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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 group, which are listed below. These ratings do not apply to any noncore or unrated entities of the group. Ratings assigned to noncore entities of the group are published individually.

## Major Rating Factors

**Strengths:**

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

| **Operating Company Covered By This Report** |
|---|
| **Financial Strength Rating** |
| *Local Currency* |
| A+/Stable/-- |

**Weaknesses:**

- High exposure to the competitive German insurance market
- Uncertainty about the sustainability of its bancassurance model
- Execution risks in successfully integrating the Gerling operations.

## Rationale

The ratings on the various primary insurance subsidiaries of Germany-based Talanx AG, which include entities of the Gerling and HDI operations, are based on the financial strength of the consolidated Talanx primary insurance group (TPG). TPG benefits from its strong competitive position, strong operating performance, and conservative management of non-life loss reserve confidence levels. These strengths are partly offset by the group's high exposure to the competitive German insurance market, uncertainties about the sustainability of its bancassurance model, and remaining execution risks inherent in smoothly integrating the Gerling operations.

The acquisition of the Gerling group in 2006 has strengthened TPG's competitive position, resulting in its market leadership in industrial lines business. Gerling has also increased the group's diversification because it has a significantly stronger position in life insurance and business with small and midsize enterprises (SMEs). The integration of the Gerling life operations supports TPG's strategy to reduce its dependence on the volatile industrial lines and motor insurance segments.

After adjusting for one-time effects caused by the Gerling integration, TPG's operating performance remained strong in 2007 and basically in line with Standard & Poor's Ratings Services expectations. The return on equity (ROE) was close to 12%, the non-life combined ratio less than 97%, and return on revenue (ROR) was more than 10%. In addition, TPG met our profitability expectations in life insurance by recording a new business margin, which was well in line with the average of 2.5% to 3.0% of the present value of new business premiums disclosed by major competitors. Similarly, the operating return on embedded value exceeded our expectations of 10% significantly.

Very strong management of non-life reserving practices and conservative confidence levels reduce earnings volatility and enhance the group's capital base. This conclusion is based on our review of TPG's non-life loss reserves at year-end 2006.

The competitive German insurance market continues to be the main impetus for TPG's business profile. About 60% of the group's non-life business stems from the domestic market, which is suffering from high competition and softening rates, specifically in the industrial lines and motor insurance business. In life insurance, more than 90% of gross premiums written (GPW) are generated in the difficult and highly regulated German life insurance market.

Although the legal and organizational restructuring of the combined group has been completed, execution risks regarding the full operational integration and successful exploitation of the additional business potential still exist. The effect of these risks were evident in 2007, when TPG spent an additional €124 million in integration costs, new business growth fell to below the market average, and the core life operation HDI-Gerling Lebensversicherung AG (A+/Stable/--) lost some of its back-office staff. In our view, execution risks will continue to absorb much of management's attention, given the scale and complexity of restructuring as well as the distinct corporate cultures and traditions of the two groups. Furthermore, additional challenges could result from further acquisitions, which management is even prepared to consider in the short term, should opportunities arise.

Another constraint to the ratings is uncertainty regarding the sustainability of TPG's bancassurance model with Germany-based Citibank Privatkunden AG & Co. KGaA (Citibank; not rated), which is a subsidiary of Citigroup Inc. (AA-/Negative/A-1+), and Deutsche Postbank AG (Postbank; A-/Stable/A-2). The proposed sale of Citibank to Banque Fédérative du Credit Mutuel (BFCM; AA-/Watch Neg/A-1+) and the recent announcement that Postbank is up for sale have raised concerns that these transactions could hamper TPG's so far successful bancassurance model. Nevertheless, the strong integration of the group's life insurance business into the banks' operations and the long-term duration of the bancassurance cooperation agreements (Citibank until 2025 and Postbank until 2022) should safeguard TPG's interests and financial position.

## Outlook

The stable outlook reflects our expectation that the enlarged group will translate its strong and improved competitive position in non-life insurance into increasingly robust earnings. This expectation assumes that the integration process will be completed smoothly, without further unexpected integration expenses, delays, or loss of key talent or support staff. The non-life combined ratio should remain at less than 100% and ROR higher than 10% on average, in the absence of extraordinary catastrophes. On the life side, we expect TPG to build its competitive position by exploiting its enlarged customer base and distribution network to achieve new business development at least in line with the market average and strong profit contributions. The operating return on embedded value should exceed 10% and the new business margin should be close to 3% of the present value of new business premiums, with the value of new business increasing its contribution to the value in force. We expect consolidated earnings to remain strong, with a posttax ROE of close to 12% over the cycle. Capitalization should also remain strong, benefiting from sound retained earnings.

