Swiss Re

Swiss Re's economists predict severe recession for industrialised economies; insurance industry needs to preserve capital to remain resilient

Contact:

Media Relations, Zurich
Telephone +41 43 285 7171

Corporate Communications, London
Telephone +44 20 7933 3445

Corporate Communications, Asia
Telephone +852 2582 3660

Corporate Communications, New York
Telephone +1 212 317 5663

Swiss Reinsurance Company Ltd
Mythenquai 50/60
P.O. Box
CH-8022 Zurich

Telephone +41 43 285 2121
Fax +41 43 285 2999
www.swissre.com

London, 9 December 2008 — Swiss Re's economists predict a severe recession until mid 2009 in industrialised economies, including the United States and Europe. In emerging markets, slower growth is expected but not a full-blown recession.
In 2008, the insurance industry successfully weathered the financial turmoil. As market uncertainty could continue well into 2010, the industry needs to preserve capital to remain resilient.

"Due to the worst financial crisis since the 1930s, the world will see a severe recession. A rebound of the economy cannot be expected before mid 2009 and market uncertainty will continue well into 2010. Insurers are not immune to the crisis," said Kurt Karl, Swiss Re's chief US economist, at the company's Economic Forum in London this morning.

Worldwide, as at end-2007, insurance companies held about USD 18 trillion of assets which they invest to match their liabilities. In terms of portfolio size, this places insurers only slightly behind pension funds (USD 22 trillion) and mutual funds (USD 19 trillion). The global insurance sector holds around USD 2.2 trillion (of the USD 18 trillion) of shareholder capital to cushion fluctuations in both claims and asset prices.

Thomas Hess, Swiss Re's Chief Economist, commented: "The insurance industry came into the crisis with very healthy balance sheets. Despite the asset meltdown, the insurance industry is able to weather the financial turbulence. There can be no 'run' on an insurance company because pay-outs are triggered by hazardous events, not by policyholders' will. The only exception is in life insurance where strict withdrawal penalties render policy cancellations unlikely. Moreover, insurers can hold assets until maturity, and are therefore not forced to sell assets just because the stock market falls."

Sharp drop in demand for unit-linked business expected in 2009 – increasing focus on underwriting results in non-life
The financial crisis is affecting both the liability and the asset sides of insurers' balance sheets, but the impact varies significantly by business line and by individual company. Life insurers are hit relatively hard due to the falling value of invested assets, along with a marked slowdown in sales. In particular, unit-linked saving products are on the decline due to poor returns and continuing volatility in the stock markets. In

contrast to the life industry, non-life insurance has been less affected because of its lower asset leverage. The demand for non-life cover has also remained stable.

For reinsurers specifically, non-life and life underwriting remains sound due to a continued focus on economic profitability. Reinsurance prices are expected to harden in both non-life and life. This is partly because alternative capacity is no longer available. In response, reinsurance premium volumes are expected to accelerate as the need for protection increases due to insurers' lower capitalisation.

Emerging market growth will be significantly affected
While economic growth in emerging markets was healthy in the first half of 2008, it was weakened by the severe global financial turmoil in the second half of the year. With the major industrialised countries in recession in 2008 and into mid 2009, emerging market growth will be significantly affected, particularly in those countries that are dependent on external financing or exports.

"While (re)insurance in emerging markets is expected to grow at a slower pace in 2008 and 2009, its longer term prospects remain positive," said Clarence Wong, Swiss Re's chief economist in Asia. "Between 2008 and 2013, life growth in emerging markets is estimated to land in the range of 7-10%, and non-life growth between 3% and 8%, after adjusting for inflation."

Re-thinking insurance regulation
The crisis will also trigger a re-think of financial regulation. For the insurance industry, it is important that future regulation takes into account the characteristics of insurance, since underlying risks are vastly different from those related to banking. Hence, insurance does not face the systemic risks associated with banking.

However, the need for the incoming Solvency II regulatory framework, with its focus on holistic risk management, has been strongly underpinned by the financial turmoil. This includes an increase in the importance of sound liquidity management. The issue of pro-cyclicality will also need to be addressed. There are elements in accounting, ratings and capital requirements that have the potential to amplify cyclicality in times of stress. Strong group supervision is another important factor. In this respect, collateral requirements should not result in increased liquidity risk, nor destroy insurers' value proposition.

Focus on de-risking in the short term – strong turn-around possible in 2010

Given that the amount of risk-bearing capacity in the industry has been reduced by the financial crisis, insurers are expected initially to focus on preserving their capital. Share buy-back programmes, for example, which have been heavily used by insurance companies in recent years, may be postponed or reconsidered. Asset risks will be reduced or hedged further, and dividends may be cut. Also, drawing on past experience, some companies are likely to exit non-core business lines. Further, M&A activity in the financial sector is expected to increase in the coming years.

Thomas Hess concluded: "Although market conditions are severe at the moment, we should not be too pessimistic looking ahead. The challenges currently being faced by the insurance industry are temporary. Current market valuations have already priced-in a severe recession. If the economy recovers in the course of 2009, we expect to see a rare combination of good underwriting and excellent investment results in non-life in 2010. Equally, life insurance could see a strong recovery too."

Materials from today's event

Copies of presenters' slides, photographs and other materials from today's event are available at www.swissre.com under 'Media Centre'. An audio recording will be posted within 24 hours of this Media Information being issued.

Notes to editors

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