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## Talanx Primary Insurance Group

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# Talanx Primary Insurance Group

Please note that the ratings covered by this full analysis apply only to core entities of the Talanx Primary Insurance Group (TPG), which are listed below. These ratings do not apply to any noncore or unrated entities of TPG. Ratings assigned to noncore entities of TPG are published individually.

## Major Rating Factors

### Strengths:

- Strong competitive position
- Strong operating performance
- Very conservative management of non-life loss reserve confidence levels

### Weaknesses:

- High complexity of organizational structure
- Challenge to translate the potential from the HDI-Gerling/Aspectra life insurance division into a competitive strength

<b>Holding Company:</b> Talanx AG
<b>Counterparty Credit Rating</b> <i>Local Currency</i> A-/Stable/--
<b>Operating Companies Covered By This Report</b>
<b>Financial Strength Rating</b> <i>Local Currency</i> A+/Stable/--

## Rationale

The ratings on the various primary insurance subsidiaries of Germany-based Talanx AG, which include the HDI-Gerling operations, are based on the financial strength of the consolidated Talanx primary insurance group (TPG). In Standard & Poor's Ratings Services' view, TPG benefits from a strong competitive position, strong operating performance, and conservative management of non-life loss reserve confidence levels. These strengths are partly offset by the challenge to translate the potential from the HDI-Gerling/Aspectra life insurance division into a competitive strength and by TPG's highly complex organizational and management structure.

TPG's competitive position is strong, in our view, supported by a sound franchise in industrial lines business and a market-leading position in the German non-life insurance market. During the soft market cycle, TPG has, in our view, demonstrated competitive strength by defending its market position while maintaining underwriting profitability. In addition, TPG's business and earnings profile benefits from diversification potential added by lower-risk property/casualty business with small and midsize enterprises (SMEs) and from its top-five position in the German life insurance market.

Despite the capital market disruption, TPG's operating performance, based on results according to International Financial Reporting Standards (IFRS), remained strong in 2008, reflected in an overall return on equity (ROE) of about 10%. TPG benefited from a strong non-life underwriting performance and a prudent investment strategy. The non-life combined ratio of 95% and the return on revenue (ROR) of 16.3% were well above our expectations. However, profitability in life insurance, based on market-consistent embedded-value results, deteriorated in 2008, reflecting the high proportion of interest-sensitive life insurance products. Both, the operating return on embedded value and the new business margin based on the present value of new business premiums (PVNBP) were well below the expected 10% and 3%.

In our view, TPG's very strong management of non-life reserving practices and its conservative confidence levels

reduce earnings volatility and enhance TPG's capital base. This conclusion is based on our review of TPG's non-life loss reserves at year-end 2007.

TPG faces the challenge of translating the potential from the HDI-Gerling/Aspecta life insurance operations into a competitive strength. In 2008, the HDI-Gerling/Aspecta division recorded a decline in new business premiums--based on the annual premium equivalent--of 23% compared with an increase of 6.7% on average in the market. The division was affected by the significant decline in demand for unit-linked products during the capital market crisis. In addition, sales through the broker distribution channel decreased because of the implementation of the EU intermediary directive, which largely used up marketwide broker capacities.

TPG's organizational structure is, in our view, highly complex, with four subholdings under Talanx AG (A-/Stable/--), each heading one of the different business segments. In addition, each of the subholdings is coordinated and administered by its own service company. TPG's decentralized approach, with a large number of separate legal entities, may, in our opinion, affect the ability to fully maximize synergies and to effectively manage and allocate capital throughout TPG. It is our view that the highly complex organizational and management structure could lead to a competitive disadvantage relative to major peers, who are currently streamlining their organizations by transferring business to only a reduced number of risk carriers.

## Outlook

The stable outlook reflects our expectation that the enlarged TPG group will continue to translate its strong and improved competitive position in non-life insurance into continuously robust earnings. The segment is likely to deliver EBIT of about €250 million in 2009. The non-life combined ratio should, in our view, remain at less than 98% and the ROR should exceed 10% on average, in the absence of extraordinary catastrophes. On the life side, we expect TPG to improve its competitive position by better exploiting its large customer base, HDI-Gerling/Aspecta's distribution network, and the considerable business potential of its bancassurance partnerships. Given their high sales potential, both HDI-Gerling/Aspecta and the bancassurance division should, in our view, outperform the market with regard to the development of new business premiums and gross premiums written (GPW) in 2009 and 2010. Overall, we believe the life insurance segment should continue to deliver strong contributions to TPG's IFRS profit, reflected in an EBIT of between €150 million and €200 million in 2009. In a slowly recovering economic environment, life insurance profitability--based on embedded-value results--should gradually improve. We expect this to be reflected in an increase in the new business margin to about 2% of the PVNBP by 2010, with an increasing contribution from the value of new business to the value in force. The operating return on embedded value should exceed 10%.

