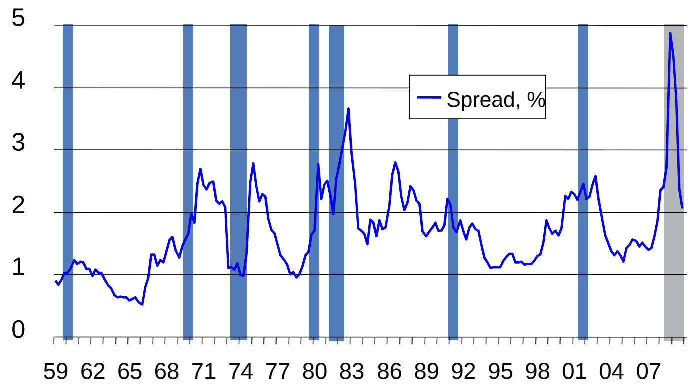
Spread of Baa to 20-year T-bond, quarterly avg



Source: Moody's, Federal Reserve Board, NBER, SR Economic Research & Consulting

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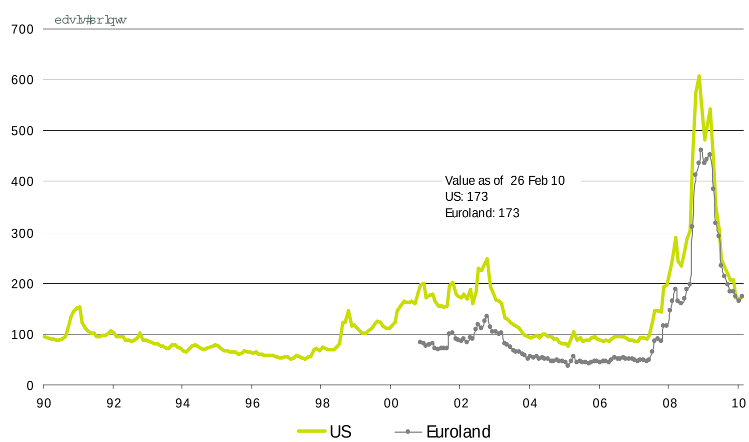
Investment grade credit spreads have narrowed, but remain elevated

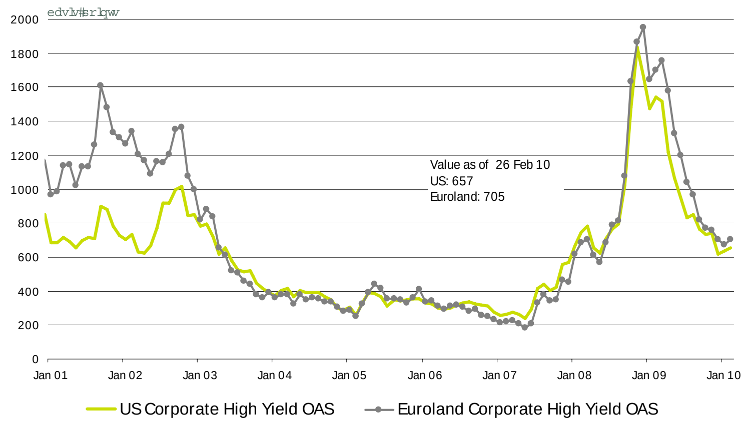
Corporate bond spreads (Investment grade, since 1989), monthly data



Source: Barclays Capital

High yield spreads remain elevated

High yield spreads, monthly data



Source: Barclays Capital

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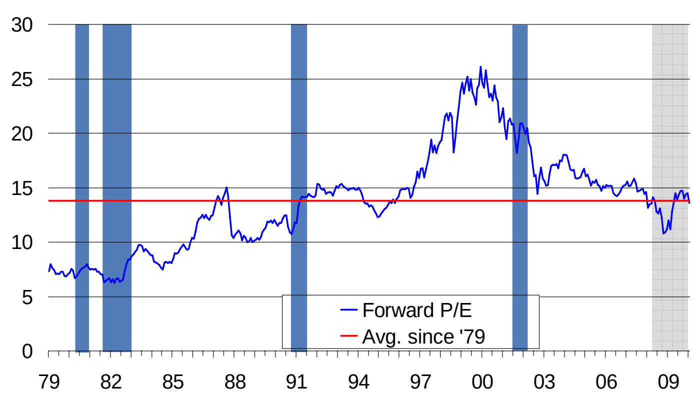
12-Month Forward P/E Ratio



