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IH 2008 Challenging Times

➤ Benfield Research

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Challenging times

Challenging times

Turbulence in the financial markets made the first half of 2008 a difficult period for the Benfield European Quarterly (BEQ) group as results were weaker in all departments. Munich Re issued a profits warning and lowered its full year earnings target.

Declining premiums

Business falling short of pricing targets was declined as the softening of premium rates continued. A weaker dollar also contributed to a 10% fall in net earned premiums.

Losses up

The period was notable for an above average number of large losses, including heavy snow and ice in China, flooding in the US Midwest and Queensland, European storm Emma, the Sichuan earthquake in China and hail storms in Germany. There was also a significant number of man-made losses. Nevertheless, the aggregate combined ratio rose by only 0.2pp to 98.0%. Lower earned premiums caused a commensurate fall in underwriting profits.

Written down

Dislocations in global financial markets meant that investment income was driven down by lower yields, realised capital losses and write-downs. Swiss Re took a charge of CHF1.2bn on its credit default swap book.

Capital commitment

Planned repatriation of capital continued, with Munich Re and Swiss Re repurchasing their own shares, and all paying dividends. The aggregate capitalisation of the BEQ group declined 16% to EUR45.3bn.

Stormy weather

Since the end of the first half, the BEQ group has suffered further catastrophe losses and more challenging investment markets. Swiss Re gave additional disclosure on its investment portfolio, and Munich Re commented that its capitalisation is solid despite adverse impacts from the financial markets. It also announced EUR400m losses from hurricanes Gustav and Ike. Hannover Re has warned that higher than expected hurricane losses and investment write-downs will drive it into a nine months loss of some EUR140mn.

Premium income

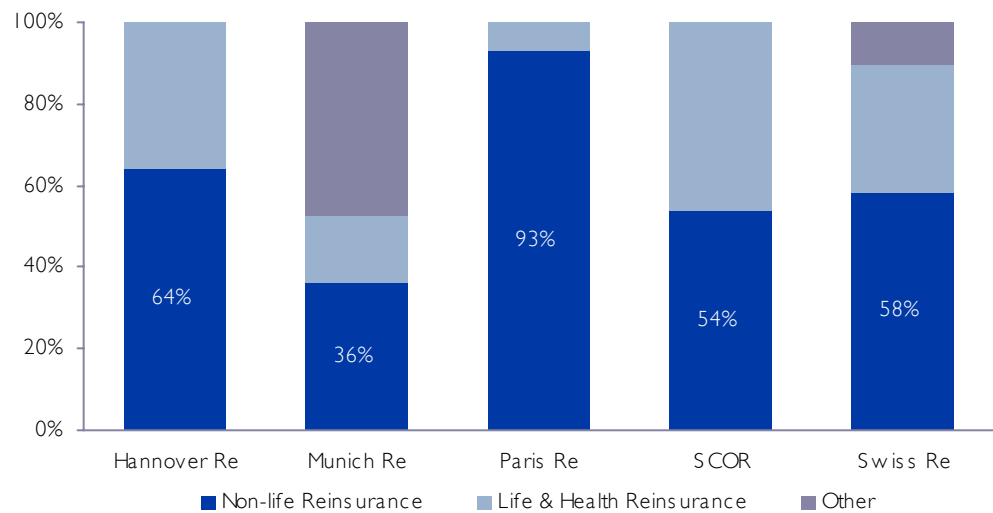
Softening premium rates, a willingness to sacrifice business which failed to meet pricing targets, as well as the weakness of the US dollar, all contributed to declining premium income for most of the BEQ group. The acquisition of Converium boosted SCOR's premiums. Further price erosion was evident in recent renewals, particularly in some US casualty lines.

Premiums

The European reinsurance groups continue to exhibit a mixed business profile. The contribution of non-life reinsurance to total gross premiums ranged from 93% to 36%, as shown in Chart 1. The "Other" segment for Munich Re comprises its substantial primary insurance businesses.

