// Welcome to a new world, Bertrand R. Wollner, CEO

// SIGNAL IDUNA Group on course for success

SI Re

# STEPS 2/10

## Welcome to a new world

Insurers, the financial markets and banks are bound together by close ties, and this situation is not going to change. As a financial intermediary, the insurance sector depends on functioning financial markets as it needs to make profitable use of the «bridging» period between receiving premium income and paying claims. If it becomes impossible to earn adequate income from investments, the only alternatives left are to increase premiums and/or to adjust the conditions of cover.

A few facts will illustrate the closeness of these ties. At an event for the sector in November 2009, Jean-Claude Trichet, President of the European Central Bank (ECB), stated that insurers and pension funds account for 10% of all debt securities issued by banks and he added this quota was set to rise. In Europe, according to estimates by Standard & Poor's, the financial sector accounts for over 90% of all corporate debt securities due for refinancing in the next three years. Given this background, the insurance industry must be careful to avoid cluster risks in the financial sector which, however, is easier said than done, because the issues market for first-class bonds offers virtually no alternatives outside of the financial sector, and investment opportunities are very limited at present. New issues (such as those from industrial corporations) typically have very long terms to maturity that entail correspondingly high risks in terms of future interest-rate development. What is more, yields have hit all-time lows.

In the wake of the dramatic events between September 2008 and March 2009, managing investments again poses one of the greatest challenges for the (re)insurance sector. During that period, the objective was to keep assets away from the unparalleled maelstrom of value destruction; nowadays (re)insurers find that they are confronted with nothing short of an «investment emergency». Yields from government bonds are at all-time lows because they continue to be the preferred option for risk-averse investors. Despite low interest-rate levels, the private sector is reluctant to enter into credit- or bond-financed investments. There is too much fear that the global economy could slide into another recession, and too much uncertainty about the state of government budgets. Likewise, the equities and real-estate markets offer little prospect of relief, be-

cause the volatility of these investment classes has risen dramatically due to the uncertain economic outlook and the public-sector debt problems which have now assumed critical proportions. Another factor is that both Solvency II and the Swiss Solvency Test (SST) now require equities, hedge funds, private equity and other volatile investment classes to be backed with significantly more regulatory capital (over 50% of the total sum invested in some cases). Under these circumstances, Swiss Life CEO Bruno Pfister, for example, expects that life insurers will only be able to hold a maximum of 7% of their investments as equities in future. This further limitation imposes a structural restriction on the return potential from insurers' invest-

# SI Re – Mutually yours

## Sustainable, agile, committed

ments, thereby threatening to undermine one of the traditional cornerstones of their revenue.

What does all of this signify for (re)insurance companies' management teams? Essentially, it means that in the foreseeable future, revenue will have to be earned from the core business of insurance risk underwriting. Technical profitability, to which in many cases only lip service was paid in the past, is now becoming a strategic imperative. Apart from the difficult conditions pertaining to capital investments, other factors forcing the reinsurance industry to pay more attention to the profitability of new business include the renewed rise in catastrophe claims and the decrease in reserve releases. No matter which economic scenario is assumed, there is no alternative: another recession entailing sustained deflation would put reinsurers' investments under yet more pressure, while prospects of new investments and premium growth would become even gloomier. If, on the other hand, we assume an economic recovery accompanied by a rapid surge in inflation, many reinsurers' loss reserves could soon prove to be inadequate.

Whichever way we care to look at it, the fact is that maximum possible technical profitability has to be the goal when new business is acquired. This presents no fundamental difficulties for most reinsurers, as long as they are prepared to abandon loss-making market shares. In their endeavours to achieve technical profitability, reinsurers benefit from the lack of correlation between their technical results and general economic developments. An economic slump does not affect the frequency or severity of natural catastrophes and most other insured events. Even under difficult conditions, therefore, reinsurers themselves have the wherewithal to remain attractive to investors and to achieve the sound results in their core business that will ultimately enable them maintain their role as a cornerstone of risk management.

Figure 1 shows that the technical results of the forty largest reinsurers have remained largely independent from overall economic performance by the developed countries in the last fifteen years. The downward trend of technical results since 2006 is also clearly visible.

FIG. 1: NO CORRELATION BETWEEN THE TECHNICAL REINSURANCE RESULT AND THE ECONOMIC OUTPUT OF THE ADVANCED ECONOMIES

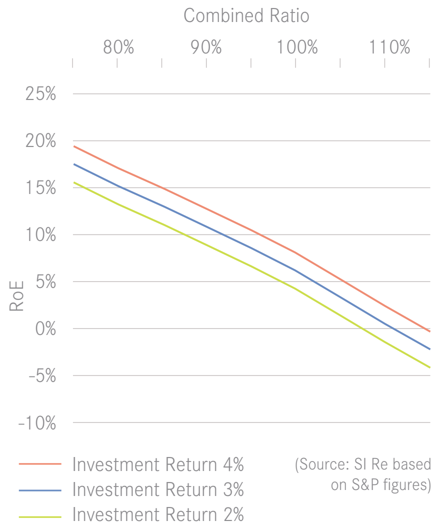

However, it remains to be seen whether reinsurers embrace the idea of shedding loss-making business. All too frequently in the past, market shares have been acquired or defended under technically irresponsible conditions. Anyone following such a policy is gambling on a rapid improvement in the investment environment. But a reinsurer who loses this bet may find its very existence in jeopardy.

Figure 2 clearly shows that technical profitability is an imperative. With a return on investments of 2% (which corresponds approximately to the current yield from ten-year German government bonds), a reinsurer must achieve a combined ratio (i.e. the ratio of claims and other costs to premium income) of well under 90% in order to offer a return of at least 10% on its shareholders' capital.

