

Market Views

Published by U.S. Insurer in association with PartnerRe

The Balancing Act

In reinsurance, balancing the interests of clients, investors and employees can be a challenge, especially considering the cyclical nature of our business. Investors seek attractive risk adjusted returns and growth over time, while trying to minimize risk and volatility; cedants seek a secure balance sheet and continuity of offer at a fair price to offset their own risk and volatility; and employees desire a challenging and rewarding work environment. Are the pressures of return on capital, client retention, ratings, consistency of offer, growth in book value, rate changes, and a secure and rewarding work environment at odds with each other? Can a reinsurer truly align the long term interests of its clients, employees, and shareholders while at the same time managing the ups and downs of the pricing cycle? Tad Walker, Chief Underwriting Officer of PartnerRe U.S. shares his view.

Aligning the interests of clients, employees and shareholders of a reinsurer can be achieved when there are common goals, common metrics for defining success, and a shared understanding internally and externally.

A Common Goal

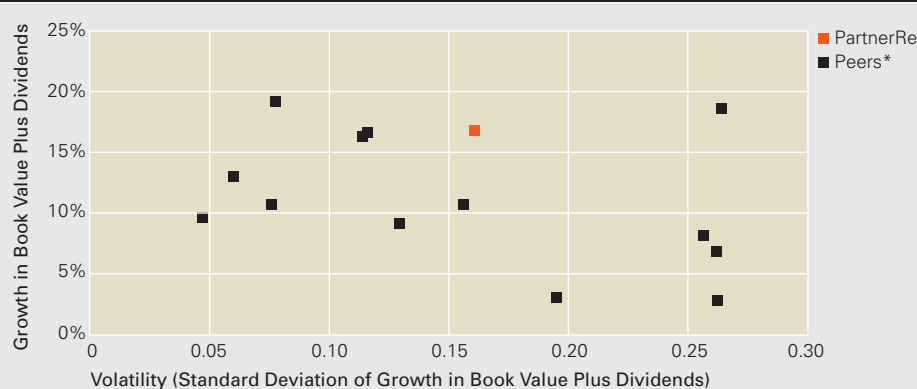
For a reinsurer, the common goal across constituents is to build and maintain a strong balance sheet to meet its commitments to its clients, investors and employees and to be in the market for the long-term. This can only be achieved through the generation of appropri-

ate risk adjusted returns over the cycle. The challenge is that appropriate risk adjusted returns are subject to market swings due to the cyclical nature of our business. A consistent approach to analyzing and pricing exposures will help mitigate this volatility.

Common Metrics

Reinsurance by its nature is a long-term business with long-term relationships. To ensure alignment across key stakeholders, performance metrics need to reflect this view. They need to adequately measure risks and return

The Risk and Return Profile of the Reinsurance Industry (Dec 31, 2001 – Dec 31, 2006)



*The group includes Arch Capital, Axis Capital, Endurance Specialty, Everest Re, Berkshire Hathaway, Hannover Re, IPCRe, Montpelier Re, Munich Re, RenaissanceRe, Swiss Re, Transatlantic and XL Capital.

To align the interests of clients, investors and employees, a reinsurer must look at risks, returns and correlations between risks, and aim to balance risk appetite with market demand.

Brought to you in association with

PartnerRe

Published by US Insurer



At PartnerRe, we believe our long term success can only be achieved by aligning the interests of our clients, shareholders and our employees.

Tad Walker, Chief Underwriting Officer of PartnerRe U.S.

over the long term, and do so within an established and clearly understood risk management framework.

Many metrics have been and continue to be used in the reinsurance industry. These include technical ratio, combined ratio, operating profit, and net income. For many years these were stalwarts when evaluating operating performance in the industry. However, when considering performance across companies with significantly different risk characteristics, these more traditional metrics are insufficient. None of them adequately captures risk or long term value creation. The technical ratio for a catastrophe reinsurance portfolio will inherently be different than that of a casualty portfolio. In recent years, it is the advances in value-at-risk or tail value at risk and their translation into economic capital models that have helped the industry to more effectively describe, evaluate and manage risk.

As an industry we have come a long way since the days of technical ratios as an expression of operating performance. Capital mod-

els have been developed to help us measure risk uniformly across different segments with different risk characteristics, including long tail and short tail liabilities. These models allow us to determine for each client and transaction the level of risk adjusted capital required.

Diversification benefit is increasingly attributed to segments or even individual transactions that consider different correlations to the overall portfolio of risks assumed. Of course, it has long been recognized that reinsurers provide clients with risk management and capital support because of the diversification they offer. However, with more robust economic capital models this diversification potential is more analytically derived.

To measure performance and align interests over time, economic value is an appropriate metric. It emphasizes the growth in economic book value per share over the long term, and matches assets and liabilities on a consistent basis of accounting for the time value of money. Distinct from the more tradi-

tional GAAP accounting metrics, this metric incorporates long term value creation and shows the true strength of a balance sheet. For clients, a company that manages to build strength in the balance sheet through economic value represents a financially secure reinsurer, who can reliably pay claims, and can be counted on as a long-term trading partner.