Chart 1

Business mix
Company information,
Benfield Research



The development of reinsurance premium income is shown in Table 1. Premiums declined in both nominal and currency-adjusted terms. The 58% rise in published premiums at SCOR reflects the acquisition of Converium in August 2007. The former Converium business is included in IH 2008 but not in the prior year. On a pro-forma and constant currency basis, premium income fell 3%, largely reflecting the planned reduction of business from the London joint ventures with Global Aerospace and the Medical Defence Union (MDU).¹ At constant exchange rates, Hannover Re's premiums fell 5%, reflecting the withdrawal from US specialty programme business.² The acquisition, in April, of The Midland Company in the USA helped to boost Munich Re's premiums 8%, which largely compensated for adverse currency movements.³ Paris Re, which reports in US dollars, benefited from that currency's weakness. At constant exchange rates, premiums declined 8%, which the company attributed to disciplined underwriting and a generally weaker price environment.⁴ Swiss Re attributed an underlying decline in premium volume to cycle

¹ SCOR, press release and conference call, 27 August 2008

² Hannover Re, press release and conference call, 7 August 2008

³ Munich Re, press release and conference call, 6 August, 2008

⁴ Paris Re, press release and conference call, 28 August 2008

management and general pressure on prices,⁵ which were common themes echoed in all the conference calls.

7 Table 1

Non-life reinsurance gross written premiums

Company information, Benfield Research

			IH 2007	IH 2008	Change
Hannover Re	EUR mn		2,964	2,656	-10%
Munich Re	EUR mn		7,335	7,290	-1%
Paris Re	USD mn		1,119	1,084	-3%
SCOR	EUR mn		943	1,488	58%
Swiss Re	CHF mn		11,180	9,642	-14%

Broadly similar trends were evident in net written premiums, although Hannover Re and Paris Re increased net retentions. In contrast, the effects of the 20% quota share with Berkshire Hathaway are evident at Swiss Re, which resulted in a 24% reduction. In aggregate, net written premiums for the BEQ group declined 12% and net earned premiums by 10%.⁶

7 Table 2

Net written premiums

Company information, Benfield Research

			IH 2007	IH 2008	Change
Hannover Re	EUR mn		2,469	2,375	-4%
Munich Re	EUR mn		6,823	6,439	-6%
Paris Re	USD mn		855	901	5%
SCOR	EUR mn		876	1,385	58%
Swiss Re	CHF mn		18,089	13,736	-24%

Pricing trends

Commentary on the state of the market was concentrated on the 1 April and 1 July renewals. All companies reiterated that the general softening of rates continued, and there was great stress on disciplined underwriting, resulting in business not meeting technical price hurdles being declined. Swiss Re pointed to US casualty where price erosion led to a 40% reduction in this line at 1 July, continuing a trend of the two previous renewals. Swiss Re also mentioned further reductions in US catastrophe rates, but from high level so that pricing was still considered technically adequate. Hannover Re observed similar trends, as did Munich Re, adding that excess of loss pricing was generally down by more than proportional. CEO Nikolaus von Bomhard commented that "Casualty was under a hell of a lot of pressure".⁷

Hannover Re noted that it was mostly able to obtain prices which were "commensurate with the risks" while conditions remained broadly acceptable. Addressing the 1 July renewals, Hannover Re witnessed a 5-10% decline in US property non-catastrophe rates and a 5-7% fall in casualty rates. The group commented that rates were predominantly stable in Australia, Latin America and Canada.

⁵ Swiss Re, press release and conference call, 5 August 2008

⁶ Premiums for Paris Re and Swiss Re converted to euros at period-average exchange rates

⁷ Munich Re, conference call, 6 August 2008

Earnings

Despite an increase in the frequency of large losses, the weighted average combined ratio for the BEQ group edged up only 0.2pp to 98.0% but lower earned premiums depressed underwriting results. Investment income was driven down by lower yields, realised capital losses and write-downs. Profits consequently fell sharply.

Major losses

The first half of 2008 was notable for an above average number of large losses, rather than any severe market losses. Significant natural events included heavy snow and ice in China, flooding in the US Midwest and Queensland, European storm Emma, the Sichuan earthquake in China and hail storms in Germany. There was also a significant number of man-made losses, including the well publicised fire at Universal Studios in California. Table 3 shows the major losses incurred, net of retrocession, and their impact on combined ratios. In both absolute and relative terms, Munich Re had the heaviest burden. Australian floods cost the company EUR200mn while the China earthquake, US floods and Windstorm Hilal in Germany totalled some EUR100mn. Man-made losses amounted to EUR352mn, compared with EUR71mn in IH 2007. Swiss Re's largest individual losses came from China with winter storms of CHF92mn and the earthquake at CHF54mn. The latter cost SCOR EUR25mn and Hannover Re EUR20mn. Emma was Paris Re's only large loss.