Standard & Poor's will closely monitor the completion of the integration process because the group's failure to enhance its competitive position through the additional business and synergy potential could have negative rating implications. We may revise the outlook to negative if the combined group were to significantly underperform relative to earnings and capitalization targets. Downside pressure on the ratings could also occur if the bancassurance model with Citibank and Postbank proved unsustainable under the new ownership of one or both distribution partners. 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 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 (main operating entity Hannover Rueckversicherung AG; AA-/Stable/--).

Following Talanx AG's 2006 acquisition of the primary insurance operations of the Germany-based Gerling group, Gerling-Konzern Lebensversicherung AG merged with HDI Lebensversicherung AG and was renamed to HDI-Gerling Lebensversicherung AG (HG-LV). Together with Aspecta Lebensversicherung AG (A+/Stable/--), HG-LV forms the group's life insurance arm in addition to the bancassurance division. In September 2007, the merger of Gerling-Konzern Allgemeine Versicherung AG with HDI Industrie Versicherung AG was completed and the new entity renamed HDI-Gerling Industrie Versicherung AG (HG-Industrie; A+/Stable/--). At the same time the portfolio of the combined HDI-Gerling non-life operations was allocated to three operations as follows: HG-Industrie focuses on industrial line business. Standard business with private customers is operated by HDI Direkt Versicherung AG (HDI Direkt; A+/Stable/--), which represents the former HDI Privat Versicherung AG. The remaining portion of personal line and the small and medium enterprise (SME) business was taken over by HDI-Gerling Firmen und Privat Versicherung AG (HG-FP; A+/Stable/--), that is, the former ASPECTA Versicherung AG. HG-Industrie, HDI Direkt, and HG-FP are wholly owned subsidiaries of Talanx AG and represent core parts of TPG's insurance operations. In 2007, TPG also enhanced its bancassurance segment by acquiring the remaining 50% stake in Postbank and 100% of the Germany-based BHW Lebensversicherung AG.

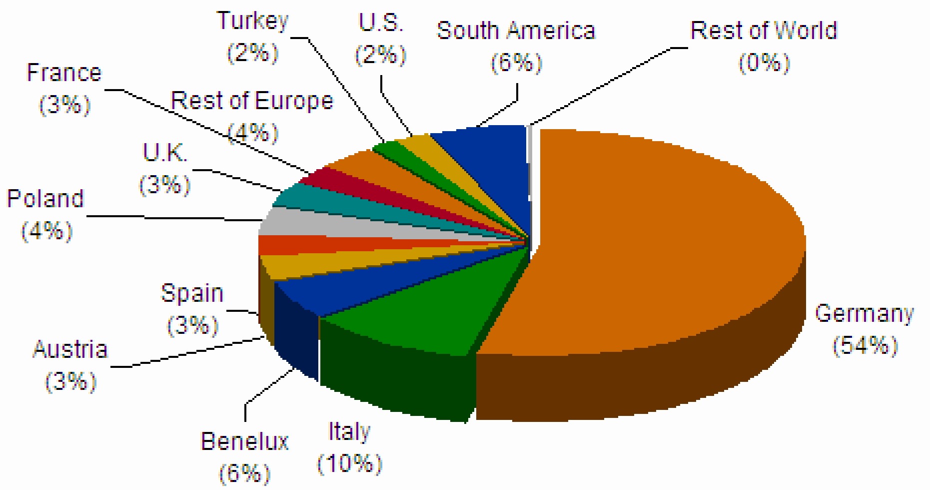
HDI Haftpflichtverband der Deutschen Industrie VaG (HDI VaG: A+/Stable/--), a mutual insurance company, is the group's ultimate owner and does a small degree of business through its coinsurance activities with HG-Industrie.

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

The acquisition of Gerling's primary insurance operations has raised the relative contribution of these activities to more than one-half of the group's consolidated gross premium income. Before the acquisition, reinsurance dominated, accounting for up to 70% of total GPW on a fully consolidated basis. TPG's annual GPW reached €11.4 billion in 2007, 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 54% of non-life GPW. The remaining 46% of non-life business stemmed from Southern and Western Europe (32%)--mainly Benelux, Italy, Spain and Austria--Poland (4%), Turkey (2%), the U.S. (2%), and South America (6%).

**Chart 1**

Geographic Spread Of Talanx Primary Insurance Group's Non-Life Business 2007




Subtotal for Europe excl. Germany is 36.1%.