Source: Standard & Poor's

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Insurers' capital situation

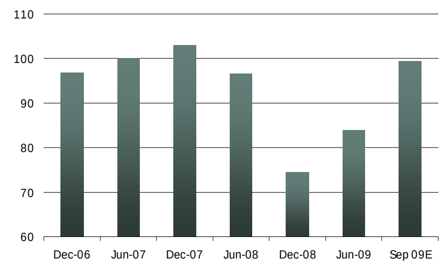
Shareholder capital

- The top 30 companies were able to restore their capital
- The positive development is due to lower dividends and better capital markets; some companies also raised capital

… in life insurance

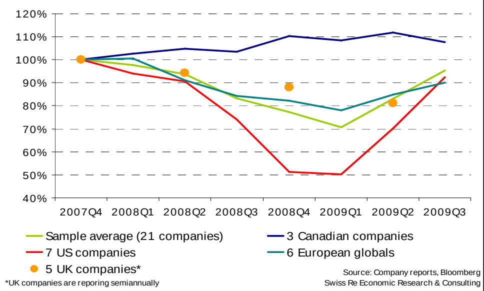
- Accounting differs considerably between countries

Shareholder's Equity
Index Jun 2007=100, USD*



*) Sample: ACE, AEGON, AIG, Allianz, Aviva, AXA, AXIS, Fortis, Generali, Hartford, HSBC, IAC, ING, Liberty Mutual, Lincoln Financial Group, Manulife Financial, Mass Mutual, MetLife, MSIG, Prudential, PLC, QBE, RSA, Talanx, Travelers, Vienna, XL Capital, Tokyo Marine, Zurich, Chubb, Prudential Financial

Shareholder's Equity by country
Index Q4 2007=100, USD



Sources: Company reports, Bloomberg, Swiss Re Economic Research & Consulting

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Current situation and prospects 2010

Sharp drop in new business also 2009

- Single premiums and unit linked business decreased sharply 2009
- Demand for risk products is more stable
- Positive exceptions are France, Germany and Italy

New life business declined but not everywhere (real yoy chg.)

Country	2006	2007	2008	2009
US	3.5%	6.3%	-4.4%	-7.4%
UK	33.8%	14.1%	-20.6%	-25.3%
Australia	7.3%	41.1%	-17.9%	-13.0%
Japan	-7.8%	-0.7%	2.8%	-7.7%
France	18.0%	-5.2%	-15.0%	2.9%
Germany	20.7%	-1.0%	1.9%	13.5%
Italy	-9.6%	-16.8%	-16.9%	34.6%
Netherlands	6.4%	-13.1%	-2.2%	-29.8%
Sample*	8.1%	3.6%	-8.6%	-6.2%

* Inforce premium weighted average of new business growth rates

Source: Swiss Re Economic Research & Consulting

Forecasts life insurance 2010

- Premium growth will gradually resume along with the economy next year
- Low interest rates make it difficult for life insurers to earn guaranteed returns also 2010
- Profitability is expected to improve along with the capital market

Forecasts life reinsurance

- Life reinsurance continues to grow despite lower need for capital relief deals
- Profits increase along with capital markets
- Life securitisation will remain confined to peak risk; embedded value will take time to recover (assumed by end 2011, early 2012)

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Growth prospects for life insurance

▪Real growth of direct life insurance in-force premiums in major markets, 2006-2010

