Interim management report

Report on economic position

Business development

- Business continues to develop well in the third quarter
- Both business groups achieve their targets
- Premium growth as planned
- Pleasing investment income – target return generated
- On track to deliver targeted Group net income for the year

We are satisfied with the development of our business in the third quarter. Although market conditions for reinsurers – especially in property and casualty reinsurance – remain challenging on account of vigorous competition, Hannover Re's positioning nevertheless enabled the company to achieve and in some cases surpass its targets. Both business groups and the investment portfolio contributed to very pleasing Group net income for the first nine months.

Gross written premium in total business increased by a modest 1.6% as at 30 September 2014 to EUR 10.7 billion (EUR 10.5 billion). At constant exchange rates, growth would have come in at 2.9%. We are thus within our target corridor of generating stable to slightly higher gross premium for the full financial year. The level of retained premium decreased to 87.0% (88.9%). Net premium earned consequently contracted by 1.7% to EUR 9.0 billion (EUR 9.1 billion). A reduction of 0.5% would have been booked at constant exchange rates.

Given the protracted low interest rate environment, we are highly satisfied with the development of our investments. The portfolio of assets under own management stood at EUR 35.0 billion, a level considerably higher than at the end of the previous year (31 December 2013: EUR 31.9 billion). This increase derived in part from currency translation effects associated with our USD and GBP holdings. It was also driven by the positive operating cash flow as well as a further increase in the unrealised gains in our portfolio of fixed-income securities due to declining yields and narrowing risk premiums on US corporate bonds. Despite stubbornly low interest rates, ordinary investment income (excluding interest on deposits) was slightly higher than in the previous year's period at EUR 791.8 million (EUR 781.1 million). Interest on deposits improved to EUR 285.3 million (EUR 267.6 million).

Net realised gains on investments as at 30 September 2014 climbed to EUR 137.4 million (EUR 97.4 million), while changes in the fair value of our assets recognised at fair value through profit or loss were negative at -EUR 8.8 million (-EUR 18.8 million). The impairments taken in the period under review were once again only very minimal. Although conditions on financial markets remained challenging, income from investments under own management surpassed the level of the comparable period (EUR 785.6 million) to come in at a pleasing EUR 836.0 million.

We are thoroughly satisfied with the operating profit (EBIT) of EUR 1,090.8 million (EUR 985.8 million) as at 30 September 2014. Group net income further improved by an appreciable 10.3% on the already good performance of the previous year's corresponding period to reach EUR 695.4 million (EUR 630.2 million). Earnings per share stood at EUR 5.77 (EUR 5.23).

Hannover Re's equity base was again substantially boosted to EUR 7.0 billion (31 December 2013: EUR 5.9 billion) as at 30 September 2014. The book value per share rose sharply to EUR 58.01 (31 December 2013: EUR 48.83). The annualised return on equity for the first nine months was a pleasing 14.4% (31 December 2013: 15.0%).

In the third quarter we successfully placed another subordinated bond with a volume of EUR 500 million on the capital market. This new issue enabled us to take advantage of the low level of interest rates and at the same time optimise the maturity profile of our outstanding hybrid capital. The bond has a perpetual maturity with a first scheduled call option after approximately ten years. It carries a fixed coupon of 3.375% until this date.

Results of operations, financial position and net assets

Property and casualty reinsurance

- Property and casualty reinsurance still highly competitive
- Moderate major losses in the first nine months
- Another good underwriting result

Property and casualty reinsurance continues to be intensely competitive. The supply of reinsurance comfortably exceeds demand. This state of affairs was therefore also instrumental in shaping the treaty renewals as at 1 July 2014. Parts of the North American portfolio, most agricultural risks and business from Latin America traditionally come up for renewal on this date.

US business recorded rate decreases of between 5% and 10% under programmes that had been spared losses. For loss-impacted treaties, on the other hand, increases of up to 30% were achieved. Prices in US property catastrophe business remained under heavy pressure, particularly due to the absence of major losses and the inflow of capital from alternative markets. In certain segments and regions, however, there were isolated positive indications that a bottom might have been reached. Competition in the US casualty market was even fiercer than it had been in the renewals at the beginning of the year. Against the backdrop of our selective underwriting policy, we slightly reduced our premium volume for North America as at 1 July 2014.

Broadly speaking, we were satisfied with the outcome of the treaty renewals in Latin America. Growth here remains strong, even though modest rate decreases are also being seen in the markets of Central and South America. Parts of our business with agricultural risks were also up for renewal. Although an excess supply of reinsurance capacity also prevails in this segment, we nevertheless succeeded in preserving our good market position.

The premium volume for total property and casualty reinsurance remained stable despite our selective underwriting policy. The gross premium of EUR 6.1 billion was slightly higher than the previous year's figure (EUR 6.0 billion). At constant exchange rates growth of 3.2% would have been booked. The level of retained premium was virtually unchanged at 89.6% (89.1%). Net premium earned was on a par with the previous year at EUR 5.1 billion (EUR 5.1 billion); adjusted for exchange rate effects, a gain of 1.5% would have been reported.

After lower-than-average major losses in the first half of 2014, major loss expenditure rose somewhat in the third quarter. The aviation line was particularly hard hit. The crash of the Malaysia Airlines plane over Ukraine resulted in a net strain of EUR 32.2 million. The largest single loss was caused by armed clashes in Libya, which left Tripoli airport heavily damaged. We have set aside reserves of EUR 50.0 million for this loss. The total net burden of major losses for the first nine months stood at EUR 242.2 million (EUR 446.7 million) – a figure well below our major loss budget for this period. The combined ratio of 95.3% (95.0%) was not only positive, it was also well below our targeted ceiling of 96%. The underwriting result for property and casualty reinsurance as at 30 September 2014 came in at a pleasing EUR 225.3 million (EUR 243.4 million).

Income from assets under own management rose to EUR 632.1 million (EUR 567.2 million) for property and casualty reinsurance. The normalised result from changes in the fair value of inflation swaps, which stood at -EUR 4.2 million after -EUR 27.4 million in the comparable period of the previous year, was a contributory factor here. Hannover Re uses inflation swaps to hedge inflation risks associated with part of the loss reserves in its technical account.

The operating profit (EBIT) for property and casualty reinsurance as at 30 September 2014 reached EUR 846.8 million, thereby surpassing the previous year's figure (EUR 804.6 million) by 5.2%. The EBIT margin came in at 16.6% (15.8%), comfortably beating the minimum target of 10%. Group net income improved by 5.0% to EUR 560.8 million (EUR 534.4 million). Earnings per share increased to EUR 4.65 (EUR 4.43).

Key figures for property and casualty reinsurance

in EUR million	2014					2013	
	1.1.–30.6.	1.7.–30.9.	+/– previous year	1.1.–30.9.	+/– previous year	1.7.–30.9.	1.1.–30.9.
Gross written premium	4,078.1	1,981.9	+6.6%	6,060.0	+1.7%	1,859.4	5,956.4
Net premium earned	3,370.2	1,734.2	+2.7%	5,104.5	+0.2%	1,689.3	5,093.2
Underwriting result	158.3	66.9	+11.8%	225.3	-7.5%	59.9	243.4
Net investment income	398.8	248.8	+15.8%	647.6	+12.0%	214.9	578.0
Operating result (EBIT)	521.0	325.8	+27.5%	846.8	+5.2%	255.5	804.6
Group net income	347.9	212.9	+23.6%	560.8	+5.0%	172.3	534.4
Earnings per share in EUR	2.89	1.77	+23.6%	4.65	+5.0%	1.43	4.43
EBIT margin [1]	15.5%	18.8%		16.6%		15.1%	15.8%
Combined ratio [2]	95.0%	95.8%		95.3%		96.3%	95.0%
Retention	91.1%	86.6%		89.6%		86.7%	89.1%

[1] Operating result (EBIT)/net premium earned
[2] Including funds withheld

Life and health reinsurance

- Positive profit trend sustained
- EBIT well above the level of the previous year's period
- First regular premium annuity treaty in the French market successfully completed

Our life and health reinsurance portfolio developed in line with our expectations in the course of the third quarter. In Germany the continued very low level of interest rates has served to ratchet up the pressure on life insurers to find solutions for the long term that will enable them to meet their benefit obligations under existing policies despite such low rates. The adoption of new – and in most instances also more rigorous – regulatory requirements around the world is another dominant topic on the international life insurance market.

In Australia the result for the third quarter just ended improved on the comparable period, despite in some cases slightly negative effects from group business. US business was shaped by opposing developments: while the experience in seniors markets did not entirely live up to our expectations, the development of new business as a whole was exceptionally pleasing. Overall, our expectations were surpassed, even though somewhat reduced profitability was also observed in mortality business in the third quarter.

In the period under review we successfully completed the first regular premium annuity treaty in France. Bearing in mind that the evolution of the longevity market in Europe outside the United Kingdom is still in an early phase, it is all the more gratifying that we were able to reinsure an annuity portfolio with a leading French life insurer covering more than 22,000 insureds with associated pension liabilities representing almost EUR 750 million. Under the arrangement we assume solely the biometric risk and receive in return a premium of around EUR 47.5 million for 2014.

Total gross premium in life and health reinsurance amounted to EUR 4.6 billion (EUR 4.6 billion) as at 30 September 2014. This is equivalent to growth of 1.4% relative to the previous year's period; the increase would have been 2.6% on a currency-adjusted basis. The retention retreated to 83.7% after 88.5% in the comparable period. Net premium earned consequently contracted by 4.0% to EUR 3.9 billion (EUR 4.0 billion); adjusted for currency translation effects, the decrease would have been 2.9%.