## Competitive Position: Gerling Integration Enhances TPG's Very Strong Competitive Position

**Table 1**

**Talanx Primary Group/Business Statistics***

| | --Year ended Dec. 31-- | | | | |
|---|---|---|---|---|---|
| **(Mil. €)** | **2007** | **2006** | **2005** | **2004** | **2003** |
| **Consolidated (primary group)** | | | | | |
| Total gross premiums written | 10,422 | 9,518 | 6,005 | 5,200 | 4,182 |
| Annual change (%) | 9.5 | 58.5 | 15.5 | 24.3 | 7.7 |
| Total net premiums written | 7,523 | 7,011 | 4,196 | 3,429 | 2,528 |
| Annual change (%) | 7.3 | 67.1 | 22.4 | 35.6 | 6.2 |
| Total assets under management | 65,689 | 63,238 | 37,096 | 33,845 | 22,797 |
| Nonlinked (%) | 53.7 | 56.9 | 40.3 | 47.3 | 37.9 |
| Linked (%) | 6.6 | 5.5 | 4.9 | 3.3 | 2.6 |
| Third-party funds (%) | 39.7 | 37.6 | 54.8 | 49.4 | 59.5 |
| **Non-life*** | | | | | |
| Gross premiums written | 6,011 | 5,632 | 3,537 | 3,423 | 3,149 |

**Table 1**

| Talanx Primary Group/Business Statistics*(cont.) | | | | | |
|---|---|---|---|---|---|
| Annual change (%) | 6.7 | 59.2 | 3.3 | 8.7 | 5.8 |
| Net premiums written | 3,689 | 3,470 | 2,175 | 1,913 | 1,721 |
| Annual change (%) | 6.3 | 59.5 | 13.7 | 11.1 | 2.0 |
| **Net premiums written by line of business (%)** | | | | | |
| Accident & health | 3.6 | 5.6 | 5.4 | 5.9 | 3.0 |
| Motor | 37.8 | 50.6 | 57.8 | 58.0 | 58.6 |
| Marine, aviation and transport | 6.8 | 7.0 | 3.5 | 3.5 | 3.4 |
| Property | 25.3 | 22.0 | 14.0 | 15.1 | 16.3 |
| Liability | 21.9 | 8.7 | 10.2 | 9.4 | 10.2 |
| Credit | 0.5 | 0.9 | 1.5 | 0.6 | 0.6 |
| Inward reinsurance | 4.1 | 5.2 | 7.6 | 7.5 | 7.9 |
| **Life*** | | | | | |
| Gross premiums written | 4,410 | 3,885 | 2,498 | 1,803 | 1,066 |
| Annual change (%) | 13.5 | 55.6 | 38.5 | 69.2 | 17.5 |
| **Analysis of gross premiums written (%)** | | | | | |
| Endowment | 32.6 | 32.2 | 30.5 | 33.3 | 19.3 |
| Annuities | 36.8 | 36.5 | 35.3 | 27.8 | 18.4 |
| Term | 2.6 | 3.0 | 2.0 | 2.3 | 0.7 |
| Disability | 1.8 | 1.5 | 1.3 | 4.1 | 2.3 |
| Unit linked | 18.5 | 14.4 | 14.9 | 13.5 | 19.8 |
| Credit life | 7.7 | 12.4 | 16.0 | 19.1 | 39.4 |

*From 2007, new segmentation in line with IFRS (allocation of Italian life business to non-life; allocation of accident business from bancassurance to life business); 2006 figures adjusted accordingly.

With the acquisition of Gerling, TPG has further enhanced its strong competitive position in the German primary insurance sector, increasing business, distribution, and customer diversity as well as market share in key areas. These strengths are partly offset by the group's continued exposure to the competitive German insurance market. Furthermore, the sustainability of TPG's bancassurance model with Citibank and Postbank is unclear, following announcements about the proposed sale of both banking cooperation partners.

### Non-life insurance: Lower premium income, mainly due to the exit from unprofitable business in a soft market environment

The enlarged group has become the market leader in the German industrial lines business, with this segment accounting for about 46% of total GPW in property/casualty insurance. TPG should benefit further from the excellent expertise and relationships of both Gerling and Talanx in this business segment and so enhance its standing as a reliable provider with essential market capacity. The integration of Gerling has provided additional diversification potential by increasing the proportion of SME business in the domestic property/casualty business to 16% from 3%. The private lines segment is likely to expand, thanks to direct access to the workforce of the industrial clients.