Against the background of the currently difficult operating environment, we expect TPG's consolidated net income to remain largely stable at about €300 million and the posttax ROE at about 10% in 2009, with prospects for further improvement in 2010. Capitalization should also remain strong, benefiting from retained earnings.

We may revise the outlook to negative if TPG were to significantly underperform relative to earnings and capitalization targets. Downside pressure on the ratings could also occur if the competitive position of the life operations were to deteriorate, reflected in a continuing decline in new business volumes and loss of market share. Upside potential is remote at this stage.

## Corporate Profile: A Leading Industrial And Group-Life Insurance Player

Talanx AG is the intermediate management holding company of the Germany-based Talanx group, which includes TPG, the fourth-largest primary insurance group in Germany, and Hannover Re, the world's fourth-largest reinsurer in terms of GPW. Hannover Re's main operating entity is Hannover Rueckversicherung AG (AA-/Negative/--).

Following Talanx AG's 2006 acquisition of the primary insurance operations of the Germany-based Gerling group and the merger of various HDI and Gerling operations, the combined HDI-Gerling non-life business was allocated to the following operations:

- HDI-Gerling Industrie Versicherung AG (HG-Industrie, A+/Stable/--) focuses on industrial line business;
- HDI Direkt Versicherung AG (HDI Direkt; A+/Stable/--) conducts standard business with private customers;
- HDI-Gerling Firmen und Privat Versicherung AG (HG-FP; A+/Stable/--) handles the remaining portion of personal lines and SME business; and
- Various foreign HDI-Gerling insurance operations mainly in Europe, Turkey, the U.S., and Middle and South America under HDI-Gerling International Holding AG (not rated).

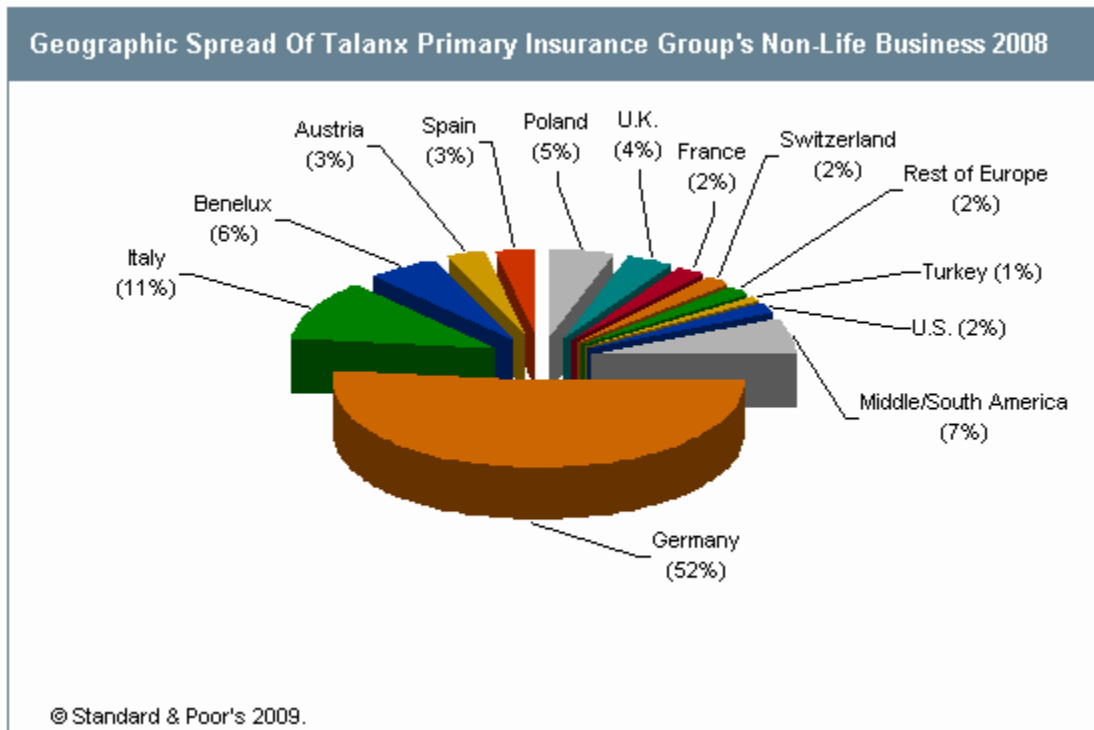
HG-Industrie, HDI Direkt, and HG-FP are wholly owned subsidiaries of Talanx AG and represent core parts of TPG's insurance operations. HDI-Gerling Lebensversicherung AG (A+/Stable/--) and Aspecta Lebensversicherung AG (Aspecta; A+/Stable/--) together form TPG's life insurance arm, in addition to the bancassurance division.