Country	2006	2007	2008	2009	2010
US	3.4%	5.4%	-3.6%	-2.9%	1.3%
Canada	3.7%	9.5%	-0.3%	-7.3%	1.0%
UK	17.9%	24.9%	-31.7%	-21.6%	4.3%
Japan	-2.2%	11.5%	8.5%	-3.0%	0.2%
Australia	6.6%	34.1%	-16.2%	-10.0%	3.0%
France	14.2%	-3.7%	-12.4%	9.8%	3.7%
Germany	2.2%	-2.1%	-2.0%	4.7%	-2.0%
Italy	-7.5%	-13.2%	-14.1%	24.5%	13.0%
Netherlands	3.3%	1.2%	0.3%	-0.3%	1.5%
Spain	5.7%	-1.5%	12.3%	-2.0%	1.4%
Industrialized World	4.7%	8.0%	-8.2%	-2.9%	2.1%
Emerging Markets	19.9%	13.9%	16.2%	2.5%	8.0%
World	5.8%	8.5%	-5.9%	-2.2%	2.8%

Source: Swiss Re Economic Research & Consulting

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Developments in the L&H industry

- The recovery of the L&H industry is gaining traction
- Life companies operating results have improved mainly due to the recovery in financial markets
- Life insurers' capital increased in Q209 and Q309 owing to strong earnings, unrealized capital gains, infusion from capital markets and accommodative regulatory and accounting changes
- Investment results will be a drag on performance — yields will remain low for the foreseeable future, a consequence of slow economic growth
- New business has declined precipitously from the impact of high unemployment and lower disposable income, coupled with capacity constraints and reserve funding issues of providers
- Sales are expected to rebound later in 2010 and 2011
- M&A activity has been minimal but will likely accelerate as financial markets continue to improve

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What caused the crisis?

Too easy and too cheap credit as main cause of the crisis

- **Loose monetary policy**
- Loose credit standards, particularly in the area of subprime mortgages
- Weak risk management at banks
- Lax supervision of mortgage lending by non-banks and weak supervision of the "shadow" banking industry in general
- **Excess leverage, in particular through intransparent off-balance sheet accounts at major banks**
- Intransparent asset-backed securities and an over-reliance on ratings firms and financial guarantee insurers for their valuation

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How did insurance perform in the crisis?

- **Insurers did remarkably well - the crisis revealed weaknesses in risk management and accounting but no systemic problems**
  - cover was always provided both in insurance and reinsurance, claims were always paid
  - most capital was lost on assets, but insurers remained solvent throughout the crisis
  - problems were with monoline insurers involved in credit business and insurers with FS operations
  - other weaknesses:
    - liquidity risk in insurance companies underestimated
    - pro-cyclicity of accounting
    - asymmetric treatment of assets and liabilities
- **Very few insurers needed government support and this was minimal compared with banks**
  - only 3% of the total of more than USD 336 billion worldwide government support went to insurance operations

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Differences between banks and insurers demand different regulatory treatment

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Issue	Insurers	Banks
Contract	Insurance **only pays when there is an insurable interest** (a financial loss)	Capital market contracts **pay whether or not the counterparty has a loss**
Liquidity risk	Insurance business **is pre-funded** through premium payments. Insurance liabilities are **triggered by an insured event**. However life savings products can be redeemed, but usually only at a high cost	Many of the **liabilities of banks – deposits** , saving accounts and commercial paper – **are short term**
Contagion	There is **little risk of contagion** between insurers	The inter-bank markets and other short term funding make banks vulnerable to contagion (bank run)
Unwinding of global groups	Due to the long **duration of liabilities**, insurance books of **business can be liquidated** by regulatory authorities **in an orderly manner**	Due to the risk of a bank run, **regulatory authorities must act very quickly** to avoid further disruptions. And the **crisis revealed** that there was a **need for bankruptcy laws** for large investment banks

Regulatory response (1 of 2)

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Regulatory trends

- In the US, the two key areas that are being reviewed are
  - systemic risk regulation and
  - the creation of a national insurance office
- In Europe the focus also on systemic risk regulation but the main most critical area is changes to Solvency II
  - many new initiatives would result in substantially higher capital requirement, if realised