With GPW of about €2.8 billion or 46% of the total property/casualty premium income, Gerling has provided the group with its own platforms for international business to serve industrial customers abroad. In 2007, TPG included the full-year premiums of the Gerling business for the first time, after consolidating only the nine-month figures for

2006. If Gerling's full-year premium income had been included in the 2006 consolidated accounts, TPG's 2007 GPW would have shown a decrease of 11% from the previous year, or 6.4% if adjusted for one-time effects. This compares with a decline of only 0.4% for the market. The premium decline resulted from the group's exit from unprofitable businesses, such as the former Gerling-Lloyd syndicate. It also reflects TPG's adherence to underwriting rigor in the currently soft industrial lines and motor insurance markets, which yield insufficient premium levels. Brazil, Poland and Turkey were the main growth areas for the international business, although the level of business was relatively low.

### Life insurance: Additional business potential from Gerling yet to be realized; sustainability of bancassurance partnerships with Citibank and Postbank uncertain

The Gerling acquisition strengthened TPG's competitive position in life insurance, which was previously weaker than that in property/casualty insurance. The group, however, has yet to prove its ability to take advantage of the additional distribution capacities of the Gerling sales organization, which complements its bancassurance channels. These include partnerships with Citibank, which has just been sold to BFCM, Deutsche Postbank AG, and more than 90 members of the widespread network of 446 independent German savings banks. In addition, we expect Gerling to add positive momentum, owing to its leading position in the rapidly expanding German group-savings business, where it has successfully used its close links with the corporate sector to provide high-quality pension consulting, customized products, and administration services.

If we had included HG-LV's full-year 2006 figures, GPW from the HDI-Gerling/Aspecta operations would have shown an increase of 11% in 2007, which is significantly above the 0.7% market average. This increase was mainly fueled by single-premium business, specifically, the sale of unit-linked products and private pension business. New business premiums at the German operations decreased by 5.5% compared with the average market decline of 1.3%. The underperformance reflects execution risks in realizing the business potential of the Gerling life operation, reflected in the loss of back-office staff and lower sales capacities of the broker channel because of the implementation of the EU's directive to regulate insurance intermediaries. This development demonstrates that TPG has yet to demonstrate its ability to use its know-how, customer base, and distribution potential to derive meaningful growth in life insurance. In bancassurance, GPW remained at the previous year's level, after eliminating the one-time effects from the full consolidation of the Postbank/BHW insurance operations, which Talanx fully acquired in 2007. New business development in bancassurance also declined, partly due to a market-wide drop in sales of "Riester" pension products, which offset an extraordinary increase in 2006. The fall in new business from the Citibank partnership stemmed from the restructuring of the bank and further demonstrates the group's heavy dependence on its banking partner.

Overall, the German life insurance market remains difficult, suffering from high regulation, although interest rates have shown an upward trend for some time now.

### Prospective

We expect TPG to maintain its strong and enhanced competitive position by focusing on volume growth in its most profitable segments. The group should benefit from its excellent know-how in industrial lines business and additional distribution capacities, as well as from substantial diversification and synergy potential, while adhering to its strict cost-management and risk-conscious underwriting policy. Prospective growth in its core segments, industrial lines and motor insurance, are likely to remain limited mainly because of the highly competitive and softening German market.

On the life side, Standard & Poor's expects TPG to strengthen its competitive position by taking advantage of its access to a larger customer base and enhanced distribution capabilities. This should translate into new business development at least in line with the market average. It remains to be seen whether TPG can sustain its bancassurance partnerships with Citibank and Postbank, given uncertainties about the strategic direction of the banks' potential new owners and the impact on the insurance operations. Nevertheless, 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 the group's interests and financial position.

## Management And Corporate Strategy: High Operational Execution Risks In Successfully Combining Two Large, Complex Insurance Groups

The group's strategy and operational management support the ratings. Nevertheless, although the legal and organizational integration of the Gerling operations has been largely completed, we consider operational execution risks to be still high because of the scale and complexity involved and the distinct corporate cultures and traditions of the two groups. Additional execution risks could result from further potential acquisitions, which management might consider if suitable opportunities arise.

### Strategy: Gerling acquisition supports potential flotation

The Gerling acquisition supports management's long-term goal of positioning the group 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. However, Standard & Poor's is concerned that the operational integration is continuing to absorb a substantial amount of management's attention. The loss of key talent and supporting functions could also threaten TPG's competitive position. Our concerns have been heightened by management's inclination to consider a further acquisition should the opportunity arise. Such an acquisition could also take place before the group finalizes the operational integration of Gerling and realizes the strong earnings it expects as a result.