Investment income including interest on deposits was on a par with the previous year at EUR 461.8 million (EUR 460.5 million). The performance of the embedded ModCo derivatives deteriorated from EUR 5.2 million to -EUR 1.6 million.

The operating result (EBIT) in life and health reinsurance was boosted by steps taken to improve profitability, with EBIT rising sharply by 39.6% as at 30 September 2014 to EUR 233.9 million (EUR 167.6 million). In the areas of Financial Solutions and Longevity this is reflected in an EBIT margin of 5.6% (4.6%). The target mark of 2% was thus surpassed. The EBIT margin of 6.3% (2.8%) for our Mortality and Morbidity business beat the 6% target. Group net income rose by 8.6% to EUR 166.2 million (EUR 153.0 million). This increase was significantly less than the EBIT growth on account of lower tax expenditure in the comparable period. Earnings per share amounted to EUR 1.38 (EUR 1.27).

Key figures for life and health reinsurance

in EUR million	2014					2013 [1]	
	1.1.–30.6.	1.7.–30.9.	+/– previous year	1.1.–30.9.	+/– previous year	1.7.–30.9.	1.1.–30.9.
Gross written premium	2,986.9	1,657.7	+14.2%	4,644.6	+1.4%	1,451.9	4,581.6
Net premium earned	2,469.0	1,392.4	+12.6%	3,861.4	-4.0%	1,236.3	4,023.7
Investment income	299.5	162.2	+12.0%	461.8	+0.3%	144.9	460.5
Operating result (EBIT)	154.8	79.1	+134.2%	233.9	+39.6%	33.8	167.6
Net income after tax	115.4	50.8	-4.9%	166.2	+8.6%	53.4	153.0
Earnings per share in EUR	0.96	0.42	-4.9%	1.38	+8.6%	0.44	1.27
Retention	83.1%	84.7%		83.7%		86.1%	88.5%
EBIT margin [2]	6.3%	5.7%		6.1%		2.7%	4.2%

1 Adjusted pursuant to IAS 8 (cf. Section 2 of the notes)
2 Operating result (EBIT)/net premium earned

Investments

- Diversified investment portfolio continues to be of a high quality
- Ordinary investment income somewhat better than the previous year's level
- Return on investment of 3.3% higher than target

The investment environment was once again challenging in the period under review and continued to be shaped by the protracted low level of interest rates as well as relatively modest risk premiums on corporate bonds. UK and Eurozone government bonds saw further – in some cases marked – declines in yields across all durations. This was also true of the Southern European countries with higher risk premiums – which have been the focus of so much attention of late – and Ireland. Yields on US treasuries retreated only at the long end of the curve, with increases recorded across shorter and medium durations.

Credit spreads on US corporate bonds moved lower in most rating classes, whereas they remained largely stable in the case of European corporate bonds. In general, credit spreads on corporate bonds from emerging economies were virtually unchanged or recorded modest declines. In total, the unrealised gains on our fixed-income securities increased to EUR 1,461.8 million (EUR 767.9 million). This was a factor in the appreciable growth of our portfolio of assets under own management, which rose by EUR 3.2 billion to EUR 35.0 billion (EUR 31.9 billion). The primary drivers of this increase, however, were exchange rate effects associated with our USD and GBP holdings as well as the inflow of cash from the technical account.

We left the allocation of our assets to individual classes of securities broadly unchanged in the reporting period, making only minor adjustments as part of regular portfolio maintenance and modestly expanding our exposure to emerging markets. We also continued to slightly enlarge our real estate portfolio. The modified duration of our fixed-income portfolio was virtually unchanged from the previous year at 4.5 (4.4).

Despite the low interest rate environment, ordinary investment income excluding interest on deposits was slightly higher than in the corresponding period of the previous year at EUR 791.8 million (EUR 781.1 million). In this context we enjoyed stronger income from our exposure to private equity and real estate, which more than offset reduced income from fixed-income instruments. Interest on deposits was higher than in the comparable period at EUR 285.3 million (EUR 267.6 million).

Impairments of altogether EUR 16.1 million (EUR 13.7 million) were taken. This includes impairments of EUR 2.4 million (EUR 3.5 million) on alternative investments; as in the corresponding period of the previous year, no impairments had to be taken on fixed-income securities or equities. Scheduled depreciation on directly held real estate rose to EUR 13.7 million (EUR 10.1 million).

The net balance of gains realised on disposals stood at EUR 137.4 million (EUR 97.4 million). It can be attributed primarily to portfolio regrouping measures in connection with the changeover in reporting currency at our subsidiary in Bermuda, the repayment in the first quarter of this year of the bond that we had issued in 2004 and amounts realised as part of regular portfolio maintenance.

We recognise a derivative for the credit risk associated with special life reinsurance treaties (ModCo) under which securities deposits are held by cedants for our account; the performance of this derivative in the period under review gave rise to fair value changes of -EUR 1.6 million (EUR 5.2 million) recognised in investment income. The inflation swaps taken out to hedge part of the inflation risks associated with the loss reserves in our technical account have produced fair value changes in the year to date of -EUR 4.2 million (-EUR 27.4 million) recognised in investment income. These changes in fair value are recognised in income as a derivative pursuant to IAS 39. In economic terms we assume a neutral development for these two items over time, and hence the volatility that can occur in specific quarters has no bearing on the actual business performance. Altogether, the changes in the fair value of our assets recognised at fair value through profit or loss amounted to -EUR 8.8 million (-EUR 18.8 million).

Our investment income (including interest on deposits) of EUR 1,121.3 million was higher than in the corresponding period of the previous year (EUR 1,053.2 million). With interest rates remaining stubbornly low, we are thoroughly satisfied with this performance – in particular also because we were able keep our ordinary income somewhat above the previous year's level. Altogether, net income from assets under own management totalled EUR 836.0 million (EUR 785.6 million) as at 30 September 2014, equivalent to an annualised average return of 3.3%. We are thus well on track to achieve our anticipated target of 3.2% for the full financial year.

Interim management report

Net investment income

in EUR million	2014					2013	
	1.1.–30.6.	1.7.–30.9.	+/– previous year	1.1.–30.9.	+/– previous year	1.7.–30.9.	1.1.–30.9.
Ordinary investment income [1]	490.1	301.7	+8.7%	791.8	+1.4%	277.5	781.1
Result from participations in associated companies	4.3	1.2	-66.9%	5.5	-44.0%	3.6	9.8
Realised gains/losses	88.5	48.9	+278.3%	137.4	+41.0%	12.9	97.4
Appreciation	–	–		–		–	0.3
Depreciation, amortisation, impairments [2]	10.3	5.8	+11.1%	16.1	+18.3%	5.2	13.7
Change in fair value of financial instruments [3]	10.0	(18.8)	-200.5%	(8.8)		18.7	(18.8)
Investment expenses	50.0	23.6	+1.2%	73.7	+4.4%	23.3	70.5
Net investment income from assets under own management	**532.6**	**303.5**	**+6.8%**	**836.0**	**+6.4%**	**284.1**	**785.6**
Net investment income from funds withheld	174.9	110.3	+37.8%	285.3	+6.6%	80.1	267.6
Total investment income	**707.5**	**413.8**	**+13.6%**	**1,121.3**	**+6.5%**	**364.2**	**1,053.2**

[1] Excluding expenses on funds withheld and contract deposits
[2] Including depreciation/impairments on real estate
[3] Portfolio at fair value through profit or loss and trading

Opportunity and risk report

Risk report

- Taking a deliberate and controlled approach, we enter into a broad variety of risks which, on the one hand, can open up opportunities for profit but, on the other hand, can also have adverse implications for our company.
- We are convinced that our risk management system gives us a transparent overview of the current risk situation at all times and that our overall risk profile is appropriate.

Risk landscape of Hannover Re

As part of its business operations the Hannover Re Group enters into a broad variety of risks. These risks are deliberately accepted and controlled in order to be able to act on the associated opportunities. For the purpose of systematising and managing these risks we split them into:

- technical risks in property/casualty and life/health reinsurance which originate from our business activities and manifest themselves inter alia in fluctuations in loss estimates as well as in unexpected catastrophes and changes in biometric factors such as mortality,
- market risks which arise in connection with our investments and also as a consequence of the valuation of sometimes long-term payment obligations associated with the technical account,
- default and credit risks resulting from our diverse business relationships and payment obligations inter alia with clients and retrocessionaires,
- operational risks which may derive, for example, from deficient processes or systems and
- other risks, such as reputational and liquidity risks.

The parameters and decisions of the Executive Board with respect to the risk appetite of the Hannover Re Group, which are based on the calculations of risk-bearing capacity, are fundamental to the acceptance of risks. Through our business operations on all continents and the diversification between our Property & Casualty and Life & Health reinsurance business groups we are able to effectively allocate our capital in light of opportunity and risk considerations and generate a higher-than-average return on equity. In property and casualty reinsurance we practise active cycle management and adopt a selective and disciplined underwriting approach.

By expanding our portfolio of life and health reinsurance we reduce the volatility of results within the Group and maintain stable dividend payments. Along with our principal business operations as a reinsurer of property/casualty and life/health business, we also transact primary insurance business in selected niche markets as a complement to our core reinsurance business. With this approach we are well positioned for further profitable growth. Crucial importance attaches to our risk management in order to ensure, among other things, that risks to the reinsurance portfolio remain calculable and also that exceptional major losses do not have an unduly adverse impact on the result.