At the transaction level, using risk adjusted return on capital reflects value creation per unit of capital used. At a portfolio level, economic profit extends this to provide a total measure of value creation by taking into account the total underwriting capital deployed. Earning appropriate risk adjusted returns will, over time, strengthen a company's balance sheet and add to the financial security offered to clients, while at the same time providing value to investors and employees. This consistent approach to measuring returns over a cycle also benefits clients through stability in technical pricing and continuity of offer.

A Common Understanding of Risk Management

Having metrics which adequately describe risk and return are important. But the metrics aren't relevant without a risk management framework which describes the company's common goals and philosophy for evaluating, assuming and managing risk. In fact, one can't exist without the other. In the absence of clear risk and return parameters and metrics, it is difficult to establish a risk management framework which stretches across the enterprise.

Commitments to shareholders, employees and clients alike, are long term. By adopting a consistent process of risk evaluation, a strong risk management framework, a commitment to financial strength and a determination to engage in open and transparent discussions, it is possible to align the interests of all key stakeholders. An effective framework includes an open dialogue around the process of analyzing risk, the limits and constraints it puts on key exposures, calculation of value at risk, controls placed on operational risks, and a consistent approach to building and maintaining reserves to meet future commitments.

A long-term view

While we have developed better tools through which we can more uniformly describe risk

PartnerRe's Risk Management Framework

At PartnerRe, our risk management framework addresses our risk appetite and tolerance for all categories of risk, and the governance, controls and processes for mitigating those risks. We believe that the risks that pose the greatest economic threat to our continuing success are the reinsurance and capital market risks that we assume for a return. In seeking to limit and manage our assumed risks, we want to protect the Company from downside risk that can have a negative impact on our organization and materially impair our balance sheet. Therefore we determine our appetite for our assumed risks based on the creation of economic value over time. We determine the level of risk we are willing to assume, based on our tolerance for exposing the capital that our shareholders entrust to us. We explicitly articulate our risk limits as a numerical expression in internal and public discourses. The limits are both absolute limits as well as limits modeled to losses for different time periods. The charts illustrate PartnerRe's consolidated risk appetite for three of the more significant components of our assumed risk portfolio as of June 30, 2007.

CATASTROPHE RISK LIMITS

| Risk Metric | Aggregate Limit |
|---|-----------------|
| Maximum aggregate exposure in any single zone on any single peril | \$1.3 billion |

Risk Dash Board: Current level of Catastrophe exposure as at June 30, 2007



| Risk Metric | Aggregate Appetite |
|---|--------------------|
| Maximum aggregate appetite for 1-in-75 year aggregate net annual loss for catastrophe | \$975 million |

Risk Dash Board: Current level of Catastrophe exposure as at June 30, 2007



CASUALTY RESERVE RISK LIMIT

| Risk Metric | \$ millions |
|--|---------------|
| Limit earned premiums for casualty and other long-tail lines for the four most recent underwriting periods | \$3.7 billion |

Risk Dash Board: Current level of 4-year aggregate long-tail earned premiums as at June 30, 2007



EQUITY INVESTMENT RISK LIMIT

| Risk Metric | Absolute Limit |
|---|----------------|
| Maximum investment in equity and equity-like assets | \$2.65 billion |

Risk Dash Board: Current level of Equity exposure as at June 30, 2007



and attribute capital, convergence of the reinsurance and capital markets will drive this further. We will be presented with the same risk in different forms, as we have already seen in the catastrophe bond market. In order for risk and return propositions to be considered, it will be even more important that common metrics are used in the future.

Every reinsurer needs to balance the interests of its various stakeholders to provide quality and value over the long term. For clients this means providing a product of value – appropriately priced capacity when needed, clear and open dialogue around our risk parameters, and above all be able to pay claims.

At PartnerRe, we believe our long term success can only be achieved by aligning the interests of our clients, our shareholders and our employees. Fundamentally, we achieve this

through a consistent approach to business, underpinned by common risk and return metrics. It is with a transparent risk management process that we are able to deliver a product of value to our clients, while creating value for

our investors and employees alike. This alignment allows us to deliver on our commitment to meet our long-term obligations, and trade with our clients consistently through the ups and downs of the market.