### Operational management: Creating a common culture and maximizing synergy potential present major challenges

Operational management has 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 management still faces the challenge of creating one common culture from the combined Talanx and Gerling groups, each of which had its own unique corporate identity based on long-standing traditions. Furthermore, management's decentralized approach may affect TPG's ability to fully maximize synergies. This approach is reflected in its decision to organize the combined primary group into three subholdings, one for life, one for bancassurance and one for non-life business, each coordinated and administered by its own service company. After one-time costs of about € 270 million in 2006 and 2007, we estimate benefits from synergies to reach at least €50 million annually from 2009 onward.

### Financial management; Solid financial profile that is in line with the current rating

TPG's financial profile is strong, based on our expectation that management's financial policy will comfortably preserve the group's strong capitalization and financial leverage in line with the rating guidelines. We expect the group's investment and reserving strategies to remain conservative. We also expect TPG to maintain its solid financial management, despite further potential acquisitions.

The group's targeted ROE is a minimum of 750 basis points above the prevailing risk-free return. To achieve this target, top management has clearly communicated its commitment to adhering to a strict underwriting discipline throughout the cycle.

## Enterprise Risk Management: Strong Controls For Major Risks Support Adequate ERM

TPG's enterprise risk management (ERM) is adequate and includes strong risk controls. In our view, ERM is of high importance to the rating on TPG. The group operates in complex and potentially volatile business lines and is highly exposed to the competitive German insurance market.

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

TPG's risk-management culture is adequate, but it still lacks a truly holistic approach. A consistent groupwide risk-management framework is currently being developed. 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, the group has implemented central management and control through the group's risk management team.

Market-risk controls, including those for credit risks, are strong. These risks are centrally monitored, reported, and controlled by the group's internal asset manager AmpegaGerling, based on entity-specific investment guidelines. In addition, group risk management manages and controls credit risk accumulations centrally.

We consider asset-liability management (ALM) risk controls, which are founded on entity-specific guidelines for investments and ALM, to be adequate. ALM committees are in place at all major life insurers. They are responsible for monitoring asset allocation and risk exposure, making recommendations to optimize risk and return targets, and implementing ALM actions.

Property/casualty underwriting risk controls are adequate. Risk monitoring, controlling, and reporting processes are performed locally, based on entity-specific underwriting guidelines.

Reserving risk controls are strong. Management has identified potential losses from inadequate reserving as one of TPG's largest risks. The group's risk-management team monitors the 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. The company 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 the group'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 the group's inhouse reinsurance broker Protection Reinsurance Intermediaries AG (Protection Re).

Reinsurance credit risks, one of the group's most important risks, are subject to close monitoring and controlling through group risk management.

Emerging risk management has been weak, but is improving because TPG has implemented specific processes to deal with emerging risks.

We regard strategic risk management as adequate. This is because the group has only recently included risk capital and risk return consideration in its value-based management approach. The full and consistent entrenchment of risk and return aspects in the group's strategic and operational management processes across all operating units and management levels has yet to be tested. The group's internal risk-based capital model, currently used to determine the risk position, is still based on the standard model of the German Insurance Association, although adjusted for group specifics. We expect overall risk management to improve because the group is planning to introduce a more sophisticated, holistic, and consistent economic capital model in the near future.

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

Talanx AG reported its consolidated 2007 financial statements, including the relevant subsidiaries of TPG and Hannover Re, in accordance with International Financial Reporting Standards (IFRS). In addition, the parent company 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, the group publishes its annual results more than five months after the end of the financial year and does not yet present interim reports. Disclosure at the group level does also not yet include market-consistent embedded value information. We expect, however, the group to pick up with the current disclosure standards of major competitors in the near future.

The group's 2007 profit and loss figures included Gerling's full-year figures for the first time.

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 pension deficit.

For the first time, we evaluated the profitability of the life insurance business in 2007, using market-consistent embedded-value calculations, which, so-far are not yet publicly disclosed.

