

MANAGEMENT REPORT

of the Hannover Re Group

Economic climate

The expansion of the global economy was initially sustained in 2006, although it flagged somewhat as the year progressed. This can be attributed in particular to weaker cyclical impetus in the industrialised nations; developments nevertheless varied in the major economic zones. The petroleum market eased appreciably in the second half of the year under review as bottlenecks were eliminated and because the high price level of recent years had triggered important substitution processes.

Particularly in the United States, the economy slowed in the year under review. From the spring onwards activity levels here were sharply lower – especially due to declining housing investment. The US Federal Reserve Board initially responded to the impending threat of inflation with further rate hikes, only to halt such moves from the summer onwards in view of the emerging cooldown in the economy.

Slackening demand stimuli in Japan also adversely impacted the world economy. In the developing and emerging markets of Asia, on the other hand, the economic upturn continued undiminished.

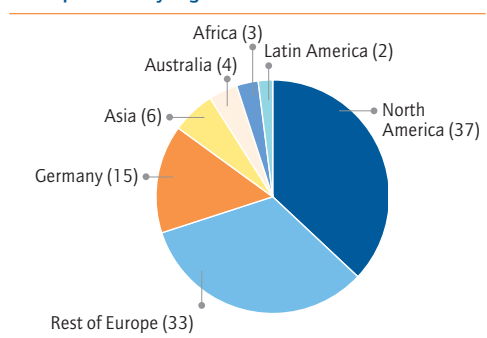
The Eurozone emerged as a driver of growth for the global economy in the year under review. The rise in output and growing domestic demand were key factors in offsetting negative effects from the USA and Japan. The upward revaluation of the euro against the US dollar and the yen also suggest that economic consolidation will be sustained.

In Germany, too, the economy enjoyed a vigorous surge in momentum in the year under review. This development was driven in part by rising export figures and a more competitive position in international markets – despite the appreciation of the euro. The business climate was also boosted by increased spending on construction. Yet this growth in residential construction in Germany can probably be attributed primarily to the discontinuation of home-building subsidies and the increase in value-added tax in 2007. Thanks not least to the cyclical turnaround on the labour market, private consumption picked up for the first time since 2001.

Business development

We were thoroughly satisfied with the development of the 2006 financial year. Market conditions in property and casualty reinsurance remained attractive, enabling us to write profitable business in virtually all segments.

Gross premium by region in %



After two years of results overshadowed by a heavy toll of natural disasters, the burden of catastrophe losses in the year under review – at 2.7% – was well below the multi-year average of 8% of net premium in property and casualty reinsurance. The vigorous pace of growth observed in international life and health reinsurance was undiminished, opening up good opportunities for our business. Financial reinsurance saw again an increased interest in structured products. Our fourth business group, specialty insurance, was notable on two counts: firstly, the ongoing restructuring of the business at the beginning of the year under review and, secondly, the announcement that Praetorian Financial Group, Inc. had been sold to an Australian insurance group in December 2006. Once this

transaction has been completed – most likely in the second quarter of 2007 – we shall concentrate exclusively on our core business of reinsurance.

In compliance with IFRS 5 we are reporting the result of our subsidiary Praetorian Financial Group, Inc. in both the consolidated and segmental statement of income (after tax) in a separate line ("net income from discontinued operations"). In order to ensure comparability of the reported figures, those referring to the previous year were – to the extent required by IFRS – adjusted accordingly. For further explanation and additional information please see Section 5.2 of the Notes "Disposals and discontinued operations."

The development of the individual business groups is discussed in the following pages.

The gross premium income booked by the Hannover Re Group came in on a par with the previous year at EUR 9.3 billion (EUR 9.3 billion). At constant exchange rates growth of 0.3% would have been generated. The Group's retention contracted by a modest 2.9 percentage points to 76.3% (79.2%). Net premium decreased by 5.4% to EUR 7.1 billion (EUR 7.5 billion).

Overall, we were highly satisfied with the performance of our investments: the sustained strong inflow of cash more than offset price effects associated with the rise in yields on international bond markets, causing the portfolio of assets under own management to grow by EUR 0.1 billion year-on-year to EUR 19.2 billion. Ordinary investment income excluding deposit interest climbed by 19.9% to EUR 784.8 million (EUR 654.6 million). As part of our active portfolio management the balance of profits and losses on disposals came in at EUR 217.4 million (EUR 162.2 million). Total net investment income climbed – despite a further fall in deposit interest – by 5.9% to EUR 1,181.2 million (EUR 1,115.8 million).