Strategy implementation

The risk strategy derived from the corporate strategy constitutes the basis for our handling of opportunities and risks. The strategy is implemented on multiple levels. Our corporate strategy encompasses ten basic strategic principles, which safeguard across divisions the accomplishment of our mission "Growing Hannover Re profitably". The orientations of the different business groups are guided by these principles and thus contribute directly to attainment of the overarching goals. Key strategic points of departure for our Group-wide risk management are the principles of active risk management, an adequate capital base and sustained compliance. The risk strategy specifies more concretely the goals derived from our corporate strategy with respect to risk management and documents our understanding of risk. With a view to achieving these goals, we have defined ten overriding principles:

1. We keep to the risk appetite defined by the Executive Board.
2. We integrate risk management into value-based management.
3. We promote an open risk culture and the transparency of the risk management system.
4. We aspire to each rating agency's highest risk management rating and we seek approval of our internal capital model for Solvency II.
5. We define a materiality limit for our risks.
6. We use appropriate quantitative methods.
7. We apply suitable qualitative methods.
8. We practise risk-based allocation of our capital.
9. We ensure the necessary separation of functions in our organisational structure.
10. We evaluate the risk content of new business areas and new products.

The risk strategy is specified with an increasing degree of detail on the various levels of the company, for example down to the adoption and testing of contingency plans in the event of an emergency or the underwriting guidelines of our treaty and regional departments. The risk strategy and the guidelines derived from it, such as the Framework Guideline on Risk Management and the central system of limits and thresholds, are reviewed at least once a year. In this way, we ensure that our risk management system is kept up-to-date.

We manage our total enterprise risk such that we can expect to generate positive Group net income with a probability of 90% and the likelihood of the complete loss of our economic capital and IFRS shareholders' equity does not exceed 0.03% p. a. These indicators are monitored using our internal capital model and the Executive Board is informed quarterly about adherence to these key parameters. The necessary equity resources are determined according to the requirements of our economic capital model, solvency regulations, the expectations of rating agencies with respect to our target rating and the expectations of our clients. Above and beyond that, we maintain a capital buffer in order to be able to act on new business opportunities at any time.

Major external factors influencing risk management

Opportunities are expected to open up for Hannover Re inter alia as a consequence of the impending implementation of risk-based solvency systems such as Solvency II in Europe. The main goals of the Solvency II framework directive are to strengthen protection for insureds, put in place consistent competitive standards in the insurance sector of the European Single Market and hence ensure a broadly uniform regulatory practice in Europe. Key details must still be determined on the European and national level before the new regime can fully enter into effect on 1 January 2016. Hannover Re has been preparing intensively for Solvency II for years and is well equipped to provide the markets with tailored products. We believe that we are well placed for Solvency II because we are a solid and low-risk contracting partner with an excellent rating. We can make multiple use of the know-how that we have acquired through development of the internal capital model, and we expect the convergence of supervisory, rating and internal capital requirements to bring relief that will provide us with additional reinsurance capacity. Further major external influencing factors are the protracted low level of interest rates and the Euro debt crisis.

Risk capital

In the interests of our shareholders and clients we strive to ensure that our risks remain commensurate with our capital resources. Our quantitative risk management provides a uniform framework for the evaluation and steering of all risks affecting the company as well as of our capital position. In this context, the internal capital model is our central tool. The internal capital model of the Hannover Re Group is a stochastic enterprise model. It covers all subsidiaries and business areas of the Hannover Re Group. The central variable in risk and enterprise management is the economic capital, which is calculated according to market-consistent measurement principles and in many respects corresponds to the business valuation likely to be adopted in future under Solvency II. Hannover Re's internal capital model reflects all risks that influence the development of the economic capital. They are split into technical risks, market risks affecting investments, credit risks and operational risks. For each of these risk classes we have identified a number of risk factors for which we define probability distributions. These risk factors include, for example, economic indicators specific to each currency area, such as interest rates, exchange rates and inflation indices, but also insurance-specific indicators such as the mortality of a particular age group within our insurance portfolio in a particular country or the number of natural catastrophes in a certain region and the insured loss amount per catastrophe. The specification of the probability distributions for the risk factors draws upon historic and publically available data as well as on the internal (re)insurance data stock of the Hannover Re Group. The process is further supplemented by the know-how of internal and external experts. The suitability of the probability distributions is regularly checked by our specialist departments, although more importantly it is also verified in the context of the regular, company-wide use of the capital model when assessing risks and allocating the cost of capital. Hannover Re calculates the required risk capital as the Value at Risk (VaR) of the economic change in value over a period of one year with a confidence level of 99.97%. This reflects the goal of not exceeding a one-year ruin probability of 0.03%. The internal target capitalisation of the Hannover Re Group is therefore significantly higher than the confidence level of 99.5% which will be required in future under Solvency II. It goes without saying that Hannover Rück SE also meets the current capital requirements set by regulators. Since the corresponding calculation is neither market-consistent nor risk-based a relevant comparison with the coverage ratio under the internal capital model is not possible. The Hannover Re Group is seeking approval of its internal model for the determination of regulatory capital under Solvency II. In the event of approval and depending on the final measurement rules of Solvency II, the capitalisation with a confidence level of 99.5% constitutes an indication of the fulfilment of future regulatory requirements. Our excess capital coverage at the target confidence level of 99.97% is currently very comfortable. We hold additional capital above all to meet the requirements of the rating agencies for our target rating. In this connection we strive for a rating from the rating agencies most relevant to our industry that facilitates and secures our access to all reinsurance business worldwide. Hannover Re is analysed by the rating agencies Standard & Poor's (S&P) and A.M. Best as part of an interactive rating process, meaning that both these rating agencies are also given access to confidential information about Hannover Re. The current financial strength ratings are assessed as "AA-" (Very Strong, stable outlook) by Standard & Poor's and "A+" (Superior, stable outlook) by A.M. Best. Standard & Poor's evaluates Hannover Re's risk management as "Very Strong", the best possible rating. The rating highlights, in particular, the company's very good risk management, the consistent and systematic implementation of corporate strategy by management and the excellent capital resources. Hannover Re's internal capital model is also examined as part of the rating. Based on this review, Standard & Poor's factors the results of the internal capital model of the Hannover Re Group into the determination of the target capital for the rating.

Organisation and processes of risk management

Our Group-wide risk management is geared to making a significant contribution to profitable growth and hence to implementation of our strategy through the systematic weighing up of opportunities and risks. Profit and value creation constitute the foundation of our sustainable development in the interests of our clients, shareholders, employees and business partners. Hannover Re has set up risk management functions and bodies Group-wide to safeguard an efficient risk management system. The individual elements of risk management are closely interlinked in this system and the roles, tasks and reporting channels are clearly defined and documented in guidelines. This makes possible a shared understanding of Group-wide and holistic monitoring of all material risks. Regular meetings of the Group-wide risk management functions are held in order to promote risk communication and establish an open risk culture. The organisation and interplay of the individual risk management functions are fundamental to our internal risk management and control system. The chart on the following page provides an overview of the central functions and bodies within the overall system as well as of their major tasks and powers.

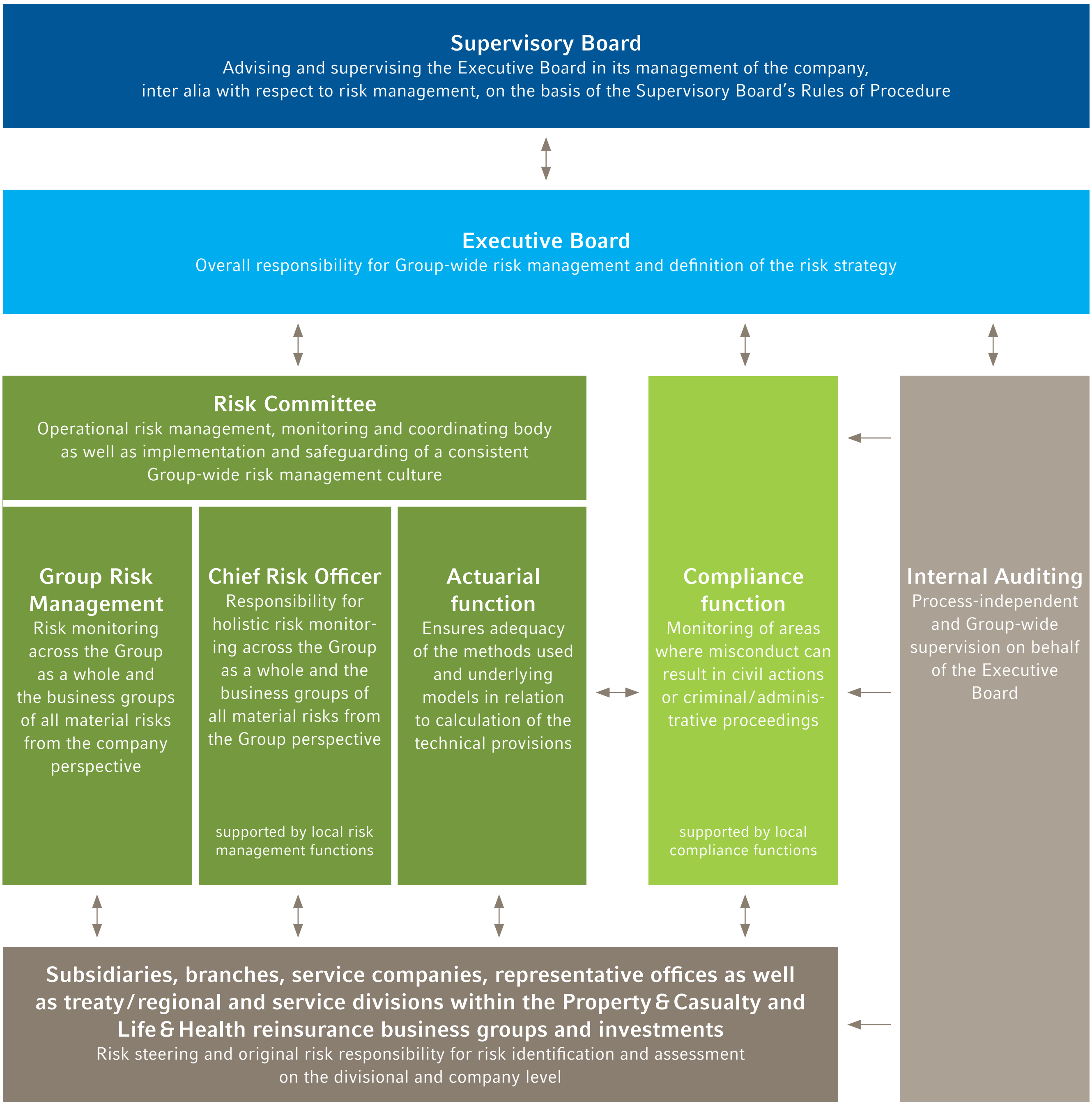
Systematic risk identification, analysis, measurement, steering and monitoring as well as risk reporting are crucial to the effectiveness of risk management as a whole. Only by giving prompt consideration to risks can the continued existence of our Group be assured. The system that is in place – in common with the corporate and risk strategy – is subject to a constant cycle of planning, action, control and improvement.