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

**Table 2**

**Talanx Primary Group/Operating Statistics***

| | --Year ended Dec. 31-- | | | | |
|---|---|---|---|---|---|
| **(Mil. €)** | **2007** | **2006** | **2005** | **2004** | **2003** |
| **Consolidated (primary group)** | | | | | |
| Total revenue (based on allocated investment income) | 9,301 | 8,370 | 4,897 | 4,763 | 3,185 |
| Core operating profit | 382 | 413 | 517 | 592 | 350 |
| Realized gains & losses/core operating profit (%) | 17.5 | (10.9) | 13.6 | 108.2 | 57.6 |
| Net income | 176 | 376 | 503 | 539 | 310 |
| Post-tax ROE (%) | 6.1 | 6.7 | 13.1 | 24.4 | 20.2 |
| Administrative expense ratio (%) | 9.8 | 14.6 | 8.8 | 9.4 | 9.9 |
| Acquisition expense ratio (%) | 12.8 | 9.6 | 14.0 | 10.6 | 14.6 |
| Nontechnical expenses/total revenue (%) | 4.0 | 8.5 | 7.4 | 9.8 | 12.8 |
| Nontechnical expenses/total assets (bps) | 57 | 120 | 142 | 234 | 365 |
| **Non-life*** | | | | | |
| Non-life revenue (based on allocated investment income) | 4,206 | 3,792 | 2,338 | 2,025 | 1,964 |
| Non-life operating result (based on allocated investment income) | 240 | 353 | 340 | 191 | 144 |
| Return on revenue (%) (based on allocated investment income) | 5.7 | 9.3 | 14.5 | 9.4 | 7.3 |
| Net loss ratio (%) | 72.7 | 72.3 | 70.1 | 82.0 | 72.4 |
| Net expense ratio (%) | 27.1 | 20.5 | 20.1 | 13.3 | 18.1 |
| Net combined ratio (%) | 99.8 | 92.8 | 92.8 | 93.8 | 91.8 |
| **Life*** | | | | | |
| Life revenue | 4,903 | 4,496 | 2,537 | 1,909 | 951 |
| Growth in net life technical reserves (%) | 107.1 | 297.1 | 16.3 | 160.5 | 6.6 |
| Pretax return on life assets (before bonus allocation) (bps) | 363 | 184 | 232 | 375 | 375 |
| Total net expenses/total assets (bps) | 206 | 351 | 473 | 496 | 507 |
| Maintenance expenses/gross premiums written (%) | 4.1% | 6.8% | 6.3% | 8.2% | 9.2% |
| **Investments** | | | | | |
| Net investment income | 1,772 | 1,399 | 696 | 575 | 295 |
| Direct yield on invested assets (%) | 4.3 | 4.9 | 4.2 | 4.7 | 3.4 |
| Yield (incl. realized gains) (%) | 4.4 | 5.6 | 4.6 | 9.9 | 5.7 |
| Total return (incl. realized gains) (%) | 4.0 | 5.2 | 4.8 | 10.1 | 5.8 |
| **Portfolio composition (%)** | | | | | |
| Investment in affiliates | 1.5 | 1.6 | 2.9 | 4.1 | 8.4 |
| Loans to affiliates | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 |
| Bonds and other fixed-interest securities | 72.8 | 73.2 | 67.4 | 73.9 | 62.1 |
| Mortgages | 3.4 | 3.5 | 0.9 | 0.6 | 0.2 |
| Equities and other variable-interest securities | 4.8 | 5.1 | 2.0 | 2.1 | 3.6 |
| Property | 1.2 | 1.7 | 2.1 | 2.7 | 4.7 |

**Table 2**

| Talanx Primary Group/Operating Statistics*(cont.) | | | | | |
|---|---|---|---|---|---|
| Cash and bank deposits | 3.4 | 5.9 | 14.5 | 14.0 | 17.7 |
| Reinsurance deposits | 0.4 | 0.4 | 0.7 | 1.0 | 1.5 |
| Other investments | 3.7 | 0.8 | 0.6 | 1.6 | 1.7 |
| Total nonlinked investments | 91.3 | 92.2 | 91.1 | 93.5 | 93.7 |
| Assets held to cover linked liabilities | 8.7 | 7.8 | 8.9 | 6.5 | 6.3 |

*From 2007, new segmentation in line with IFRS (allocation of Italian life business to non-life; allocation of accident business from bancassurance to life business); 2006 figures adjusted accordingly. Bps--Basis points. N.A.--Not available.

Based on the group's historically sound operating performance, TPG delivered strong earnings in 2007. Moreover, it has not been affected by the subprime crisis. After adjusting for one-time effects from the integration of the Gerling business, the 2007 performance was basically in line with our expectations. Our adjustments included, in particular, one-time integration costs and additional reserve strengthening of the Gerling portfolio to align the reserve confidence level with that of the overall group. Standard & Poor's expects all extraordinary expenses to have been covered in 2006 and 2007 and that no further negative effects will arise in 2008 or the years ahead. Taking this into account, we expect the combined primary insurance group to deliver strong profitability in 2008 and beyond, resulting in a posttax ROE of close to 12% over the cycle.