The bancassurance division consists of CiV Lebensversicherung AG (A/Stable/--), the exclusive cooperation partner of Citibank; neue leben Lebensversicherung AG (A+/Stable/--), which sells life insurance products through major savings banks; and PB Lebensversicherung AG and PBV Lebensversicherung AG (both rated A/Stable/--), the exclusive insurance cooperation partners of Deutsche Postbank AG (A-/Positive/A-2) and building savings bank BHW Bausparkasse AG, Hameln (BBB+/Positive/A-2).

HDI Haftpflichtverband der Deutschen Industrie VaG (A+/Stable/--), a mutual insurance company, is TPG's ultimate owner and does a small degree of business through its coinsurance activities with HG-Industrie.

TPG benefits from a broad range of sales channels, including tied agents, independent financial advisers, banks, brokers, and affinity group marketing.

The primary insurance operations currently contribute about 60% of the Talanx group's consolidated gross premium income. TPG's annual GPW reached €11.6 billion in 2008, with the non-life and life insurance segments contributing almost equally to overall premiums. Business generated in Germany contributed more than 90% of life GPW and about 52% of non-life GPW. The remaining 48% of non-life business stemmed from Southern and Western Europe (33%), followed by South America (7%), Poland (5%), Turkey (1%), and the U.S. (2%).



## Competitive Position: One Of The Top Five Insurance Groups In Germany

Table 1

<b>Talanx Primary Insurance Group/Business Statistics</b>					
	<b>--Year ended Dec. 31--</b>				
<b>(Mil. €)</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>Consolidated (Primary group)</b>					
Total gross premiums written	10,507	10,422	9,518	6,005	5,200
Annual change (%)	0.8	9.5	58.5	15.5	24.3
Total net premiums written	7,981	7,523	7,011	4,196	3,429
Annual change (%)	6.1	7.3	67.1	22.4	35.6
Total assets under management	67,800	65,689	63,238	37,096	33,845
Nonlinked (%)	57.0	53.7	56.9	40.3	47.3
Linked (%)	5.0	6.6	5.5	4.9	3.3
Third-party funds (%)	38.0	39.7	37.6	54.8	49.4
<b>Non-life*</b>					
Gross premiums written	5,905	6,011	5,632	3,537	3,423
Annual change (%)	(1.8)	6.7	59.2	3.3	8.7
Net premiums written	3,931	3,689	3,470	2,175	1,913
Annual change (%)	6.5	6.3	59.5	13.7	11.1
<b>Net premiums written by line of business (%)</b>					
Accident and health	6.1	3.6	5.6	5.4	5.9

Table 1

Talanx Primary Insurance Group/Business Statistics (cont.)					
Motor	43.0	37.8	50.6	57.8	58.0
Marine, aviation, and transport	10.1	6.8	7.0	3.5	3.5
Property	16.0	25.3	22.0	14.0	15.1
Liability	18.2	21.9	8.7	10.2	9.4
Credit	0.8	0.5	0.9	1.5	0.6
Inward reinsurance	5.8	4.1	5.2	7.6	7.5
<b>Life*</b>					
Gross premiums written	4,610	4,410	3,885	2,498	1,803
Annual change (%)	4.5	13.5	55.6	38.5	69.2
<b>Analysis of gross premiums written (%)</b>					
Endowment	32.6	32.6	32.2	30.5	33.3
Annuities	35.7	36.8	36.5	35.3	27.8
Term	3.4	2.6	3.0	2.0	2.3
Disability	4.7	1.8	1.5	1.3	4.1
Unit linked	18.6	18.5	14.4	14.9	13.5
Credit life	5.0	7.7	12.4	16.0	19.1

\*From 2007, new segmentation according to IFRS. Allocation of Italian life business to non-life and accident business from bancassurance to life.

TPG's competitive position is strong. The integration of the Gerling operations was successfully completed in 2008 and has enhanced TPG's strong competitive position, mainly in the German primary insurance sector, by adding scale and diversity to TPG's business portfolio, distribution capacities, and customer base. Additional diversification potential mainly results from an increase of lower-risk property/casualty business with SMEs and from life insurance. In property/casualty insurance, TPG has developed its competitive strength by exploiting the combined expertise and capacities of HDI's and Gerling's operations. In life insurance, however, TPG is still struggling to translate the additional know-how and resources into a meaningful competitive advantage.