The Hannover Re Group's Framework Guideline on Risk Management sets out the existing elements of the risk management system that has been put in place. It describes, among other things, the major tasks, rights and responsibilities, the organisational framework conditions and the risk control process. The guideline also contains principles governing the evaluation of new products in light of risk considerations as well as requirements for the outsourcing of functions. It aims to establish homogeneous Group standards for risk management. Key elements of our risk management system are as follows:

Risk-bearing capacity concept

The establishment of the risk-bearing capacity involves determining the total available risk coverage potential and calculating how much of this is to be used for covering all material risks. This is done in conformity with the parameters of the risk strategy and the risk appetite defined by the Executive Board. The quantitatively measurable individual risks and the risk position as a whole are evaluated using our risk model. A central system of limits and thresholds is in place to monitor material risks. This system incorporates – along with other risk-related key figures – in particular the indicators derived and calculated from the risk-bearing capacity. Adherence to the overall risk appetite is verified using the results of the risk model. The calculation is updated half-yearly.

Central functions of risk monitoring and steering



Risk identification

The most important source of information for monitoring risks is the risk identification carried out on a rotating basis. In order to ensure that all risks are identified in the context of risk identification an overarching categorisation containing all material risks has been established. Risk identification is carried out – adjusted to fit the particular risk – by way of, for example, structured assessments, interviews, scenario analyses, checklists or standardised questionnaires. External insights such as recognised industry know-how (e.g. from position papers of the CRO Forum; the CRO Forum is an international organisation comprised of the Chief Risk Officers (CRO) of large insurance and reinsurance companies) are incorporated into the process. Risk identification ensures that new risks identified from the current and rotating monitoring are added and known risks can be revised if necessary.

Risk analysis and assessment
Every risk that is identified and considered material is quantitatively assessed. Only risk types for which quantitative risk measurement is currently impossible or difficult are qualitatively assessed, e. g. reputational risks or emerging risks. Evaluation is carried out using, for example, qualitative self-assessments. As part of the Hannover Re risk model Group Risk Management carries out a quantitative assessment of material risks and the overall risk position. In so doing, allowance is made as far as possible for risk accumulations and concentrations.

Risk steering
The steering of all material risks is the task of the operational business units on the divisional and company level. In this context, risk steering encompasses the process of developing and implementing strategies and concepts that are designed to consciously accept, avoid or minimise identified and analysed risks. The risk/reward ratio and the required capital are factored into the division's decision. Risk steering is operationally assisted by, among other things, the parameters of the local underwriting guidelines, the system of limits and thresholds and the internal control system.

Risk monitoring
The monitoring of all identified material risks is a fundamental risk management task. This includes, inter alia, monitoring execution of the risk strategy and adherence to the defined limits and thresholds. A further major task of risk monitoring is the ascertainment of whether risk steering measures were carried out at the planned point in time and whether the planned effect of the measures is sufficient.

Risk communication and risk culture
The Executive Board is responsible for the implementation of Group-wide risk communication and risk culture. Risk Management takes responsibility for operational implementation on behalf of the Executive Board. Key elements of communication include internal and external risk reporting, information on risk complexes in the intranet (e. g. position papers on emerging risks) as well as regular meetings of risk management officers within the Group.

Risk reporting
The aim of our risk reporting is to provide systematic and timely information about risks and their potential implications and to safeguard adequate internal communication within the company about all material risks. The central risk reporting system consists primarily of regular risk reports, e. g. on the overall risk situation, adherence to the parameters defined in the risk strategy or on the capacity utilisation of natural catastrophe scenarios. Complementary to the regular risk reporting, immediate internal reporting on material risks that emerge at short notice takes place as necessary.

Process-integrated/-independent monitoring and quality assurance
The Executive Board is responsible for the orderly organisation of the company's business irrespective of internally assigned competencies. This also encompasses monitoring of the internal risk steering and control system. Process-independent monitoring and quality assurance of risk management is carried out by the internal audit function and external instances (independent auditors, regulators). Most notably, the independent auditors review the trigger mechanism and the internal monitoring system. The entire system is rounded off with process-integrated procedures and rules, such as those of the internal control system.

Internal control system

We organise our business activities in such a way that they are always in conformity with all legal requirements. The internal control system (ICS) is an important subsystem that serves, among other things, to secure and protect existing assets, prevent and reveal errors and irregularities and comply with laws and regulations. The core elements of Hannover Re's ICS are documented in a Framework Guideline that establishes a common understanding of the differentiated execution of the necessary controls. In the final analysis, it is designed to systematically steer and monitor the implementation of our corporate strategy. The Framework Guideline defines concepts, stipulates responsibilities and provides a guide for the description of controls. In addition, it forms the basis for the accomplishment of internal objectives and the fulfilment of external requirements imposed on Hannover Re. The ICS consists of systematically structured organisational and technical measures and controls within the enterprise. This includes, among other things:

- the principle of dual control,
- separation of functions,
- documentation of the controls within processes,
- and technical plausibility checks and access privileges in the IT systems.

The proper functioning of the ICS necessitates the involvement of management, executive staff and employees on all levels. Yet even with an optimally designed ICS it is not possible to avoid all errors. The system comes up against its limits, most notably with respect to fraud risks and imprecise or incomplete rules and responsibilities. The financial reporting of the parent company and the Group must satisfy international and national financial reporting standards as well as regulatory requirements. This is safeguarded in the area of accounting and reporting by processes with integrated controls which ensure the completeness and accuracy of the annual and consolidated financial statements. A structure made up of differentiated criteria, control points and materiality thresholds assures our ability to identify and minimise the risk of material errors in the annual and consolidated financial statements at an early stage. All components of the accounting-related internal control system, the processes for the organisation and implementation of consolidation tasks and for the preparation of the consolidated financial statement as well as the accompanying controls are consistently documented. In order to safeguard and continuously improve the adequacy of the control system it is subject to regular review and evaluation. In this regard, the internal audit function ensures that the quality of the control system is constantly monitored. All relevant accounting principles are collated in a Group Accounting Manual that sets out uniform Group-wide rules for the recognition, measurement and reporting of items in the consolidated financial statement.

The process for updating and, if necessary, adjusting these rules is clearly regulated with respect to information channels, responsibilities and period of validity. Not only that, we provide prompt Group-wide notification of significant developments and modified requirements in Group financial reporting. Within the scope of our control system the Group companies are responsible for Group-wide adherence to the accounting policies and the internal control guidelines. The managing directors and chief financial officers of the Group companies defined as material in our control system affirm to the Executive Board of Hannover Rück SE at each closing date the completeness, correctness and reliability of the financial data that they pass on to Group Accounting. Data for the preparation of the consolidated financial statement is delivered using a Web-based IT application. The relevant data for Group financial reporting is collected in a database and processed via automatic interfaces in a consolidation system. Depending upon the results of our checks, these figures can be corrected if necessary. Given that our Group financial reporting is heavily dependent on IT systems, these systems also need to be subject to controls. Authorisation concepts regulate system access and for each step content-based as well as system-side checks have been implemented, by means of which errors are analysed and promptly eliminated.

Internal risk assessment

Hannover Re calculates the economic equity as the difference between the market-consistent value of the assets and the market-consistent value of the liabilities. The corresponding accounting principles also apply largely to the IVC. While fair values are available for most investments, the market-consistent valuation of reinsurance treaties necessitates a specific valuation model. We establish the market-consistent value of technical items as the present value of projected payments using actuarial methods. This is adjusted by a risk loading that factors in the fluctuation in future payments. Such fluctuations result from risks that cannot be hedged by means of capital market products, such as technical risks. In a departure from the measurement rules currently under discussion in relation to Solvency II, we use risk-free interest rates derived from the yields on high-quality government bonds for discounting of our future cash flows. Market prices for options and guarantees embedded in insurance contracts are determined or approximated using option valuation models from the field of financial mathematics. The methods used are the same as those adopted in the calculation of our Market Consistent Embedded Value. The valuation reserves for investments indicate the difference between fair value and book value of those investments recognised under IFRS at book values. Other valuation adjustments encompass above all deferred tax assets and liabilities that arise in connection with valuation adjustments.

The available economic capital, which is available as liable capital for policyholders, is comprised of the economic equity measured as described above and the hybrid capital. The internal capital model is based on current methods from actuarial science and financial mathematics. In the case of technical risks, we are able to draw on a rich internal data history to estimate the probability distributions, e. g. for the reserving risk. For risks from natural perils we use external models, which are adjusted in the context of a detailed internal review process such that they reflect our risk profile as closely as possible. In the area of life and health reinsurance long-term payment flows are modelled under various scenarios. With respect to all the aforementioned risks we use internal data to define scenarios and probability distributions. The internal data is enhanced by way of parameters set by our internal experts. These parameters are especially significant in relation to extreme events that have not previously been observed.