Property/casualty insurance will continue to fuel earnings, although the life segment's profit contributions to consolidated EBIT are likely to increase to more than 30%, from 11% before the Gerling acquisition in 2005. We expect the group to realize synergy potential and efficiency improvements of €50 million from 2009 onward. We estimate that TPG's earnings before taxes will range between €500 million and €600 million in 2008. Posttax ROE should reach about 12% over the cycle. Strict cost management, a prudent investment strategy, and balanced risk exposure should further support earnings potential.

### Non-life insurance: TPG's combined ratio should remain significantly lower than 100%

Underwriting performance is expected to remain strong in 2008, as should be evinced by an estimated ROR of more than 10% and a combined ratio not to exceed 100% in the absence of extraordinary catastrophes. We expect the cost ratio to reach about 26% in 2008, which is below the average ratio of about 28% reported by major peers. Overall, the quality of earnings should remain high, with very limited reliance on realized capital gains and further supported by strong reserving practices and very conservative confidence levels.

### Life insurance: Increased profit contributions indicate improved diversification potential

Profit contributions from life insurance, historically moderate at TPG, have benefitted from the Gerling acquisition. TPG's operating profit from life business rose to about €200 million in 2007 (adjusted for one-time effects) compared with about €55 million before the acquisition in 2005. Standard & Poor's expects earnings from direct life business to remain at least stable, but to gradually improve, thanks to the enlarged portfolio and enhanced position in the group-savings business and in bancassurance. The underlying performance of TPG's various life entities, including HG-LV, is sound. The return on embedded value was well above our expectations of 10% and the new business margin, based on the present value of new business premiums, was well in line with the average of 2.5% to 3% reported by major competitors of similar financial strength. We expect the operating return on embedded value and the new business margin to remain at this level prospectively, with the value of new business increasing its contribution to the value in force.

## Investments: Prudent Investment Strategy Likely To Continue

TPG's investment strategy is prudent, founded on a high-quality investment portfolio, good level of diversity, and a conservative management approach. The group has not been affected by the subprime crisis.

### Credit risk

Credit risk is low and the quality of the fixed-income portfolio is excellent: More than 95% of the investments within the portfolio have an average rating of 'A'. Equity investments focus on European blue-chip shares.

### Market risk

Market risk in property/casualty insurance mainly relates to a sudden and sharp increase in interest rates. Strong liquidity and the relatively short duration of TPG's bond portfolio in this segment mitigate market risk. The integration of the Gerling operations has increased market risk, although this is conservatively managed when taking into account the relatively low proportion of equity and the hedging measures to minimize the risk of falling interest rates.

### Asset-liability management

We consider TPG's ALM to be adequate. Credit life insurance dominates the group's life product range, and unit-linked business mitigates the existing ALM mismatch. In addition, hedging transactions largely protect HG-LV from falling interest rates.

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

Liquidity is sound, although the Gerling acquisition has consumed part of TPG's free cash flows. We expect the combined group's operating cash flows in property/casualty insurance to remain strong. A five-year standby credit facility of up to €1.5 billion further supports liquidity.

## Capitalization: Strong

We consider TPG's capitalization and that of the entire Talanx group, including the reinsurance operation, to be strong and in line with the current rating level. The existing capital of the Talanx group fully covers the additional risk-based capital requirements of the Gerling acquisition, which was fully financed by equity. Capital quality has remained sound, based on robust retained earnings, very conservative asset allocation, and very strong and conservative management of non-life reserve confidence levels.

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

We consider non-life reserving to be very strong. In our view, the confidence level in the group's loss reserves is very conservative. This conclusion is based on Standard & Poor's own review of TPG's non-life reserves at year-end 2006. In the past, TPG's conservative reserve position on its property/casualty portfolio was reflected in a track record of fairly stable underwriting results. In 2006 and 2007, TPG also applied its conservative groupwide reserving standards to the Gerling portfolio, resulting in reserve strengthening of about €200 million in 2006 and 2007.