#### Non-life insurance: Selective underwriting in a soft market

In the non-life segment, TPG benefits from the excellent expertise and customer relationships of both HDI and Gerling. In its most important market, Germany, which accounts for 52% of TPG's total GPW, TPG has enhanced its standing as a reliable provider with essential market capacity. TPG ranks No. 2 in the domestic market with a market share of 6.5%, and leads the market for industrial lines and motor business. The non-domestic business contributes about 48% to TPG's total premiums income. Outside Germany, TPG underwrites predominantly industrial lines and motor business in various countries, mainly in Europe and Latin America. TPG benefits from additional Gerling platforms for international business to serve industrial customers abroad. Across geographic regions, TPG has built a strong franchise in industrial lines business, which accounts for 41% of TPG's total non-life GPW. TPG claims to maintain business relationships with 70% of the Euro Stoxx firms and 97% of the DAX-listed companies, with a high proportion of lead and exclusive mandates. During the soft market cycle, TPG has demonstrated competitive strength by maintaining underwriting profitability without recording major losses in premium volume. As an example, GPW from non-life insurance decreased only slightly by 1.5% to €5.9 billion in 2008, and the combined ratio remained significantly below 100%.

### **Life insurance: Additional business potential of Gerling yet to be realized**

TPG, with its two divisions--HDI-Gerling/Aspecta and bancassurance--ranks No. 4 in the German life insurance market. With GPW of €5.9 billion in 2008, the life insurance segment contributed about 49% of TPG's total premium income for the year.

However, TPG has not yet fully taken advantage of the additional life insurance capacities provided by the Gerling operations. In 2008, the HDI-Gerling/Aspecta division recorded a sharp 23.5% decrease in new business premiums based on the annual premium equivalent, compared with an increase of 6.7% on average in the market. After adjusting for the one-time impact of the "Riester" pension business, the decrease was 28.5%, still substantially higher than the market average decline of 13.2%. The HDI-Gerling/Aspecta division was disproportionately affected by the deterioration of demand for unit-linked products, which is Aspecta's domain. In addition, the division suffered from lower sales through insurance brokers, which represents one of TPG's main distribution channels. Broker capacities were largely absorbed, due to the implementation of the EU's directive to regulate insurance intermediaries. So far, TPG has not been able, in our view, to use its enhanced position in the German group-savings business and its close links with the corporate sector to offset lower broker sales and unit-linked business through increased sales of customized products, pension consulting, and administration services.

In the first quarter of 2009, sales remained under pressure, in line with the overall development in the German life insurance market as a result of the difficult economic environment.

The bancassurance division benefits from partnerships with Citibank, Deutsche Postbank, and more than 90 members of the widespread network of independent German savings banks. This division recorded overall new business growth of 14.9% in 2008, including the one-time impact of Riester pension business, outperforming the market. Excluding the one-time Riester effect, new business premiums decreased by only 0.4%, which is substantially better than the market average. Growth stemmed mainly from TPG's partnerships with the savings banks and Postbank, which largely benefited from the sale of Riester pension products. However, the positive development seen in 2008 did not continue in the first five months of 2009. This is because bancassurance distribution has been adversely affected by difficult economic conditions and sluggish Riester product sales. In addition, Citibank's and Postbank's sales capacities have been restricted, owing to the banks' focus on realigning their own operations under new shareholders.

### **Prospective**

We expect TPG to defend its strong and enhanced competitive position in non-life insurance by focusing on volume growth in its most profitable segments. We believe TPG should further benefit from its excellent know-how, sound underwriting, and sales capacities in industrial lines business and from exploiting its substantial diversification and synergy potential. Because fierce competition in the German motor insurance industry is likely to continue in 2009, and the recovery of premium rates in industrial lines business will only become effective at the end of the year, we expect TPG to record a decline of GPW of up to 5%.

In life insurance business, we expect TPG to build its competitive position by better exploiting its large customer base, HDI-Gerling/Aspecta's distribution network, and the high business potential of its bancassurance partnerships. The bancassurance division should be able to outperform the market with regard to new business and premiums development in 2009 and 2010. Nevertheless, we consider TPG's target of doubling HDI-Gerling/Aspecta's new business volume by 2012 to be highly challenging, in particular, given the expectation of a rather slow economic recovery. The bancassurance division's new business development is, in our opinion, likely to slow in 2009. This is

because of the economic turmoil as well as uncertainties about the strategic direction of Citibank's and Postbank's new owners and the potential impact on the insurance operations. Nonetheless, we expect sales development to outperform the market average in 2009. The strong integration of TPG's life insurance business into the banks' operations and the long-term character of the cooperation agreements (Citibank until 2025 and Postbank until 2022) should safeguard TPG's interests and financial position prospectively.