© Hannes Bok, detail of «Dolce Vita»

Furthermore, European insurers will be particularly reliant on support from investors in the coming years. Whether or not it is regarded as correct and appropriate, the supervisory authorities are attempting to make the insurance sector «stormproof» by increasing capital requirements. In doing so, of course, they have the somewhat inglorious experiences of the recent past in mind: in 1998, they «missed» the insolvency of Russia, which forced the Long-Term Capital Management (LTCM) hedge fund to its knees and unleashed major turmoil in the global economy. Their radar also failed to pick up the huge risk positions held by the banks and by some insurers which since 2004 they had build up in structured and derivative products, based on real estate (such as credit default swaps). So everything points to an increase in the average solvency requirements (for more on this, see Steps 1/2010). In these circumstances, any players who can retain the trust of their investors and hence their financial flexibility should emerge from the contest as clear winners.

FIG. 2: THE RELATIONSHIP BETWEEN THE COMBINED RATIO AND RETURN ON EQUITY




# SIGNAL IDUNA Group on course for success

The SIGNAL IDUNA Group, our parent company, can look back on its long and the latest phase of its corporate history with pride and satisfaction. In 2009 alone, this bancassurance group (whose four umbrella companies are mutual insurance firms) was able to increase its premium income by 14.2% to EUR 5.27 billion through mergers, acquisitions and internal growth. This trend is continuing in 2010: in the first five months, premiums written by our Dortmund and Hamburg based Group rose by a further 15.6% compared to the prior year. In the 2009 financial year, expenses for insurance claims rose by a mere 7.4%. So despite the financial crisis, these achievements led to an increase of almost 29% in the operating result, which climbed to EUR 771 million. The investments and account deposits managed by the Group (including its financial subsidiaries) grew by over ten billion euros in 2009 to a total of some EUR 50.6 billion. The Group's Chief Executive Officer, Reinhold Schulte assessed these results with satisfaction: «2009 was a good year, and an exciting one. The Group stands on very solid and reliable foundations.»

Our growth comes as no surprise to industry insiders. In 2009, our Group, whose headcount has risen to 13,600, joined the ranks of Germany's ten largest insurers for the first time. According to a headline in Handelsblatt published following our balance-sheet press conference in June this year, the SIGNAL IDUNA Group is among the fastest-expanding insurance companies in Germany.

Our group benefited strongly also from the reorganisation of the Deutscher Ring Group. After the Bâloise Group decided to insulate its Deutscher Ring property and life companies from the remainder of Deutscher Ring in November 2008, the Deutscher Ring Krankenversicherungsverein (health insurance association), a mutual insurance company like

SIGNAL IDUNA, joined the SIGNAL IDUNA Group in April 2009. Agreement was reached with the Bâloise Group in June 2010 regarding the separation of Deutscher Ring. De facto, this agreement adds another 250 field service staff to the SIGNAL IDUNA Group's sales force, and makes the insurance mutual the majority shareholder in the OVB Holding brokerage firm.

Our Group is well aware that the foundations for the successful expansion of recent years were laid by the merger between the SIGNAL insurance companies and the IDUNA NOVA Group to form the SIGNAL IDUNA Group in 1999. A number of other companies have joined the SIGNAL IDUNA Group since then. But as our CEO, Reinhold Schulte, explains, the SIGNAL IDUNA Group is not targeting size at any price. «In the future too, we shall continue to seek out selected partners who are a good strategic fit for our firm. The Group has significantly consolidated its position on the insurance market, and it shows particular strength as a bancassurance group that is successfully able to integrate insurance companies «as well as financial service providers.»

## THE SIGNAL IDUNA GROUP

The SIGNAL IDUNA Group is an economic alliance of various individual companies in Germany. The controlling companies of the SIGNAL IDUNA Group are:

- SIGNAL Krankenversicherung a. G., Dortmund (health insurance)
- IDUNA Vereinigte Lebensversicherung aG für Handwerk, Handel and Gewerbe, Hamburg (life insurance)
- SIGNAL Unfallversicherung a. G., Dortmund (accident insurance)
- Deutscher Ring Krankenversicherungsverein a. G., Hamburg (health insurance)

These controlling companies are mutual insurance companies under the same management, and they form what is known as a «horizontally organised group» (Gleichordnungskonzern) under German law.

The companies in the SIGNAL IDUNA Group are legally autonomous. They adopt a uniform approach at both strategic and operational levels, because the same individuals are sometimes members of their various boards of directors, supervisory boards and workforces, and also because they have formed joint working groups and organisational partnerships.

The SIGNAL IDUNA Group has two headoffices in Germany: one in Dortmund and one in Hamburg.

In the financial services sector, the Group includes a private bank, a building society, an investment company and an asset management company.

The SIGNAL IDUNA Group is represented in Europe by insurance companies in Hungary, Poland and Romania and by a reinsurance company in Switzerland.

Group figures (insurance) totalled as per HGB:

| in EUR millions | 2009 | 2008 |
|---|---|---|
| Premiums written, gross | 5 274 | 4 617 |
| Health | 2 578 | 2 006 |
| Life | 1 536 | 1 452 |
| Composite | 1 160 | 1 159 |
| Result from investments | 1 556 | 1 207 |
| Net interest (%) | 4.1 | 3.6 |
| Loss and loss-adjustment expenses, gross | 4 427 | 4 123 |
| Operating result | 771 | 599 |
| Appropriation of profit (clients) | 622 | 467 |
| Result before tax | 149 | 131 |
| Result after tax | 70 | 60 |
| Investments | 37 807 | 33 242 |

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