Table 3

Major losses

Company information,
Benfield Research

		Catastrophe loss mn	Combined ratio p.p.
Hannover Re	EUR mn	130	6.2%
Munich Re	EUR mn	777	12.1%
Paris Re	USD mn	14	2.5%
SCOR	EUR mn	87	6.3%
Swiss Re	CHF mn	292	8.5%

Combined ratios

Table 4 shows half year combined ratios for BEQ companies' P&C reinsurance segment.⁸ Despite higher catastrophe losses, the weighted average combined ratio for the group was only marginally higher at 98.0%.⁹ Companies attributed this to better underlying performance excluding catastrophes. Favourable reserve development was also a factor, although little detail was provided. On the Benfield basis, Munich Re's combined ratio was the highest, reflecting its higher large loss costs. The combined ratio at Paris Re was the lowest combined ratio, despite incorporating the highest expense ratio. The loss ratio was impacted by the relative absence of

⁸ For consistency, Benfield calculates combined ratios as the sum of net claims incurred and expenses to net premiums earned, all as recorded in the technical accounts. In some cases, the resulting ratios differ from those published by companies, where different calculation bases have been used or adjustments have been made to the figures shown in the income statements.

⁹ Weighted by net earned premiums, converted to euros at period average exchange rates.

significant large loss events and the offsetting USD 12mn of favourable reserve development which reduced the loss ratio by 2.1 percentage points (pp).

Table 4

Combined ratios

Company information,
Benfield Research

	Combined ratio		Loss ratio	Expense ratio
	IH 2007	IH 2008	IH 2008	IH 2008
Hannover Re	102.4%	98.9%	72.8%	26.1%
Munich Re	98.4%	100.1%	71.8%	28.3%
Paris Re	93.5%	90.4%	56.4%	34.1%
SCOR	98.8%	99.3%	69.6%	29.7%
Swiss Re	95.5%	94.7%	65.3%	29.4%
Weighted average	97.8%	98.0%	69.4%	28.6%

Swiss Re also benefited from net favourable reserve development of around 4pp. Adverse development Workers' Compensation and Financial Guarantee Re was offset by positive development in Aviation and Engineering, Property and Motor. The combined ratio was negatively impacted by the accounting effect of the unwinding of the discount on reserves acquired from GE Insurance Solutions.

SCOR benefited from a change in business mix, with a reduction in the structurally high combined ratio Medical Defence Union business and the non-recurrence of a number of one-off items which had added 1.7pp to the prior year's loss ratio.

Investment income

Table 5 shows investment income, excluding capital gains, across all business segments. The return on average invested assets mostly fell, reflecting lower interest rates. The average value of invested assets was mostly higher compared with the prior year period, but this was not sufficient to drive up investment income. The increase at SCOR was explained by the inclusion of the former Converium business in 2008.

Table 5

Current investment income

Company information,
Benfield Research

		Investment income		Return on avge inv assets	
		IH 2007	IH 2008	IH 2007	IH 2008
Hannover Re	EUR mn	586	445	3.4%	3.4%
Munich Re	EUR mn	3,982	3,544	4.5%	4.1%
Paris Re	USD mn	120	130	n.a.	4.8%
SCOR	EUR mn	258	351	3.8%	3.7%
Swiss Re	CHF mn	5,116	4,666	4.6%	4.0%

The contribution from capital gains is shown in Table 6. In all cases, this was negative, reflecting sometimes substantial investment write-downs. For the most part, these were on equity holdings. Some, such as Hannover Re, noted that these were offset, at least in part, by positive results from hedging activities, which appear elsewhere in the accounts. Impairments on fixed interest holdings also featured.