When it comes to aggregating the individual risks, we make allowance for dependencies between risk factors. Dependencies arise, for example, as a consequence of market shocks, such as the financial crisis, which simultaneously impact multiple market segments. What is more, several observation periods may be interrelated on account of market phenomena such as price cycles. In dealing with these dependencies, however, it is our assumption that not all extreme events occur at the same time. The absence of complete dependency is referred to as diversification. Hannover Re's business model is based inter alia on building up the most balanced possible portfolio so as to achieve the greatest possible diversification effects and in order to deploy capital efficiently. Diversification exists between individual reinsurance treaties, lines, business segments and risks. We define the cost of capital to be generated per business unit according to the capital required by our business segments and lines and based on their contribution to diversification.

Technical risks in property and casualty reinsurance

Risk management in property and casualty reinsurance has defined various overall guidelines for efficient risk steering. These include, among other things, the limited use of retrocessions to reduce volatility and conserve capital. It is also crucially important to consistently maximise the available risk capacities on the basis of the risk management parameters of the Hannover Re Group and to steer the acceptance of risks systematically through the existing underwriting guidelines. Diversification within the Property & Casualty reinsurance business group is actively managed through allocation of the cost of capital according to the contribution made to diversification. A high diversification effect arises out of the underwriting of business in different lines and different regions with different business partners. In addition, the active limitation of individual risks – such as natural catastrophes – enhances the diversification effect.

Given that the establishment of inadequate reserves constitutes the greatest risk in property and casualty reinsurance, the conservative level of our reserves is crucial to our risk management. We make a fundamental distinction between risks that result from business operations of past years (reserving risk) and those stemming from activities in the current or future years (price/premium risk). In the latter case, special importance attaches to the catastrophe risk. With respect to the catastrophe risk, we differentiate between natural catastrophes and man-made disasters.

The reserving risk, i.e. the risk of under-reserving losses and the resulting strain on the underwriting result, is the overriding priority in our risk management. We attach the utmost importance to a conservative reserving level and therefore traditionally have a high confidence level. In order to counter this potential risk we calculate our loss reserves based on our own actuarial estimations and establish, where necessary, additional reserves supplementary to those posted by our cedants as well as the segment reserve for losses that have already occurred but have not yet been reported to us. Liability claims have a major influence on this reserve. The segment reserve is calculated on a differentiated basis according to risk categories and regions. In the case of asbestos- and pollution-related claims it is difficult to reliably estimate future loss payments. The adequacy of these reserves can be estimated using the so-called "survival ratio". This ratio expresses how many years the reserves would cover if the average level of paid claims over the past three years were to continue. The statistical run-off triangles used by our company are another monitoring tool. They show the changes in the reserve over time as a consequence of paid claims and in the recalculation of the reserves to be established as at each balance sheet date. Their adequacy is monitored using actuarial methods. Our own actuarial calculations regarding the adequacy of the reserves are also subject to annual quality assurance reviews conducted by external firms of actuaries and auditors.

Hannover Re has taken out inflation swaps (USD and EUR zero coupon swaps) to partially hedge inflation risks. These serve to protect parts of the loss reserves against inflation risks. An inflation risk exists particularly inasmuch as the liabilities (e.g. loss reserves) could develop differently than assumed at the time when the reserve was constituted because of inflation. We also secure parts of the inflation protection for our loss reserves by purchasing bonds with inflation-linked coupon payments.

Licensed scientific simulation models, supplemented by the expertise of our own specialist departments, are used to assess our material catastrophe risks from natural hazards (especially earthquake, windstorm and flood). Furthermore, we establish the risk to our portfolio from various scenarios in the form of probability distributions. The monitoring of the risks resulting from natural hazards is rounded out by realistic extreme loss scenarios. Within the scope of this process, the Executive Board defines the risk appetite for natural perils once a year on the basis of the risk strategy by specifying the portion of the economic capital that is available to cover risks from natural perils. This is a key basis for our underwriting approach in this segment. As part of our holistic approach to risk management across business groups, we take into account numerous relevant scenarios and extreme scenarios, determine their effect on portfolio and performance data, evaluate them in relation to the planned figures and identify alternative courses of action. For the purposes of risk limitation, maximum amounts are also stipulated for various extreme loss scenarios and return periods in light of profitability criteria. Adherence to these limits is continuously verified by Group Risk Management. The Risk Committee, Executive Board and Non-Life Executive Committee are kept regularly updated on the degree of capacity utilisation.

The price/premium risk lies primarily in the possibility of a random claims realisation that diverges from the claims expectancy on which the premium calculation was based. Regular and independent reviews of the models used for treaty quotation as well as central and local underwriting guidelines are vital management components. In addition, Hannover Re's regional and treaty departments prepare regular reports on the progress of their respective renewals. The reporting in this regard makes reference inter alia to significant changes in conditions, risks (such as inadequate premiums) as well as to emerging market opportunities and the strategy pursued in order to accomplish targets. The development of the combined ratio in property and casualty reinsurance is shown in the table below:

Combined and catastrophe loss ratio

in %	Q1–3 2014	2013	2012	2011	2010	2009	2008	2007	2006	2005[1]	2004[1]
Combined ratio (P&C reinsurance)	95.3	94.9	95.8	104.3	98.2	96.6	95.4	99.7	100.8	112.8	97.2
Thereof catastrophe losses[2]	4.7	8.4	7.0	16.5	12.3	4.6	10.7	6.3	2.3	26.3	8.3

1 Including financial reinsurance and specialty insurance
2 Net share of the Hannover Re Group for natural catastrophes and other major claims in excess of EUR 10 million gross as a percentage of net premium earned (until 31 December 2011: in excess of EUR 5 million gross)

Technical risks in life and health reinsurance

All risks directly connected with the life of an insured person are referred to as biometric risks (especially the miscalculation of mortality, life expectancy, morbidity and occupational disability); they constitute material risks for our company in the area of life and health reinsurance. Our goal is to find a balance between biometric risks. Counterparty, lapse and catastrophe risks are also material since we additionally prefinance our cedants' new business acquisition costs. The reserves are determined on the basis of secure biometric actuarial bases in light of the information provided by our clients. The biometric actuarial bases used and the lapse assumptions are continuously reviewed with an eye to their adequacy and if necessary adjusted. This is done using the company's own empirical data as well as market-specific insights. We calculate the diversification effect between mortality and longevity risks prudently in view of the fact that the contracts are normally taken out for different regions, age groups and individuals.

Diversification is a central management tool for our company. We seek to spread risks as far as possible across different risk classes and different regions. In our pricing of reinsurance treaties we provide incentives to further increase diversification. Through our quality assurance measures we ensure that the reserves established by ceding companies in accordance with local accounting principles satisfy all requirements with respect to the calculation methods used and assumptions made (e.g. use of mortality and morbidity tables, assumptions regarding the lapse rate). New business is written in all regions in compliance with underwriting guidelines applicable worldwide, which set out detailed rules governing the type, quality, level and origin of risks. These global guidelines are revised annually and approved by the Executive Board. Special underwriting guidelines give due consideration to the particular features of individual markets. By monitoring compliance with these underwriting guidelines we minimise the risk of an inability to pay or of deterioration in the financial status of cedants. Regular reviews and holistic analyses (e.g. with an eye to lapse risks) are carried out with respect to new business activities and the assumption of international portfolios. The interest rate risk, which in the primary sector is important in life business owing to the guarantees that are given, is of only minimal relevance to our company thanks to the structure of our contracts. The actuarial reports and documentation required by local regulators ensure that regular scrutiny also takes place on the level of the subsidiaries. We have confidence in the entrepreneurial abilities of our underwriters and grant them the most extensive possible powers. In our decentralised organisation we manage risks where they arise using a consistent approach in order to obtain an overall view of the risks in life and health reinsurance. Our global underwriting guidelines provide underwriters with an appropriate framework for this purpose. Another major element of risk management in life and health reinsurance is the Market Consistent Embedded Value (MCEV). The MCEV is a ratio used for the valuation of life insurance and reinsurance business; it is calculated as the present value of the future shareholders' earnings from the worldwide life and health reinsurance portfolio plus the allocated capital. The calculation makes allowance as far as possible for all risks included in this business. The MCEV is established on the basis of the principles of the CFO Forum published in October 2009 (the CFO Forum is an international organisation of Chief Financial Officers from major insurance and reinsurance enterprises). For detailed information please see the MCEV report 2013 published on our website.

Market risks

Faced with a challenging capital market climate, particularly high importance attaches to preserving the value of assets under own management and the stability of the return. Hannover Re's portfolio is therefore guided by the principles of a balanced risk/return profile and broad diversification. Based on a risk-averse asset mix, the investments reflect both the currencies and durations of our liabilities. Market price risks include equity risks, interest rate risks, currency risks, real estate risks, spread risks and credit risks.

