# Letter to shareholders

**Walter B. Kielholz**
Chairman of the Board of Directors

**Stefan Lippe**
Chief Executive Officer

## Dear shareholders

Swiss Re substantially increased its capital strength in the second quarter of 2009. We estimate that our excess capital at the AA level improved to CHF 4.5 billion. At the same time, Swiss Re reported a net loss of CHF 381 million for the quarter, which equates to earnings per share of CHF –1.13.

This apparent ambiguity stems from three factors that generated substantial volatility in the income statement. First, the mark-to-market losses on the corporate bond hedges of CHF 1.1 billion are reflected in net income, whereas the unrealised gains of CHF 1.9 billion on these corporate bonds are recorded in shareholders' equity only. Second, impairments, primarily on securitised products, meant Swiss Re's net income further narrowed by CHF 0.6 billion. Last, while Swiss Re's credit spreads improved considerably in the quarter, US GAAP requires that we recognise the effects of our own credit spreads in certain financial liabilities, resulting in a mark-to-market loss of CHF 0.4 billion for the quarter. The effects of hedges and impairments resulted in a return on investments of 0.5%.

**Protecting our capital base**
Despite the rebound of the financial markets in the second quarter of 2009, we have maintained a cautious stance on credit. For this reason, we have retained the hedging of the corporate bonds portfolio to protect our capital base. In addition, we increased allocation to cash and cash equivalents, and government securities in the quarter. Running yield was 4.8% in the second quarter of 2009.

Shareholders' equity increased to CHF 23.8 billion at the end of June 2009, compared to CHF 23.6 billion at the end of the first quarter of 2009. Book value per common share was CHF 60.69, compared to CHF 61.39 at the end of the previous quarter.

**Legacy risk significantly reduced**
De-risking our Legacy portfolio remained a priority over the quarter. We terminated substantially all of the remaining portfolio credit default swap contracts in the Legacy portfolio and decreased corresponding notional exposure from CHF 13.9 billion at the end of March 2009 to CHF 0.8 billion at the end of June 2009.

**Strong operating result in Property & Casualty and Life & Health**
Property & Casualty posted an operating income of CHF 1.0 billion and achieved an excellent combined ratio of 89.4%, or 87.6% excluding unwind of discount. This result is primarily due to disciplined underwriting and strict expense management.

Life & Health operating income declined to a loss of CHF 10 million; however, the benefit ratio continues to be satisfactory at 78.6%. Premium and fee revenue increased slightly compared to the prior year period. The above-mentioned requirement to record the effect of improvements in the Group's own credit standing had a negative impact of CHF 0.4 billion on the discontinued variable annuity business.

**Successful renewals**
Conditions in the reinsurance market continued to improve in the second quarter of 2009. We see the strongest immediate improvements taking place in some life segments, especially in the US, and in many natural catastrophe markets. In many other segments, the softness of the market has slowed but has not yet fully reversed. In the July 2009 Property & Casualty renewals, we achieved a rate increase of 4%, reflecting the shift in our reinsurance portfolio from Casualty lines towards more profitable Property non-proportional business, as well as a gradual hardening of the market. More importantly, though, we succeeded in raising long-term price adequacy.

These renewals and transactions demonstrate that our client franchise remains strong and that we have sufficient capacity to provide the solutions our clients need.

**Improving efficiency**
Several major milestones in the company's efficiency programme were achieved in the second quarter of 2009. We optimised our global office network and merged or closed a number of offices across the globe to serve clients more effectively while consolidating support functions in regional hubs. At the same time, we informed those employees whose positions have become redundant or are being relocated. These measures translated into running cost savings, before restructuring costs, of more than CHF 300 million in the first half of 2009. Net savings, after restructuring costs, are now expected to exceed CHF 150 million in 2009, compared to our original target of CHF 100 million.

**Outlook**
We have succeeded in increasing our capital strength, and we remain a strong partner for our clients. For Property & Casualty, we expect further modest rate increases. We are likely to surpass our underwriting year 95% combined ratio target, provided that natural catastrophe events remain at normal levels. However, the economic environment remains uncertain and our investment and Legacy portfolios remain exposed to market volatility. This financial market volatility and the shift towards lower risk investments, which allowed us to reduce our exposures significantly, may adversely impact future earnings. Despite this, we believe the underlying operating trends are positive and we have the ability to allocate significant capacity to lines of business that offer an appropriate return on Swiss Re's capital.

Zurich, 5 August 2009

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