Table 6

Realised capital gains

Company information,
Benfield Research

			IH 2007	IH 2008
Hannover Re	EUR mn		97	-43
Munich Re	EUR mn		1,664	-281
Paris Re	USD mn		-2	-146
SCOR	EUR mn		83	-37
Swiss Re	CHF mn		2,360	-3,855

Munich Re reported substantially lower realised gains, partly reflecting the non-recurrence of EUR550mn of gains on real estate holdings, as well as lower gains on the sale of equities. Net investment write-downs totalled EUR1.2bn (IH 2006: EUR440mn). The reduction at Swiss Re was by far the greatest, with a swing of CHF6.2bn. This included CHF1.2bn of unrealised mark-to-market losses on the structured credit default swap portfolio, now in run-off. Other contributory factors were losses on derivatives used to hedge corporate bond exposures and mark-to-market losses on the trading portfolio.

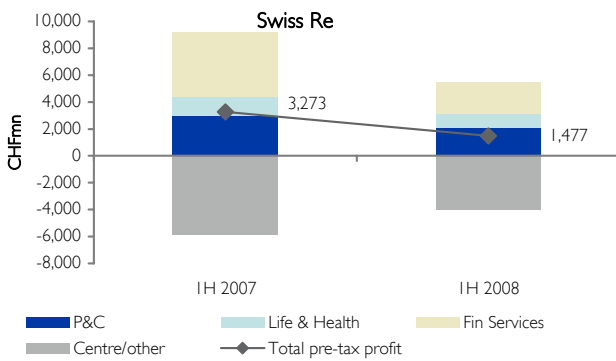
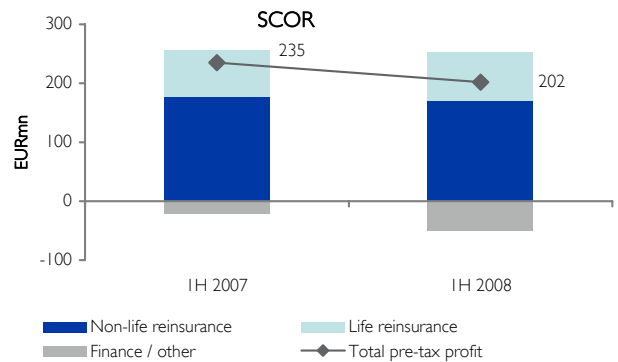
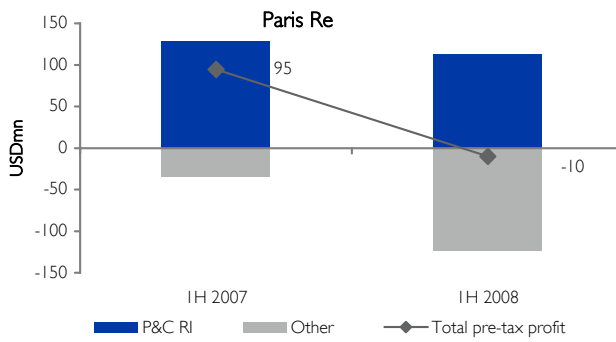
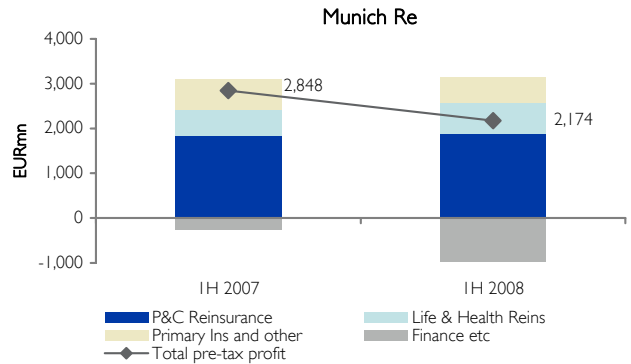
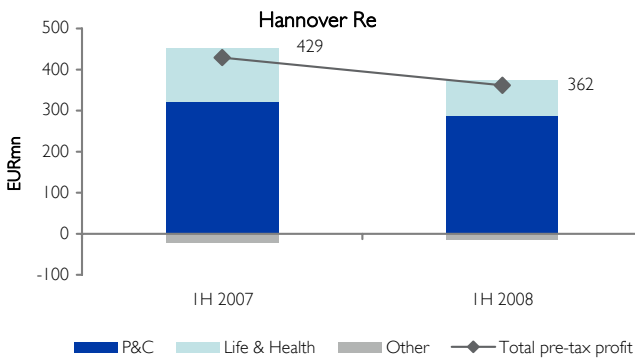
Earnings