**Reinsurance: Conservative strategy**

TPG has maintained its conservative reinsurance policies. Net retention for the property/casualty segment--including Gerling--is estimated to remain at about 70% prospectively. TPG channels all business ceded from primary insurance operations through its in-house reinsurance broker, Protection Re, although Hannover Re still maintains its position as the main reinsurer of the group. 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 3**

| Talanx Primary Insurer/Financial Statistics* | | | | | |
|---|---|---|---|---|---|
| | --Year-ended Dec. 31-- | | | | |
| (Mil. €) | 2007 | 2006 | 2005 | 2004 | 2003 |
| **Consolidated (primary group)** | | | | | |
| Total assets | 64,539 | 59,622 | 25,654 | 19,966 | 11,190 |
| Total equity | 2,959 | 2,772 | 2,638 | 2,634 | 1,770 |
| Total equity (incl. policyholder capital) | 5,173 | 4,682 | 2,896 | 2,764 | 1,860 |
| Total capital | 5,933 | 5,442 | 3,246 | 3,089 | 2,185 |
| (Debt + preferred stock)/capital (excl. policyholder capital) (%) | 20.4 | 21.5 | 14.4 | 11.0 | 15.5 |
| Liquid assets/technical reserves (%) | 126.0 | 127.5 | 123.1 | 132.8 | 129.8 |
| **Non-life** | | | | | |
| Solvency ratio (net assets/net premiums written) (%) | 82.3 | 80.9 | 91.6 | 74.7 | 73.6 |
| Technical reserves/net premiums written (%) | 240.2 | 250.2 | 168.4 | 166.9 | 163.3 |
| Net technical reserves/gross technical reserves (%) | 65.6 | 66.8 | 58.8 | 59.3 | 55.4 |
| Reinsurance utilization (%) | 38.6 | 38.4 | 38 | 44.2 | 45.6 |
| **Life** | | | | | |
| Reinsurance utilization (%) | 13.1 | 11.6 | 12.5 | 15.9 | 24.3 |

*From 2007, new segmentation in line with IFRS (allocation of Italian life business to non-life; allocation of accident business from bancassurance to life business); 2006 figures adjusted accordingly.

Financial flexibility (defined as the ability to source capital relative to capital requirements) is strong, given the group's strong capitalization, ample liquidity, and robust earnings. The group'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.

**Table 4**

| Talanx Primary Insurance Group Members |
|---|
| HDI-Gerling Industrie Versicherung AG |
| HDI Direkt Versicherung AG |
| HDI-Gerling Firmen und Privat Versicherung AG |
| HDI-Gerling Lebensversicherung AG |
| Aspecta Lebensversicherung AG |
| CiV Lebensversicherung AG |
| neue leben Lebensversicherung AG |

**Table 4**

| Talanx Primary Insurance Group Members(cont.) |
|---|
| HDI-Gerling Welt Service AG |
| HDI-Gerling America Insurance Co. |
| HDI Assicurazioni SpA |
| HDI-Gerling Assurances S.A. |
| HDI-Gerling Verzekeringen N.V. |
| Talanx AG |
| HDI Haftpflichtverband der Deutschen Industrie VaG |

| **Ratings Detail** (As Of July 24, 2008)* | |
|---|---|
| **Operating Company Covered By This Report** | |
| **HDI-Gerling Industrie Versicherung AG** | |
| Financial Strength Rating | |
| *Local Currency* | A+/Stable/-- |
| Counterparty Credit Rating | |
| *Local Currency* | A+/Stable/-- |
| **Related Entities** | |
| **Aspecta Lebensversicherung AG** | |
| Financial Strength Rating | |
| *Local Currency* | A+/Stable/-- |
| Issuer Credit Rating | |
| *Local Currency* | A+/Stable/-- |
| **CiV Lebensversicherung AG** | |
| Financial Strength Rating | |
| *Local Currency* | A/Stable/-- |
| Issuer Credit Rating | |
| *Local Currency* | A/Stable/-- |
| **HDI Assicurazioni SpA** | |
| 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/-- |

| **Ratings Detail** (As Of July 24, 2008)* **(cont.)** | |
|---|---|
| **HDI-Gerling Assurances S.A.** | |
| 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-Gerling Verzekeringen N.V.** | |
| Financial Strength Rating | |
| *Local Currency* | A/Stable/-- |
| Issuer Credit Rating | |
| *Local Currency* | A/Stable/-- |
| **HDI-Gerling Welt Service AG** | |
| Financial Strength Rating | |
| *Local Currency* | A/Stable/-- |
| Issuer Credit Rating | |
| *Local Currency* | A/Stable/-- |
| **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/-- |
| **Talanx AG** | |
| Issuer Credit Rating | |
| *Local Currency* | A-/Stable/-- |
| Junior Subordinated (1 Issue) | BBB |
| **Domicile** | Germany |

*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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