## **Management And Corporate Strategy: Gerling Integration Successfully Completed, But The Group's Structure Is Highly Complex**

TPG's strategy and operational management support the ratings. The legal and organizational integration of the Gerling operations was successfully completed in 2008. We believe that TPG has managed to combine the distinct corporate cultures and traditions of the two groups. TPG's organizational and management structure, however, has become highly complex, with four subholdings under the umbrella of Talanx AG, each heading one of the different business segments. We are concerned that the complex structure could lead to a competitive disadvantage relative to major peers that are currently streamlining their organizations by transferring business to a lower number of risk carriers. Additional execution risks could result from further potential acquisitions, which management might consider if suitable opportunities arise.

### **Strategy: Gerling acquisition supports potential flotation**

Management follows a profit-oriented growth strategy to sustainably strengthen TPG's capital base and enhance shareholder value. This strategy includes the willingness to temporarily lose market share during cyclical downturns. The Gerling acquisition, in our view, supports management's long-term goal of positioning TPG for a potential flotation of up to 49.9% of Talanx AG's shares, by building up a less volatile and more balanced groupwide portfolio of reinsurance and primary insurance business.

### **Operational management: Successful execution track record, but a very complex organizational structure presents increasing challenges**

So far, operational management has, in our view, been a rating strength, supported by executive management's clear commitment to value creation and market discipline throughout the underwriting cycle and underpinned by a track record of achieving strategic objectives and financial targets. Nevertheless, we believe that TPG's decentralized management approach may affect its ability to fully maximize synergies. TPG includes four subholdings, each heading one of the following divisions: non-life domestic and international business, life, bancassurance, and asset management. The four divisions are coordinated and administered by three different service units. We are concerned that this highly complex structure could affect TPG's ability to maintain competitiveness regarding costs and efficiency relative to peers and to effectively allocate capital, given the large number of different legal entities, which are to a great extent regulated.

### **Financial management: A solid financial profile that is consistent with the rating**

We consider TPG's financial profile strong. Management's conservative financial policy has, in our view, comfortably preserved TPG's strong capitalization and financial leverage in line with the current rating. We expect TPG's underwriting, investment, and reserving strategies to remain conservative. We also expect TPG to maintain its solid financial management, despite further potential acquisitions.

Management's objective is for TPG to rank among the five most profitable European insurance groups, based on the return on IFRS equity. TPG's targeted ROE is a minimum of 750 basis points above the prevailing risk-free return

for 10-year German government bonds. To achieve this target, top management has introduced a comprehensive capital and performance management approach, focusing on intrinsic value creation under consideration of risk-capital requirements.

## Enterprise Risk Management: Adequate With A Positive Trend

TPG's enterprise risk management (ERM) is, in our view, adequate with a positive trend and has the potential to become strong over the next 2-3 years. We do not expect TPG to experience losses from traditional risk areas outside of the normal range. Over the past two years, TPG has made good progress in developing strategic risk management by implementing a risk-and-value-based performance measurement approach. ERM is of high importance to the rating on TPG. TPG operates in complex and potentially volatile business lines and is highly exposed to the competitive German insurance market.

The main factors supporting our overall assessment of TPG's ERM are risk controls, which we consider to be strong for TPG's most significant risks. The effectiveness of these controls appears to have been proven through TPG's sound track record of sustained strong earnings, even in less benign capital-market and claims environments.

TPG's risk-management culture is still adequate, in our view, although progress has been made to establish a holistic approach across all levels of TPG. A consistent groupwide risk-management framework is in place. The local operating entities are responsible for risk management, which is based on individual guidelines and limits for the various risk types. For the most significant risks, however, TPG has implemented central management and control through its risk-management team.

Credit risk and market-risk controls relating to investments are strong. These risks are centrally monitored, reported, and controlled by TPG's internal asset manager AmpegaGerling, based on entity-specific investment guidelines. In addition, group risk management manages and controls credit risk accumulations centrally.

We also consider asset-liability management (ALM) risk controls to be strong. ALM committees are in place at all of TPG's major entities and at the Talanx group level. They are responsible for defining the framework for strategic asset allocation, monitoring asset allocation and risk exposures, and for implementing ALM measures. ALM risks are assessed using multiple metrics. Central oversight of ALM risk exposure is performed at the group level.

Property/casualty underwriting risk controls are adequate, in our view. Risk monitoring, controlling, and reporting processes are performed locally, based on entity-specific underwriting guidelines and within central risk management's guidelines. A consistent, groupwide approach to monitor, control, and report underwriting risks across all operational levels of the non-life entities has not yet been implemented.

Reserving risk controls are strong. Management has identified inadequate reserving as one of TPG's potentially largest risks. TPG's risk-management team monitors the group's claims reserves, which are set up by the actuaries at the local level using multiple actuarial methods. Claims reserves are also regularly reviewed by external actuaries.

Controls for natural catastrophe risk, including those relating to risk accumulation, are strong, in our view. TPG uses a variety of external models as well as its own data to monitor and assess this type of risk. At the local level, risk exposure is permanently monitored by country and zone. In addition, group risk management closely monitors and controls risk accumulation, one of TPG's most significant risks. So far, TPG has not yet experienced major losses from natural catastrophes.