With a view to preserving the value of our assets under own management, we constantly monitor adherence to a trigger mechanism based on a clearly defined traffic light system that is applied across all portfolios. This system defines clear thresholds and escalation channels for the cumulative fluctuations in fair value and realised gains/losses on investments since the beginning of the year. These are unambiguously defined in conformity with our risk appetite and trigger specified information and escalation channels if a corresponding fair value development is overstepped. The short-term loss probability measured as the "Value at Risk" (VaR) is another vital tool used for monitoring and managing market price risks. It is calculated on the basis of historical data, e. g. the volatility of the securities positions under own management and the correlation between these risks. As part of these calculations the decline in the fair value of our portfolio is simulated with a certain probability and within a certain period. The VaR of the Hannover Re Group determined in accordance with these principles specifies the decrease in the fair value of our securities portfolio under own management that with a probability of 95% will not be exceeded within ten trading days. A multi-factor model is used to calculate the VaR indicators for the Hannover Re Group. It is based on time series of selected representative market parameters (equity prices, yield curves, spread curves, exchange rates, commodity prices and macro-economic variables). All asset positions are mapped on the level of individual positions within the multi-factor model; residual risks (e. g. market price risks that are not directly explained by the multi-factor model) can be determined through back-calculation and are incorporated into the overall calculation. The model takes into account interest rate risks, credit and spread risks, systematic and specific equity risks, commodity risks and option-specific risks.

Stress tests are conducted in order to be able to map extreme scenarios as well as normal market scenarios for the purpose of calculating the Value at Risk. In this context, the loss potentials for fair values and shareholders' equity (before tax) are simulated on the basis of already occurred or notional extreme events.

Scenarios for changes in the fair value of material asset classes

in EUR million	Scenario	Portfolio change on a fair value basis	Change in equity before tax
Equity securities and private equity[1]	Share prices -10%	-68.2	-68.2
	Share prices -20%	-136.4	-136.4
	Share prices +10%	+68.2	+68.2
	Share prices +20%	+136.4	+136.4
Fixed-income securities	Yield increase +50 basis points	-706.9	-591.4
	Yield increase +100 basis points	-1,381.1	-1,155.2
	Yield decrease -50 basis points	+729.8	+608.9
	Yield decrease -100 basis points	+1,490.4	+1,243.4

[1] In contrast to the first quarter this item now includes not only listed equities but also data on private equity. It has been expanded to reflect the increased significance of these investments.

Further significant risk management tools – along with various stress tests used to estimate the loss potential under extreme market conditions – include sensitivity and duration analyses and our asset/liability management (ALM). The internal capital model provides us with quantitative support for the investment strategy as well as a broad diversity of VaR calculations. In addition, tactical duration ranges are in place, within which the portfolio can be positioned opportunistically according to market expectations. The parameters for these ranges are directly linked to our calculated risk-bearing capacity.

Share price risks derive from the possibility of unfavourable changes in the value of equities, equity derivatives or equity index derivatives in our portfolio. We hold such assets only on a very modest scale as part of strategic participations. The scenarios for changes in equity prices consequently have only extremely slight implications for our portfolio.

The portfolio of fixed-income securities is exposed to the interest rate risk. Declining market yields lead to increases and rising market yields to decreases in the fair value of the fixed-income securities portfolio.

The credit spread risk should also be mentioned. The credit spread refers to the interest rate differential between a risk-entailing bond and risk-free bond of the same maturity. Changes in these risk premiums, which are observable on the market, result – analogously to changes in pure market yields – in changes in the fair values of the corresponding securities.

Currency risks are especially relevant if there is a currency imbalance between the technical liabilities and the assets. Through extensive matching of currency distributions on the assets and liabilities side, we reduce this risk on the basis of the individual balance sheets within the Group. The short-term Value at Risk therefore does not include quantification of the currency risk. We regularly compare the liabilities per currency with the covering assets and optimise the currency coverage in light of various collateral conditions such as different accounting requirements by regrouping assets. Remaining currency surpluses are systematically quantified and monitored within the scope of economic modelling.

Real estate risks result from the possibility of unfavourable changes in the value of real estate held either directly or through fund units. They may be caused by a deterioration in particular qualities of a property or by a general downslide in market values (such as the US real estate crash). Real estate risks continued to grow in importance for our portfolio owing to our ongoing involvement in this sector. We spread these risks through broadly diversified investments in high-quality markets of Germany, Europe as a whole and the United States.

We use derivative financial instruments only to the extent necessary to hedge risks. The primary purpose of such financial instruments is to hedge against potentially adverse situations on capital markets. A modest portion of our cash flows from the insurance business as well as currency risks associated with the difficulty of efficiently ensuring matching currency coverage are partially hedged using forward exchange transactions. Hannover Re has taken out inflation swaps (USD and EUR zero coupon swaps) to partially hedge inflation risks. These serve to protect parts of the loss reserves against inflation risks. Hannover Re holds further derivative financial instruments to hedge interest rate risks from loans taken out to finance real estate. . In the first quarter of 2014 Hannover Re also took out hedging instruments in the form of equity swaps to hedge price risks connected with the stock appreciation rights granted under the share award plan. They are intended to neutralise changes in the fair values of the stock options granted. In order to avoid credit risks associated with the use of derivative transactions the contracts are concluded with reliable counterparties and for the most part collateralised on a daily basis. The remaining exposures are controlled according to the restrictive parameters set out in the investment guidelines.

Our investments entail credit risks that arise out of the risk of a failure to pay (interest and/or capital repayment) or a change in the credit status (rating downgrade) of issuers of securities. We attach equally vital importance to exceptionally broad diversification as we do to credit assessment conducted on the basis of the quality criteria set out in the investment guidelines. We measure credit risks in the first place using the standard market credit risk components, especially the probability of default and the potential amount of loss – making allowance for any collateral and the ranking of the individual instruments depending on their effect in each case. We then assess the credit risk first on the level of individual securities (issues) and in subsequent steps on a combined basis on the issuer level.

In order to limit the risk of counterparty default we set various limits on the issuer and issue level as well as in the form of dedicated rating quotas. A comprehensive system of risk reporting ensures timely reporting to the functions entrusted with risk management.

Rating structure of our fixed-income securities[1]

Rating classes	Government bonds		Securities issued by semi-governmental entities[2]		Corporate bonds		Covered bonds/ asset-backed securities	
	in %	in EUR million	in %	in EUR million	in %	in EUR million	in %	in EUR million
AAA	68.0	4,893.5	52.6	3,420.5	1.5	189.2	61.1	2,899.0
AA	16.3	1,175.8	44.2	2,875.6	15.8	1,944.7	17.1	811.5
A	9.8	704.1	1.5	97.2	48.2	5,927.3	12.9	611.5
BBB	4.9	353.7	1.2	80.3	28.3	3,486.7	5.4	256.3
< BBB	1.0	68.7	0.5	31.8	6.2	769.4	3.5	167.7
Total	**100.0**	**7,195.9**	**100.0**	**6,505.4**	**100.0**	**12,317.3**	**100.0**	**4,746.1**

1 Securities held through investment funds are recognised pro rata with their corresponding individual ratings
2 Including government-guaranteed corporate bonds

The measurement and monitoring mechanisms that have been put in place safeguard a prudent, broadly diversified investment strategy. This is reflected inter alia in the fact that within our portfolio of assets under own management the exposures to government bonds or instruments backed by sovereign guarantees issued by the so-called GIIPS states (Greece, Ireland, Italy, Portugal, Spain) amount to altogether just EUR 241.7 million on a fair value basis. This corresponds to a proportion of 0.7%. The individual countries account for the following shares: Spain EUR 115.5 million, Italy EUR 71.3 million, Ireland EUR 29.3 million and Portugal EUR 25.7 million. No impairments had to be taken on these holdings. Our portfolio does not contain any bonds of Greek issuers. On a fair value basis EUR 4,152.6 million of the corporate bonds held by our company were issued by entities in the financial sector. Of this amount, EUR 3,491.7 million was attributable to banks. The vast majority of these bank bonds (76.3%) are rated “A” or better. Our investment portfolio under own management does not contain any written or issued credit default swaps.

Credit risks

The credit risk consists primarily of the risk of complete or partial failure of the counterparty and the associated default on payment. Since the business that we accept is not always fully retained, but instead portions are retroceded as necessary, the credit risk is also material for our company in reinsurance transactions. Our retrocession partners are carefully selected and monitored in light of credit considerations in order to keep the risk as small as possible. This is also true of our broker relationships, which entail a risk inter alia through the potential loss of the premium paid by the cedant to the broker. We minimise these risks, among other things, by reviewing broker relationships with an eye to criteria such as the existence of professional indemnity insurance, payment performance and proper contract implementation. The credit status of retrocessionaires is continuously monitored. On the basis of this ongoing monitoring a Security Committee decides on measures where necessary to secure receivables that appear to be at risk of default. This process is supported by a Web-based risk management application, which specifies cession limits for the individual retrocessionaires participating in protection cover programmes and determines the capacities still available for short-, medium- and long-term business. Depending on the type and expected run-off duration of the reinsured business, the selection of reinsurers takes into account not only the minimum ratings of the rating agencies Standard & Poor’s and A.M. Best but also internal and external expert assessments (e.g. market information from brokers). Overall, retrocessions conserve our capital, stabilise and optimise our results and enable us to act on opportunities across a broader front, e.g. following a major loss event. Regular visits to our retrocessionaires give us a reliable overview of the market and put us in a position to respond quickly to capacity changes. Alongside traditional retrocessions in property and casualty reinsurance we also transfer risks to the capital market.

Yet credit risks are relevant to our investments and in life and health reinsurance, too, because we prefinance acquisition costs for our ceding companies. Our clients, retrocessionaires and broker relationships as well as our investments are therefore carefully evaluated and limited in light of credit considerations and are constantly monitored and controlled within the scope of our system of limits and thresholds. In terms of the Hannover Re Group's major companies, EUR 302.1 million (8.9%) of our accounts receivable from reinsurance business totalling EUR 3,389.4 million were older than 90 days as at the balance sheet date. The average default rate over the past three years was 0.1%.