Editor Michael Loney **Tel:** +1 212 224 3346 **Email:** mloney@institutionalinvestor.com • **Staff writer** Verena Horne **Tel:** +44 (0)20 7779 8824 **Email:** vhorne@euromoneyplc.com • **Staff writer** Richard Crump **Tel:** +44 (0)20 7779 8193 **Email:** rcrump@euromoneyplc.com • **Design & production** Siobhan Brownlow • **Senior sales executive** Goran Pandzic **Tel:** +1 212 224 3711 **Email:** gpandzic@euromoneyny.com • **Senior sales executive** Sumehr Sondhi **Tel:** +1 212 224 3173 **Email:** ssondhi@euromoneyny.com • **Associate publisher** David Samuel **Tel:** +1 212 224 3466 **Email:** dsamuel@euromoneyny.com • **Publisher** Stewart Brown **Tel:** +44 (0)20 7779 8184

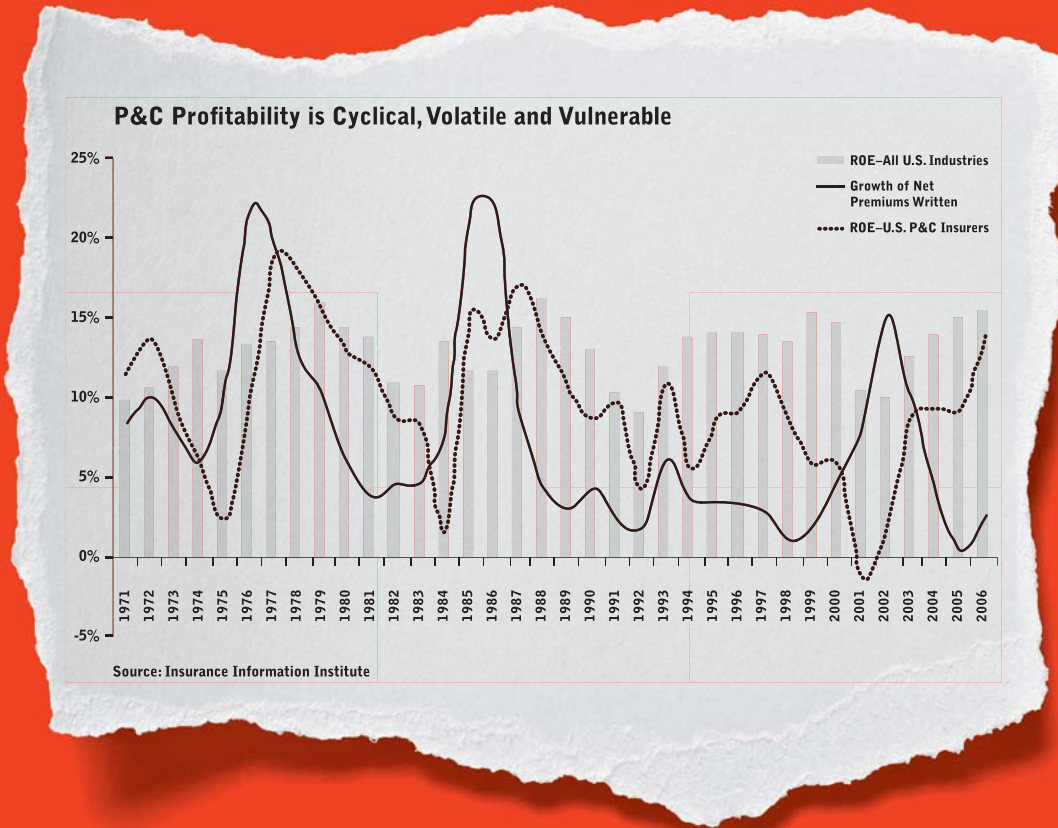
Email: sbrown@euromoneyplc.com • **Divisional Director** Roger Davies •

U.S. Insurer, Nestor House, Playhouse Yard, London EC4V 5EX, UK • **Editorial Tel:** +1 212 224 3346 **Advertising Tel:** +1 212 224 3711 **Website:** www.usinsurer.com

Directors PM Fallon (chairman and editor-in-chief); The Viscount Rothermere (joint president); Sir Patrick Sergeant (joint president); PR Ensor (managing director); D Alfano; JC Botts; SM Brady; CR Brown; MJ Carroll; DC Cohen; CHC Fordham; J Gonzalez; CR Jones; RT Lamont; G Mueller; NF Osborn; CJFS Sinclair; JP Williams

©Euromoney Institutional Investor PLC 2007. Although Euromoney Institutional Investor PLC has made every effort to ensure the accuracy of this publication, neither it nor any contributor can accept any legal responsibility whatsoever for consequences that may arise from errors or omissions or any opinions or advice given. This publication is not a substitute for professional advice on a specific transaction.

We believe straight talk can lead to steady bottom lines.



Soft markets follow hard markets. Hard markets follow soft markets. Historically, the cyclical nature of the insurance business has created uncertainty and instability in capacity and results.

To mitigate this volatility, reinsurers must be able to look beyond short-term cyclical pressures to provide the value of long-term security for clients. At PartnerRe, we strive to evaluate, assume and manage risk intelligently and consistently, irrespective of the market cycle.

We accomplish this with a technical underwriting approach, coupled with open and frank dialogue with clients about their risk exposures and our risk parameters. We believe this is the only way to ensure continuity of offer and consistent capacity for our clients over the cycle.

It is only through straight talk, mutual respect and consistent underwriting that we can best serve our clients' needs and provide the unquestionable security they require.

PartnerRe

For an opportunity to find out more or share your viewpoint visit:
partnerre.com/viewpoint