We consider reinsurance risk controls to be strong because of the centralized management of reinsurance placements through TPG's inhouse reinsurance broker Protection Reinsurance Intermediaries AG (Protection Re). Reinsurance credit risk, one of TPG's most important risks, is subject to close monitoring and control through the group's risk management.

We consider emerging risk management to be adequate. TPG has implemented a systematic approach and specific processes to identify and assess emerging risks by using different scores for the level of severity.

We regard strategic risk management as adequate. TPG has made good progress in including risk capital and risk return considerations in its value-based management and performance measurement approach. TPG's internal risk-based capital model, which is currently used to determine risk positions and measure performance at group and entity levels, is still based on the standard model of the German Insurance Association, although adjusted for group specifics. The full and consistent entrenchment of risk and return aspects in TPG's strategic and operational management processes across all operating units and management levels is currently under way. We expect overall risk management to improve because TPG is planning to introduce a more sophisticated, holistic, and consistent economic capital model in the near future.

## Accounting: Good, But Late Disclosure Of Annual Results And Lack Of Public Interim Reporting

Talanx reported its consolidated 2008 financial statements, including the relevant subsidiaries of TPG and Hannover Re, in accordance with IFRS. In addition, Talanx and its German subsidiaries prepare separate financial statements under German generally accepted accounting principles. Furthermore, Hannover Re establishes and discloses its own consolidated financial statements based on IFRS. Accounting policies conform to industry standards and are conservative.

We consider financial communication and disclosure to be good. However, TPG publishes its annual results more than five months after the end of the financial year and does not yet disclose interim reports. Moreover, disclosure at the group level does not yet include market-consistent embedded-value information. However, we expect TPG to be in line with the current disclosure standards of major competitors in the near future.

Standard & Poor's has assessed TPG's capital adequacy on a pro forma basis. We adjusted the reported IFRS shareholders' equity by:

- Crediting 67% of the non-life loss reserve discount and 50% of the loss reserve redundancy not included in the balance sheet;
- Crediting deferred taxes on the equalization reserve;
- Including the free and unallocated portion of the policyholder bonus reserve in life insurance;
- Crediting 50% of the present value of future profits; and
- Deducting the posttax effect of the off-balance-sheet pension deficit.

Since 2007, we have evaluated the profitability of the life insurance business using market-consistent embedded-value calculations, which so far have not been publicly disclosed.

## Operating Performance: Remains Strong, Mainly Thanks To Property/Casualty Insurance

Table 2

(Mil. €)	--Year ended Dec. 31--				
	2008	2007	2006	2005	2004
<b>Consolidated (Primary group)</b>					
Total revenue (based on allocated investment income)	9,239	9,301	8,370	4,897	4,763
Core operating profit	566	382	413	517	592
Realized gains and losses/core operating profit (%)	46.1	17.5	(10.9)	13.6	108.2
Net income	351	176	376	503	539
Posttax return on equity (%)	10.1	6.1	6.7	13.1	24.4
Administrative expense ratio (%)	10.2	9.8	14.6	8.8	9.4
Acquisition expense ratio (%)	12.5	12.8	9.6	14.0	10.6
Nontechnical expenses/total revenue (%)	8.8	4.0	8.5	7.4	9.8
Nontechnical expenses/total assets (bps)	125	57	120	142	234
<b>Non-life*</b>					
Non-life revenue (based on allocated investment income)	4,236	4,206	3,792	2,338	2,025
Non-life operating result (based on allocated investment income)	271	240	353	340	191
Return on revenue (%) (based on allocated investment income)	6.4	5.7	9.3	14.5	9.4
Net loss ratio (%)	70.5	72.7	72.3	70.1	82.0
Net expense ratio (%)	24.5	27.1	20.5	20.1	13.3
Net combined ratio (%)	95.0	99.8	92.8	92.8	93.8
<b>Life*</b>					
Life revenue	4,985	4,903	4,496	2,537	1,909
Growth in net life technical reserves (%)	1.5	107.1	297.1	16.3	160.5
Pretax return on life assets (before bonus allocation) (bps)	312	363	184	232	375
Total net expenses/total assets (bps)	236	206	351	473	496
Maintenance expenses/gross premiums written (%)	5.0	4.1	6.8	6.3	8.2

\*From 2007, new segmentation according to IFRS. Allocation of Italian life business to non-life and accident business from bancassurance to life. bps--Basis points.