Systemic risk regulation of insurance companies

- On systemic risk regulation much remains open. Who will be included, and what will be imposed on those who are included?
- Though there are intentions to include insurers in the systemic risk regulations, the arguments brought forward are not very convincing
- Liquidity and contagion, the issues which make banking vulnerable, hardly play a role in insurance

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Regulatory response (2 of 2)

Threats of overly restrictive regulation

- Life insurance in particular is vulnerable if regulations and capital requirements become overly restrictive with regards to market risk, pushing life insurers even more into conservative investments
- The consequences are lower returns for policyholders
  - Ů in the extreme case it may threaten the business model of private old- age provisions
- Given the importance of insurance it would mean cheaper financing for government at the cost of more expensive financing for the private sector

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Conclusions (1 of 2)

- The external environment has improved but depressed premium growth and low investment yields will continue to pressure L&H insurers' performance
- Primary insurers will continue to focus on preserving and rebuilding capital
- Reinsurers will play a critical role as primary companies manage through the crisis and the industry reshapes itself
- Demand fundamentals are solid, product demand will be driven by the shifting financial needs of consumers
- Assuming the global economic recovery gains speed, the industry will be back on track in 2011

Conclusions (2 of 2)

- The recovery from the recession will be sluggish in 2010
- Insurance coped well with the consequences of the most severe crisis since the 1930s
- Both life and non-life insurance are on a recovery path, the same for reinsurance
- There is a risk that upcoming regulatory reforms will be overly restrictive and will lead to further fragmentation

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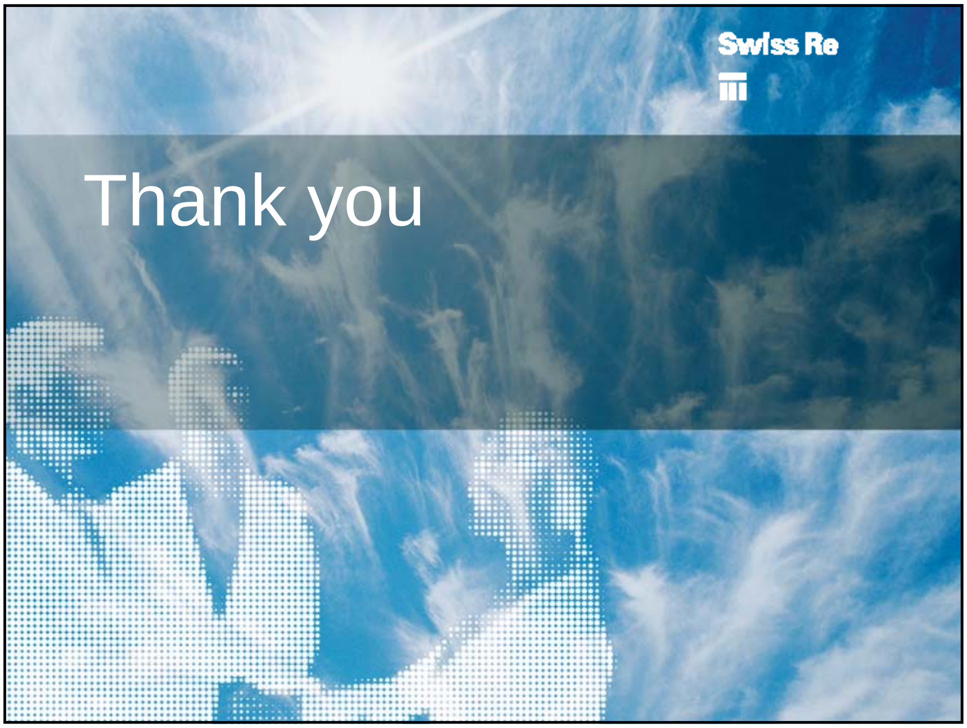
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Thank you