Chart 2 shows the divisional contribution to pre-tax profits. Segmental results reflect differences in reporting as well as the allocation of investment income and central costs. The 55% fall in pre-tax profits at Swiss Re was the largest of the BEQ group. SCOR's profits held up best, with a fall of 14%. Higher combined ratios negatively impacted the contribution from P&C reinsurance, with worse investment results comprising the majority of the remaining difference. Adverse currency movements of USD145mn were largely responsible for the reversal of profits of Paris Re, excluding which pre-tax profits fell 12% to USD113mn.

Chart 2

Divisional contribution to pre-tax profits

Company information, Benfield Research



Net income showed broadly similar trends, although there were some significant tax distortions. SCOR benefited from a tax credit in IH 2008 causing net income to rise 25%. Adverse currency effects were largely responsible for Paris Re's reported loss.

7 Table 7

Net income

Company information,
Benfield Research

			IH 2007	IH 2008	Change
Hannover Re	EUR mn		320	263	-18%
Munich Re	EUR mn		2,132	1,406	-34%
Paris Re	USD mn		80	-26	n/a
SCOR	EUR mn		181	227	25%
Swiss Re	CHF mn		2,523	1,188	-53%

Balance sheet

The value of invested assets fell during the first half, reflecting declining premium income, and falling market values. The repatriation of capital through dividends and share buy-backs contributed to a 16% reduction in the group's aggregate capitalisation, in Euro terms.

Investments

The change in invested assets during the period is shown in Table 3. Paris Re recorded a notable increase in dollar terms, which can partly be explained by the currency translation effects of the weakening dollar through the period. Swiss Re's investments dropped 16%.

Table 8

Invested assets

Company information,
Benfield Research

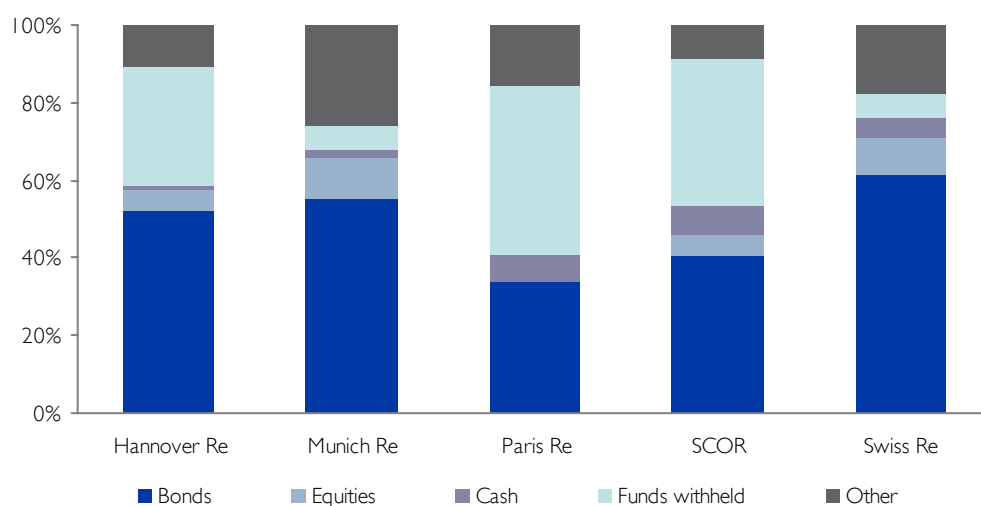
		31 Dec 2007	30 June 2008	Change
Hannover Re	EUR mn	29,042	29,096	0%
Munich Re	EUR mn	176,481	167,125	-5%
Paris Re	USD mn	5,690	6,571	15%
SCOR	EUR mn	19,093	18,590	-3%
Swiss Re	CHF mn	255,687	215,698	-16%

The composition of invested assets is shown in Chart 3. Funds withheld was a significant component for Hannover Re, Paris Re and SCOR. Equity exposure continued to fall, partly reflecting stock market movements. Paris Re has no equity holdings.