Operational risks

Operational risks refer to the risk of losses occurring because of the inadequacy or failure of internal processes or as a result of events triggered by employee-related, system-induced or external factors. In contrast to technical risks (e.g. the premium risk), which we enter into in a deliberate and controlled manner in the context of our business activities, operational risks are an indivisible part of our business activities. The focus is therefore on risk avoidance and risk minimisation. As a derivation from our strategic principle "We manage risks actively", we act according to the following principles in relation to operational risks:

1. We integrate operational risk management into the company and its culture.
2. We manage operational risks proactively and sustainably.
3. We consider events and scenarios that cover that entire spectrum of operational risks.
4. We strive for adequate risk minimisation through our actions.
5. We manage within defined limits and create transparency through measurements.

With the aid of Self-Assessments for Operational Risks (SAOR) we determine the degree of maturity of our operational risk management and define action fields for improvements. Based on these measurements, limits and thresholds are developed in light of risk indicators and efficiency considerations. One key indicator in this regard is the SAOR-based capital commitment in our internal model.

The assessment is carried out, for example, by evaluating the degree of maturity of the respective risk management function or of the risk monitoring and reporting. The system enables us, among other things, to prioritise operational risks. Within the overall framework we consider, in particular, business process risks, compliance risks, risks associated with sales channels and outsourcing of functions, fraud risks, personnel risks, information technology risks/information security risks and business interruption risks.

Business process risks are associated with the risk of deficient or flawed internal processes, which can arise as a consequence of an inadequate process organisation. We have defined criteria to evaluate the degree of maturity of the material processes, e.g. for the reserving process. This enables us to ensure that process risks are monitored. In cooperation with the process participants, the process owner evaluates the risks of the metaprocess and develops measures for known, existing risks. Data quality is also a highly critical success factor, especially in risk management, because – among other things – the validity of the results delivered by the internal model depends primarily on the data provided. The overriding goal of our data quality management is the sustainable improvement and safeguarding of data quality within the Hannover Re Group. Appropriate management of data quality risks is conditional upon clearly defined roles and associated responsibilities. Within the scope of process-integrated risk monitoring, centralised data quality management is responsible for establishing and maintaining the system and in so doing has the authority to prescribe standards and methods.

Compliance risks are associated with the risk of breaches of standards and requirements, non-compliance with which may entail lawsuits or official proceedings with not inconsiderable detrimental implications for the business activities of the Hannover Re Group. Regulatory compliance, compliance with the company's Code of Conduct, data privacy and compliance with anti-trust and competition laws have been defined as issues of particular relevance to compliance. The compliance risk also includes tax and legal risks. Responsibilities within the compliance organisation are regulated and documented Group-wide and interfaces with risk management have been put in place. The set of tools is rounded off with regular compliance training programmes.

We transact primary insurance business that complements our reinsurance activities in selected market niches. In so doing, just as on the reinsurance side, we always work together with partners from the primary sector – such as insurance brokers and underwriting agencies. This gives rise to risks associated with such sales channels, although these are minimised through the careful selection of agencies, mandatory underwriting guidelines and regular checks.

Risks associated with the outsourcing of functions can result from such outsourcing of functions, services and/or organisational units to third parties outside Hannover Re. Mandatory rules have been put in place to limit this risk; among other things, they stipulate that a risk analysis is to be performed prior to a material outsourcing. In the context of this analysis a check is carried out to determine, inter alia, what specific risks exist and whether outsourcing can even occur in the first place.

Fraud risks refer to the risk of intentional violations of laws or regulations by members of staff (internal fraud) and/or by externals (external fraud). This risk is reduced by the internal control system as well as by the audits conducted by Internal Auditing on a Group-wide and line-independent basis.

The proper functioning and competitiveness of the Hannover Re Group can be attributed in large measure to the expertise and dedication of our staff. In order to minimise personnel risks, we pay special attention to the skills, experience and motivation of our employees and foster these qualities through outstanding personnel development and leadership activities. Regular employee surveys and the monitoring of turnover rates ensure that such risks are identified at an early stage and scope to take the necessary actions is created.

Information technology risks and information security risks arise, inter alia, out of the risk of the inadequate integrity, confidentiality or availability of systems and information. By way of example, losses and damage resulting from the unauthorised passing on of confidential information, the malicious overloading of important IT systems or from computer viruses are material to the Hannover Re Group. Given the broad spectrum of such risks, a diverse range of steering and monitoring measures and organisational standards, including for example the requirement to conclude confidentiality agreements with service providers, have been put in place. In addition, our employees are made more conscious of such security risks through practically oriented tools provided online in the intranet or by way of training opportunities.

When it comes to reducing business interruption risks, the paramount objective is the quickest possible return to normal operations after a crisis, for example through implementation of existing contingency plans. Guided by internationally accepted standards, we have defined the key framework conditions and – among other measures – we have assembled a crisis team to serve as a temporary body in the event of an emergency. The system is complemented by regular exercises and tests. Regular risk reporting to the Risk Committee and the Executive Board has also been put in place.

Other risks

Of material importance to our company in the category of other risks are primarily emerging risks, strategic risks, reputational risks and liquidity risks.

The hallmark of emerging risks is that the content of such risks cannot as yet be reliably assessed – especially on the underwriting side with respect to our treaty portfolio. Such risks evolve gradually from weak signals to unmistakable tendencies. It is therefore vital to detect these risks at an early stage and then determine their relevance. For the purpose of early detection we have developed an efficient process that spans divisions and lines of business and we have ensured its linkage to risk management. Operational implementation is handled by an expert working group assembled specially for this task. The analyses performed by this working group are used Group-wide in order to pinpoint any necessary measures (e.g. the implementation of contractual exclusions or the development of new reinsurance products). By way of example, the risks arising out of the emergence of large cities and urban conurbations – so-called megacities – are analysed by this working group. The growth of such urban centres goes hand-in-hand with a host of different problems, including a growing demand for food, drinking water, energy and living space. These challenges may also have implications for our treaty portfolio – in the form not only of risks but also opportunities, e.g. through increased demand for reinsurance products. Climate change, nanotechnology, political unrest, amendments to laws and changes in regulatory requirements may be cited as examples of other emerging risks.

Strategic risks derive from a possible imbalance between the corporate strategy of the Hannover Re Group and the constantly changing general business environment. Such an imbalance might be caused, for example, by incorrect strategic policy decisions, a failure to consistently implement the defined strategies and business plans or an incorrect allocation of resources. We therefore regularly review our corporate strategy in a multi-step procedure and adjust our processes and the resulting guidelines as and when required. We have defined performance criteria and indicators for the operational implementation of the strategic guidelines; these are authoritative when it comes to determining fulfilment of the various targets. With the "Strategy Cockpit" the Executive Board and responsible managers have at their disposal a strategy tool that assists them with the planning, elaboration and management of strategic objectives and measures and safeguards their overall perspective on the company and its strategic risks. In addition, the process for the management of strategic risks is assessed annually as part of the monitoring of business process risks.

Reputational risks refer to the risk that the trust put in our company by clients, shareholders, employees or the public at large may be damaged. This risk has the potential to jeopardise the business foundation of the Hannover Re Group. A good corporate reputation is therefore an indispensable prerequisite for our core business as a reinsurer. Reputational risks may arise out of all business activities conducted by the Hannover Re Group. Reputational damage may be caused, inter alia, by a data mishap that becomes public knowledge, a serious case of fraud or financial difficulties on account of a technical risk. In addition to the risk identification methods already described, we use a number of different techniques for risk minimisation, such as our defined communication channels, a professional approach to corporate communications, tried and tested processes for specific crisis scenarios as well as our established Code of Conduct.

The liquidity risk refers to the risk of being unable to meet our financial obligations when they become due. The liquidity risk consists of the refinancing risk, i. e. the necessary cash cannot be obtained or can only be raised at increased costs, and the market liquidity risk, meaning that financial market transactions can only be completed at a poorer price than expected due to a lack of market liquidity. Core elements of the liquidity management of our investments are, in the first place, management of the maturity structure of our investments on the basis of the planned payment profiles arising out of our technical liabilities and, secondly, regular liquidity planning as well as the asset structure of the investments. Above and beyond the foreseeable payments, unexpected and exceptionally large payments may pose a threat to liquidity. Yet in reinsurance business significant events (major losses) are normally paid out after a lead time that can be reliably planned. As part of our liquidity management we have nevertheless defined asset holdings that have proven to be highly liquid even in times of financial stress. In addition, we manage the liquidity of the portfolio by checking on each trading day the liquidity of the instruments contained therein; their underlying parameters are verified on a regular and ad hoc basis. These measures serve to effectively reduce the liquidity risk.

Opportunity report

Speed is one of the qualities used to measure a successful knowledge transfer. Quick solutions and staying one step ahead of the competition is the name of the game. Hannover Re searches systematically for new business opportunities in order to generate sustainable growth and strengthen the company's profitable development. With a view to identifying opportunities and successfully translating ideas into business, Hannover Re adopts a number of closely related approaches in order to achieve holistic opportunistic and risk management. Of significance here is the interplay without overlaps of the various functions within opportunity and risk management, which is ensured by interfaces.

Key elements in Hannover Re's opportunity management include its various market-specific innovations in the Life & Health and Property & Casualty reinsurance business groups. What is more, innovative and creative ideas are generated by our employees. If they can be successfully translated into additional profitable premium volume, such ideas are financially rewarded. Further elements are the "Future Radar" initiative and the working group on "Emerging Risks and Scientific Affairs". Not only that, Hannover Re has set up a stand-alone organisational unit for "Business Opportunity Management". This service unit deals exclusively and systematically with ideas and opportunities and it concentrates its activities on generating additional premium volume with profit potential. In this context, among other things, ideas on business opportunities are refined and optimal framework conditions for fresh commercial ideas are put in place.