Operating performance has remained strong. Despite the capital market crisis, TPG's earnings were sound in 2008, resulting in a posttax ROE of about 10% and 12.6% on a five-year average. The impact of realized and unrealized losses and write-offs on investments was moderate at €580 million before allocation to policyholders. In light of the difficult operating environment, we expect TPG to record a net income of about €300 million in 2009 and to reach a posttax ROE of about 10%, with good prospects for further improvement in 2010. Adherence to underwriting discipline, a prudent investment strategy, and balanced risk exposure should support the achievement of targets. Property/casualty insurance has continued to fuel earnings, contributing about 46% of TPG's total EBIT of €566 million. The life segment accounted for 21% of EBIT.

**Non-life insurance: TPG's combined ratio likely to remain significantly lower than 100%**

We expect TPG's underwriting performance to remain strong in 2009, demonstrated by an estimated ROR of more than 10% and a combined ratio of less than 98% in the absence of extraordinary catastrophes. Overall, the quality of earnings should remain high, with very limited reliance on realized capital gains and supported by strong reserving practices and very conservative confidence levels. We expect the non-life segment to contribute between €200 million and 300 million to TPG's IFRS EBIT in 2009.

**Life insurance: Higher profit contributions indicate improved diversification potential**

TPG's EBIT from life business amounted to about €156 million in 2008. Given the currently difficult operating conditions, we expect IFRS earnings from the life insurance segment to range between €150 million and €200 million in 2009, but to gradually improve from 2010. This expectation is based on our assumption of a direct investment yield of about 3.5% and no material realized or unrealized losses or write-offs on investments in 2009. In 2008, the underlying performance of TPG's various life entities, however, was affected by the capital market crisis and a low-interest-rate environment. TPG's relatively high exposure to capital-market-sensitive traditional life insurance products resulted in a moderate operating return on embedded value and new business margin (based on the PVNBP), which were both well below our expectations of 10% and 3%, respectively.

We believe that improvements in life insurance profitability will largely depend on developments in the financial markets and on TPG's capability to shift new business uptake to less-capital-market-sensitive products. We expect the operating return on embedded value to exceed 10% and the new business margin to gradually improve to about 2% of PVNBP by 2010, assuming a slowly recovering economic and financial market environment. In addition, we expect a continuous, although moderate, increase of the contribution of the value of new business to the value in force.

**Investments: Prudent Investment Strategy Likely To Continue****Table 3**

<b>Talanx Primary insurance Group/Investment Statistics</b>					
	<b>--Year ended Dec. 31--</b>				
<b>(Mil. €)</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Net investment income	1,884	1,772	1,399	696	575
Direct yield on invested assets (%)	4.4	4.3	4.9	4.2	4.7
Yield (including realized gains) (%)	5.0	4.4	5.6	4.6	9.9
Total return (including realized gains) (%)	3.2	4.0	5.2	4.8	10.1
<b>Portfolio composition (%)</b>					
Investment in affiliates	3.4	1.5	1.6	2.9	4.1
Loans to affiliates	0.0	0.0	0.0	0.1	0.0
Bonds and other fixed-interest securities	70.3	72.8	73.2	67.4	73.9
Mortgages	3.0	3.4	3.5	0.9	0.6
Equities and other variable-interest securities	3.6	4.8	5.1	2.0	2.1
Property	2.2	1.2	1.7	2.1	2.7
Cash and bank deposits	6.5	3.4	5.9	14.5	14.0
Reinsurance deposits	0.3	0.4	0.4	0.7	1.0
Other investments	4.2	3.7	0.8	0.6	1.6

**Table 3**

<b>Talanx Primary insurance Group/Investment Statistics (cont.)</b>					
Total nonlinked investments	93.6	91.3	92.2	91.1	93.5
Assets held to cover linked liabilities	6.4	8.7	7.8	8.9	6.5

TPG's investment strategy is prudent, in our view, founded on a high-quality investment portfolio, good level of diversity, and a conservative management approach. About 62% of TPG's total investments of €46 billion are held in loans and receivables. TPG's investments mainly consist of government and semigovernment bonds as well as covered bonds.

### **Credit risk**

In our view, TPG's credit risk is low and the quality of the fixed-income portfolio is excellent: About 70% of the portfolio is invested in government, semigovernment, and covered bonds (mainly legislation-based instruments). More than 95% of TPG's investments have an average rating of 'A', of which 76% is rated 'AA' and higher.

### **Market risk**

Market risk from equities is manageable, in our view, when taking into account the relatively low proportion of equity and the hedging measures in place. Equity investments focus on European blue-chip shares. Market risk in property/casualty insurance also relates to a sudden and sharp increase in interest rates. Strong ALM management and the relatively short duration of TPG's bond portfolio in this segment mitigate market risk.

### **Asset-liability management**

We consider TPG's ALM to be strong and supported by effective hedging transactions that protect the traditional life insurance portfolios from falling interest rates.