Chart 3

Composition of invested assets

Company information,
Benfield Research



Subprime

European reinsurers' exposure to subprime related assets continues to be modest. Hannover Re and Munich Re have negligible holdings. Those of Swiss Re are mostly rated Aaa, and over 60% is hedged within the trading portfolio using ABX index products. Paris Re has not disclosed the ratings of its holdings.

7 Table 9

Subprime exposures

Company information,
Benfield Research

	Subprime % total investments	Comment
Hannover Re	0.1%	
Munich Re	0.1%	60% rated AAA
Paris Re	2.4%	Subprime and Alt-A RMBS, including those in funds withheld
SCOR	0.0%	
Swiss Re	2.5%	Subprime and Alt-A RMBS. 62% rated Aaa

Capital

Table 10 shows the development of shareholders' funds during the half year, with reductions for all except Paris Re. Falls in unrealised gains were the major contributor to this trend. The dividend payment was greater than the net profit for the period at Hannover Re and Swiss Re. Munich Re and Swiss Re continued their respective share buy-back programmes. Currency translation effects were adverse for all but Paris Re. SCOR issued EUR20mn of new shares in connection with the squeeze-out of the remaining 1.4% minority stake in SCOR Switzerland Holding.

7 Table 10

Change in shareholders' funds

Company information
Benfield Research

mn	Hannover Re EUR	Munich Re EUR	Paris Re USD	SCOR EUR	Swiss Re CHF
31 December 2007	3,922	25,458	2,474	3,630	31,867
Capital increase	0	-958	0	20	-1,204
Net profit	263	1,406	-26	227	1,188
Dividends paid etc	-318	-1,118	0	-143	-1,331
FX changes	-122	-513	178	-150	-1,824
Change in unrealised gains	-386	-2,697	0	-169	-3,256
Other	-34	-106	-50	-14	133
Total changes	-597	-3,986	103	-229	-6,294
30 June 2008	3,325	21,472	2,577	3,401	25,573
Change	-15%	-16%	4%	-6%	-20%

Converted where necessary to Euros, the group's aggregate capitalisation fell 16% to EUR45.3bn.¹⁰

¹⁰ Paris Re and Swiss Re converted to euros at exchange rates on the balance sheet date

Financial strength ratings

Ratings of the BEQ group have all recently been affirmed. SCOR was upgraded by Fitch to A.

In August 2008, Fitch upgraded its financial strength ratings of SCOR to A, reflecting the agency's view that SCOR was now over the legacy problems of reserve deficiencies. It also noted the group's considerable geographic and business diversification which has a favourable impact on the risk profile. Fitch commented that SCOR's capital position has remained strong following the acquisition of Converium.¹¹ This move was shortly followed by S&P which raised its outlook on SCOR and related entities to positive, noting "positive momentum in SCOR's financial and business profile" and significantly improved earnings and risk profile.¹²

Fitch withdrew its AA- rating on Swiss Re which was based on public information only.¹³

Table 11 shows the financial strength ratings of the principal operating entities of the BEQ group as at 26 August 2008.

Table 11

Financial strength ratings

Standard & Poor's, A.M. Best,
Fitch Ratings, Moody's

	Standard & Poor's		A.M. Best		Fitch		Moody's
	FSR	Outlook	FSR	Outlook	FSR	Outlook	
Hannover Re	AA-	Stable	A	Stable	A+	Stable	A3
Munich Re	AA-	Stable	A+	Stable	AA-	Stable	Aa3
Paris Re	A-	Stable	A-	Stable	NR	-	NR
SCOR	A-	Positive	A-	Stable	A	Stable	A3
Swiss Re	AA-	Stable	A+	Stable	NR	-	Aa2

¹¹ Fitch Ratings, press release, 21 August 2008

¹² Standard & Poor's, press release, 3 October 2008

¹³ Fitch Ratings, press release, 3 October 2008

Corporate actions

Munich Re and SCOR announced acquisitions and Swiss Re transferred further catastrophe risks to the capital markets.