The "Future Radar" initiative, the members of which cut across divisions and hierarchies, picks up on a broad range of topics and arrives at initial business approaches. The working group is tasked with evaluating trends and issues of the future. This includes, for example, increasing fluctuations in the weather, obstacles to the turnaround in energy policy, greater scarcity of resources, developments in the health market or cybercrime.

In general terms, attractive business opportunities are analysed prospectively by the "Future Radar" in order to translate them, as a second step, into marketable insurance and reinsurance products. For this purpose, concrete topics are examined by cross-divisional and interdisciplinary teams and potential business approaches are elaborated. The analyses carried out in the "Future Radar" encompass not only topics of the future but also the steps taken by competitors to identify business opportunities and niche markets at an early stage.

These business approaches are subsequently evaluated and given concrete shape by the Business Opportunity Management service unit. This unit also supports selected projects from the conceptual design of integrated business models to their operational implementation or until their handover to line responsibility. The goal is to generate new business and thereby sustainably foster Hannover Re's profitable growth. Since the unit was set up several initiatives and projects have evolved out of the roughly 100 ideas developed by the worldwide network. Under an attractive employee incentive system various project groups have already been financially rewarded, including those working on the opportunity management projects "Weather" and "Energy Savings Protect" ("Energie Einspar Protect = EEP").

Since 2010 the stand-alone service unit Business Opportunity Management has been assigned to the Chief Executive Officer's area of responsibility – a reflection of the considerable importance that Hannover Re attaches to business opportunity management. In view of the diverse range of potential future opportunities, close links exist with other projects, working groups and bodies, such as with the working group on "Emerging Risks und Scientific Affairs" in regard to emerging risks and opportunities (see page 22 et seq. "Other risks"). The working group carries out qualitative assessments of emerging risks. As a result, however, not only are the potential risks analysed but also any available business opportunities. Issues such as fracking and the repercussions of protracted heatwaves were explored by the working group.

If a business idea is translated into reality and a new reinsurance product results, the normal procedure – provided the criteria defined for this purpose by Risk Management are applicable – is to work through the so-called new product process. This process is supported by Risk Management at Hannover Re. The process is always worked through if a contractual commitment is to be entered into in a form previously not used by Hannover Re or if the exposure substantially exceeds the existing scope of coverage. If this is the case, all material internal and external influencing factors are examined beforehand (e. g. implications for the overall risk profile or the risk strategy). In so doing, Risk Management ensures that before it can be used or sold a new reinsurance product must be approved by the Executive Board.

Overall assessment by the Executive Board

We are convinced that our risk management affords us a transparent overview of the current risk situation at all times, that our overall risk profile is appropriate and that our business opportunity management plays an important part in Hannover Re's profitable growth. Based on our currently available insights arrived at from a holistic analysis of the opportunities and risks, the Executive Board of Hannover Re cannot discern any risks that could jeopardise the continued existence of the Hannover Re Group in the short or medium term or have a material and lasting effect on its assets, financial position or net income.

As an internationally operating reinsurance group, we move in a highly complex environment. Nevertheless, thanks to our business activities in all lines of reinsurance we are able to achieve optimal risk spreading through geographical and risk-specific diversification while at the same time maintaining a balanced opportunity / risk profile. We consider the risks described in the above sections to be manageable, particularly because our steering and monitoring measures are effectively and optimally interlinked. Despite these diverse mechanisms, individual and especially accumulation risks can decisively affect our assets, financial position and net income. In accordance with our understanding of risk, however, we consider not only risks but also at the same time opportunities. We therefore only enter into those risks that go hand-in-hand with opportunities.

Our steering and monitoring tools as well as our organisational and operational structure ensure that we identify risks at an early stage and are able to act on our opportunities. Our central monitoring tool is the system of risk management that we have installed Group-wide, which brings together both qualitative and quantitative information for the purpose of effective risk monitoring. Most notably, the interplay between domestic and foreign risk management functions affords us a holistic and Group-wide overview.

Our own evaluation of the manageability of existing risks is confirmed by various financial indicators and external assessments. Key monitoring indicators, reporting limits and potential escalation steps are defined on a mandatory basis in our central system of limits and thresholds for the material risks of the Hannover Re Group. As a result, the system provides us with a precise overview of potentially undesirable developments in the defined risk tolerances and enables us to react in a timely manner. One testament to our financial stability, for example, is the growth of our shareholders' equity. In this context, the necessary equity resources are determined by the requirements of our economic capital model, solvency regulations, the assumptions of rating agencies with respect to our target rating and the expectations of our clients and shareholders. This increase gives us a sufficient capital buffer to be able both to absorb risks and act on business opportunities that may arise.

Similarly, our very good ratings also testify to our financial stability. The quality of our Enterprise Risk Management (ERM) is evaluated separately by Standard & Poor's. Most notably, our established risk culture promotes the development of appropriate risk monitoring systems and strategic risk management. The evaluation encompasses above all the areas of risk culture, risk controls, the management of emerging risks, risk models and strategic risk management. This external appraisal confirms the quality of our holistic approach to to risk management. In addition, the risk trigger mechanism and internal monitoring system are reviewed annually by the independent auditor. The Group-wide risk management system is also a regular part of the audits conducted by the internal audit function. For additional information on the opportunities and risks associated with our business please see the Group Annual Report 2013.

Outlook

Forecast

- Good prospects for 2014 in property and casualty reinsurance despite softer market conditions
- Improving profitability in life and health reinsurance
- Stable to modestly higher gross premium volume in total business
- Targeted return on investment of 3.2% for assets under own management clearly within reach
- Group net income guidance in the order of EUR 850 million confirmed

The general business climate in the international (re)insurance industry remains challenging. On the one hand, the protracted low level of interest rates is making it difficult to generate attractive investment returns. At the same time, reinsurers are facing a significantly more competitive environment than in previous years. Hannover Re is nevertheless optimally placed to handle these conditions thanks to its selective underwriting policy in property and casualty reinsurance, broadly diversified investment strategy and prudent reserving approach.

Despite the pressure of competition in property and casualty reinsurance, opportunities for growth are still available to our company as a financially robust reinsurer with a very good rating. This is especially true of the Asia-Pacific markets and Latin America, where increasing insurance density and the rising concentration of values in urban population centres are key factors. Along with traditional reinsurance protection we assist our clients on an individual basis with an eye to the implementation of risk-based solvency systems as well as the analysis and evaluation of insurance risks.

For the current financial year we expect to book – at constant exchange rates – largely stable or slightly higher gross premium volume in total property and casualty reinsurance. We will not make any concessions to our systematic underwriting policy and we shall continue to exercise discipline in ensuring that treaty conditions are commensurate with the risks. We are targeting a combined ratio of less than 96%; in terms of the EBIT margin, our goal of at least 10% remains unchanged. As things currently stand, we can expect to achieve these targets for the current financial year.

Looking ahead to the 1 January 2015 treaty renewals, we see signs of reinsurance rates stabilising – aside from certain exceptions – because the scope to make further rate cuts without neglecting the return on equity required by reinsurers is ultimately limited. This was also the tone of discussions at the industry gatherings in September in Monte Carlo and in October in Baden-Baden and the United States.

The favourable development of business in life and health reinsurance should be sustained. Despite intense competition, we anticipate promising opportunities and are confident that here too we are well placed as an expert partner to assist our clients with the fulfilment of extensive regulatory requirements such as those of Solvency II. In particular, reinsurance structures offering capital relief and solvency optimisation will be of growing significance in this context. With this in mind, we expect to see further growth in demand in the area of Financial Solutions.

Increased demand for reinsurance solutions to cover longevity risks is also evident – not only in the United Kingdom but also in other markets such as Continental Europe. In emerging economies we see further growth potential on account of rising affluence in society and the resulting need for greater protection. No changes are expected in the intensely competitive climate currently prevailing in Germany.

Our 2014 guidance for life and health reinsurance of currency-adjusted organic gross premium growth in the low single-digit percentage range remains unchanged. The performance of our Australian disability portfolio, in particular, is expected to further stabilise and improve. Overall, we anticipate increased profitability in life and health reinsurance. The targeted EBIT margin for our Financial Solutions and Longevity business remains unchanged at 2%. In the reporting categories of Mortality and Morbidity we continue to target an EBIT margin of 6%.

In both property/casualty and life/health reinsurance it is our expectation that we will achieve our internal return targets.

The expected positive cash flow that we generate from the technical account and our investments should – subject to stable exchange rates and yield levels – lead to growth in our asset portfolio. In the area of fixed-income securities we continue to emphasise the high quality and diversification of our portfolio. We are not currently planning to make any significant changes to the allocation of our investments to individual asset classes. The focus here is primarily on stability while maintaining an adequate risk/return ratio, thereby enabling us to respond flexibly to general developments and opportunities that may present themselves. We are targeting a return on investment of 3.2% for 2014.

We expect to book stable or slightly higher premium income – based on constant exchange rates – for the Hannover Re Group in the current financial year.

Assuming that the burden of major losses does not significantly exceed the expected level of EUR 670 million and that there are no extraordinary movements on capital markets, Hannover Re expects at this point in time to achieve its forecast Group net income of EUR 850 million for the 2014 financial year.

Our envisaged payout ratio for the dividend remains unchanged in the range of 35% to 40% of Group net income.

For the 2015 financial year we currently anticipate – adjusted for currency translation effects – stable or slightly higher gross premium volume for the Group as a whole. The return on investment will likely be around 3.0%, while Group net income should be in the order of EUR 875 million. As usual, these statements are subject to the proviso that major losses remain within the expected bounds and that there are no unforeseen adverse movements on capital markets.

Events after the reporting date

Matters of special significance arising after the closing date for the quarterly consolidated financial statements are discussed in Section 7.6 of the notes “Events after the end of the quarter” on page 66.