## **Liquidity: Strong, Fueled By Sound Operating Cash Flows In Property/Casualty Insurance**

TPG's liquidity is sound, in our view. TPG has delivered a track record of strong positive operating cash flows in recent years. In addition, TPG's investment portfolio is highly liquid. TPG has access to a five-year standby credit facility of up to €1.5 billion, of which €950 million are still available after €550 million were used to finance TPG's acquisition of a 100% stake in BHW Versicherungen and the residual 50% of shares in Postbank Versicherungen (both rebranded PB Versicherungen). There appear to be no major liquidity needs relating to the repayment of hybrid capital in the near future.

## **Capitalization: Strong And Largely Unaffected By The Capital Market Disruption**

We consider TPG's capitalization and that of the entire Talanx group, including the reinsurance operations, to be strong and in line with the current rating level. Capital adequacy, based on our capital model, and quality of capital have remained strong, in our view. Despite the capital market disruption, there was no major negative impact from unrealized losses on equity. Capitalization has further benefited from robust retained earnings and very strong and conservative management of non-life reserve confidence levels. The statutory group solvency position remained equally strong at 153% at the end of 2008.

**Reserves: Very strong, with conservative confidence levels**

We consider non-life reserving to be very strong. In our view, the confidence level in TPG's loss reserves is very conservative. This conclusion is based on our review of TPG's non-life reserves at year-end 2007. In the past, TPG's conservative reserve position on its property/casualty portfolio was reflected in a track record of fairly stable underwriting results. Reserving for the Gerling portfolio is fully aligned with TPG's conservative groupwide reserving standards.

**Reinsurance: Conservative strategy**

TPG has maintained its conservative reinsurance policies. We estimate that the net retention for the property/casualty segment--including Gerling--will remain at about 70% prospectively. TPG channels almost all business ceded from primary insurance operations through its inhouse reinsurance broker, Protection Re, although Hannover Re still maintains its position as TPG's main reinsurer. Other contracting reinsurers remain of high quality and have a minimum rating of 'A'.

**Financial Flexibility: Strong, Backed By Ample Access To External Funding****Table 4**

Talanx Primary Insurance Group/Financial Statistics					
(Mil. €)	--Year ended Dec. 31--				
	2008	2007	2006	2005	2004
<b>Consolidated (Primary group)</b>					
Total assets	64,878	64,539	59,622	25,654	19,966
Total equity	3,974	2,959	2,772	2,638	2,634
Total equity (including policyholder capital)	6,023	5,173	4,682	2,896	2,764
Total capital	6,693	5,933	5,442	3,246	3,089
Debt and preferred stock/capital (excluding policyholder capital) (%)	16.9	20.4	21.5	14.4	11.0
Liquid assets/technical reserves (%)	128.6	126.0	127.5	123.1	132.8
<b>Non-life</b>					
Solvency ratio (net assets/net premiums written) (%)	52.9	82.3	80.9	91.6	74.7
Technical reserves/net premiums written (%)	217.7	240.2	250.2	168.4	166.9
Net technical reserves/gross technical reserves (%)	64.0	65.6	66.8	58.8	59.3
<b>Life</b>					
Reinsurance utilization (%)	12.1	13.1	11.6	12.5	15.9

In our view, TPG's financial flexibility (defined as the ability to source capital relative to capital requirements) is strong, given TPG's strong capitalization, ample liquidity, and robust earnings. TPG's access to external funding in case of need remains strong. The financial leverage and fixed-charge coverage ratios for the entire Talanx group, including Hannover Re, have remained in line with our guidelines for the rating category.

**Ratings Detail** (As Of August 6, 2009)\***Holding Company: Talanx AG**

Issuer Credit Rating

Local Currency

A-/Stable/--

Junior Subordinated (1 Issue)

BBB

**Ratings Detail** (As Of August 6, 2009)\* (cont.)**Operating Companies Covered By This Report****HDI-Gerling Industrie Versicherung AG**

Financial Strength Rating	
Local Currency	A+/Stable/--
Counterparty Credit Rating	
Local Currency	A+/Stable/--
Subordinated (1 Issue)	A-

**Aspecta Lebensversicherung AG**

Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--

**HDI Direkt Versicherung AG**

Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--

**HDI-Gerling America Insurance Co.**

Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--

**HDI-Gerling Firmen und Privat Versicherung AG**

Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--

**HDI-Gerling Lebensversicherung AG**

Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--
Junior Subordinated (1 Issue)	A-

**HDI Haftpflichtverband der Deutschen Industrie VaG**

Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--

**neue leben Lebensversicherung AG**

Financial Strength Rating	
Local Currency	A+/Stable/--
Issuer Credit Rating	
Local Currency	A+/Stable/--

<b>Domicile</b>	Germany
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**Ratings Detail (As Of August 6, 2009)\* (cont.)**

\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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