Swiss Re was again active in transferring catastrophe risk to the capital markets with the issue of an USD150mn cat bond. Its Vega Capital securitisation provides protection against Californian earthquake, Japanese earthquake and Japanese typhoon.¹⁴ SCOR completed a securitisation of mortality risk with a fully collateralised USD100mn and EUR36mn swap transaction. The deal offers two years protection and is designed to give protection notably for a rise in mortality rates due to major pandemics, natural catastrophes or terrorist attacks.¹⁵

Munich Re has continued its programme of external growth with the acquisition of Roanoke Companies Inc, which, through its subsidiary, is a major marine insurance underwriting agency and broker in the USA. The purchase price was USD53mn (approximately EUR34mn). The acquisition is intended to enhance Munich Re's position in speciality segments of primary marine insurance.¹⁶ SCOR announced a further addition in the field of life and health reinsurance with the acquisition of Paris-based Prévoyance Ré in a deal intended to reinforce its strategic ambitions to "accentuate its leading role in the French Life and Health reinsurance market and the social protection field."¹⁷

¹⁴ Swiss Re, press release, 30 June 2008

¹⁵ SCOR, press release, 3 March 2008

¹⁶ Munich Re, press release, 30 April 2008

¹⁷ SCOR, press release, 31 July 2008

Appendices

Third quarter events

Through the third quarter, reinsurers have been affected by hurricanes Gustav and Ike and the continued turbulence in global financial markets. Table 12 shows the disclosed loss estimates to the hurricanes.¹⁸

Table 12

3Q Hurricane losses

Company information

	Gustav	Ike
Hannover Re	< EUR100mn	> EUR150mn
Munich Re	Approx USD100mn	Approx USD400mn
Paris Re	USD10-20mn	USD75-95mn
Swiss Re	USD50mn	USD250mn

While a number of the Bermudian reinsurers have pre-announced third quarter results and the effects of investment write-downs, Hannover Re is so far the only European reinsurer to do so. It said it had booked year-to-date write-downs and unrealised losses of around EUR466mn, roughly EUR360mn of which was taken on equities. Together with EUR250mn of losses on Gustav and Ike, Hannover Re expects to report a nine months loss of some EUR140mn.¹⁹

Swiss Re used a pre-arranged investor day in late September to provide additional information on its investment portfolio and capitalisation, revealing further CHF277mn of mark-to-market losses on the structured credit default swap book for the period 1 July to 19 September. The company reported that it had continued to reduce the risk profile of its investment portfolio with further reductions in exposure to corporate bonds and equities. It maintained that the reduced capital allocation compensated for the additional capital requirement of wider credit spreads on other instruments.²⁰

In newspaper interviews, Munich Re CEO Nikolaus von Bomhard commented that despite market development, “no fundamental impacts on the Group are to be expected. Munich Re’s capitalisation is solid.”²¹

¹⁸ SCOR has not disclosed its Gustav and Ike losses

¹⁹ Hannover Re, press release, 21 October 2008

²⁰ Swiss Re investor presentation, 25 September 2008

²¹ Munich Re website

Reporting dates

Upcoming reporting dates are shown in the following table.

Table 13

Reporting dates

Company information

Company	9M 2008	FY 2008
Hannover Re	5 November 2008	11 March 2009
Munich Re	5 November 2008	3 March 2009
Paris Re	13 November 2008	t.b.a.
SCOR	14 November 2008	t.b.a.
Swiss Re	4 November 2008	19 February 2009

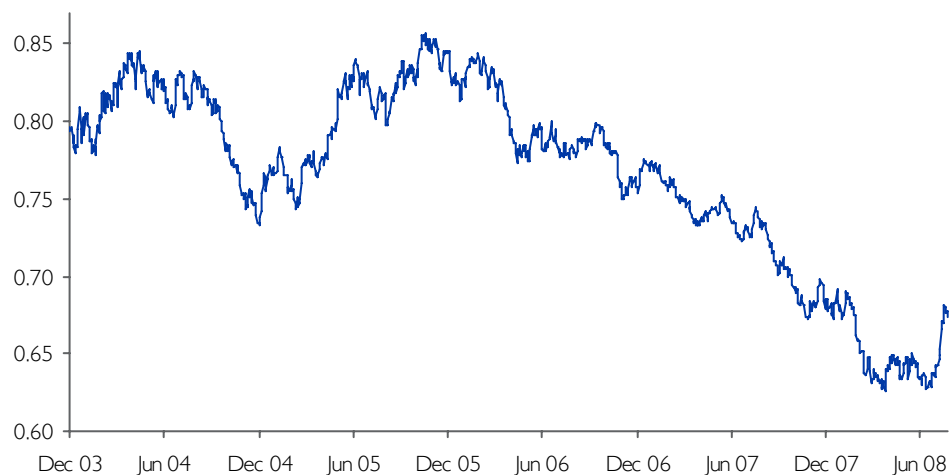
Exchange rates

Chart 4 shows the evolution of the US dollar/euro exchange rate over the period 2004 to mid-2008. The daily average rate (used for the translation of income statement items) for IH 2008 was 0.654, 13.1% lower than the 0.752 average rate for IH 2007. The dollar weakened appreciably against the euro through the middle of the six month period, reaching a low of EUR0.625 on 22 April before rallying somewhat to end the period down 7.4%. Nominal growth rates for those companies reporting in European currencies with significant US dollar denominated business were therefore depressed.

Chart 4

USD/EUR exchange rate

Bloomberg



Bond yields

Chart 5 shows the yield on selected 5-year government bonds. Yields continued their downward trend in the first quarter of 2008, before reaching an inflection point in March. Thereafter, yields firmed to end the first half up 0.62pp at 5.09% in the UK and up 0.36pp to 4.49% in the Eurozone. In the USA, yields closed the period down 0.14pp at 3.35%. Average yields fell by 0.89pp in the UK, 0.29pp in the Eurozone and 1.77pp in the US.

Chart 5

5-year government bond yields
Bloomberg



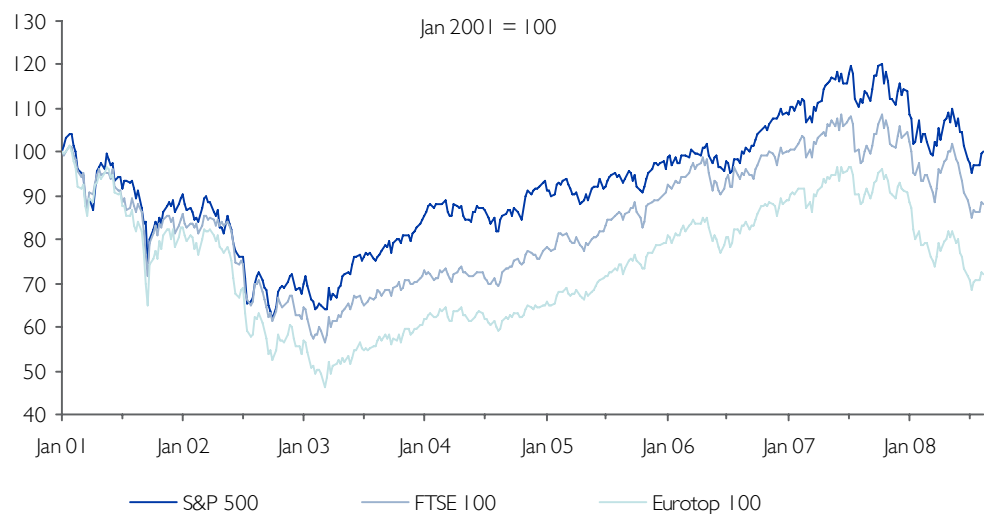
Falling bond yields have mixed implications for reinsurers. While they benefit from the higher market value of bond holdings with a beneficial effect on capitalisation and solvency, there is a reduction in income on reinvestment and new cash flow.

Equity markets

Chart 6 shows movements in major equity market indices, rebased to January 2001 = 100. Markets weakened during the first quarter of 2008. A modest rally was short-lived, as further weakness set in from mid-May. European markets, measured by the FTSE 100 and the Eurotop 100, ended the first half down 14.6% and 21.2%, respectively, while the US market, measured by the S&P 500 index fell 13.5%.

Chart 6

Equity markets
Bloomberg





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