The operating profit (EBIT) in the year under review was most gratifying; it was boosted to EUR 819.9 million (EUR 91.6 million). It should, however, be borne in mind that the comparable

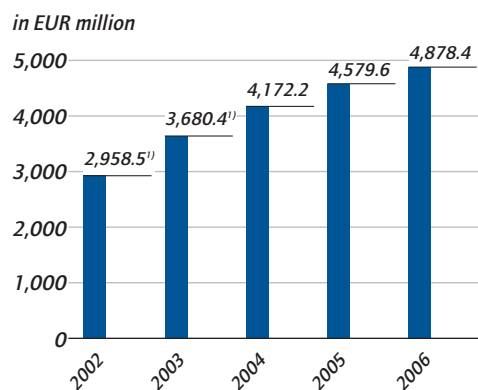
result for 2005 was heavily affected by the exceptional hurricane losses. Group net income in the year under review stood at an excellent EUR 514.4 million after EUR 49.3 million in the previous year. This corresponds to record earnings per share of EUR 4.27 (EUR 0.41).

Hannover Re's financial strength was also further reinforced in the year under review: shareholders' equity increased by 11.4% compared to the previous year to reach EUR 2.9 billion (EUR 2.6 billion). The book value per share consequently improved by 11.4% to EUR 24.03 (EUR 21.57). The total policyholders' surplus – shareholders' equity, minority interests and hybrid capital – grew by 6.5% to EUR 4.9 billion (EUR 4.6 billion).

Financial strength further reinforced

In view of the overriding importance of a very good rating for a reinsurer's business in today's market environment, we are pleased to report that the rating agencies Standard & Poor's and A.M. Best confirmed Hannover Re's strong ratings.

Policyholders' surplus



¹⁾ On a US GAAP basis

We use retrocession, i.e. the passing on of portions of our covered risks to other reinsurers, as a risk optimisation tool. As at year-end the resulting reinsurance recoverables on unpaid claims stood at EUR 3.0 billion (EUR 4.7 billion). This represents a decrease of 35.7% relative to the previous year, attributable inter alia to the reduction of commodity business at our US subsidiary Clarendon. We nevertheless continue to attach considerable importance to the quality

of our retrocessionaires: more than 95.8% of the companies with which we maintain such busi-

ness relations have an investment grade rating of "BBB" or better from Standard & Poor's.

Our business groups

In the following section we discuss the development of the financial year on the basis of our four strategic business groups: property and casualty reinsurance, life and health reinsurance, financial reinsurance and specialty insurance. In

addition, the segmental report provided in the annual financial statement shows the key balance sheet items and profit components broken down into each business group.

Property and casualty reinsurance

In the context of our total portfolio, property and casualty reinsurance is the largest, most significant and also the most difficult business group.

In the year under review the state of the market was once again favourable: the renewal season as at 1 January 2006 already demonstrated that the "hard" market was holding up. The treaty renewals in April, July and October underscored, in particular, the further improvement in market conditions for catastrophe-exposed property business in the United States.

Rate hikes in property reinsurance had been prompted first and foremost by the exception-

ally intense 2005 hurricane season. Increases of 100% and more were obtained under reinsurance programmes that had been affected by the hurricanes. In addition to the shortage of reinsurance capacity, another factor here was the updating of pricing and rating models – in light of the experience of the previous year's hurricane events – to include components that had previously been inadequately modelled or indeed entirely neglected. In the year under review this was particularly apparent in the 1 July renewals, the second-most important renewal date in the USA, after external model providers had also recalibrated their simulation models. Prices for catastrophe covers consequently rose again.

Further improvement
in market conditions

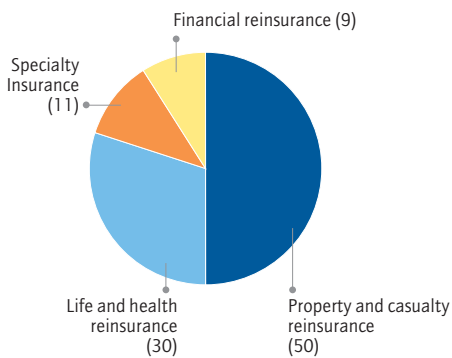
Key figures for property and casualty reinsurance

| Figures in EUR million | 2006 | +/- previous year | 2005 | 2004 | 2003 ¹⁾ | 2002 ¹⁾ |
|---------------------------|---------|-------------------------|---------|---------|--------------------|--------------------|
| Gross written premium | 4,619.7 | -0.4% | 4,639.3 | 4,211.1 | 4,787.1 | 6,020.0 |
| Net premium earned | 3,913.8 | -0.2% | 3,922.9 | 3,456.2 | 3,500.0 | 3,502.1 |
| Underwriting result | 63.9 | -112.8% | (500.5) | 98.5 | 141.1 | 130.8 |
| Net investment income | 693.1 | +27.2% | 544.8 | 440.7 | 393.4 | 255.9 |
| Operating result (EBIT) | 670.0 | | (28.3) | 463.0 | 465.9 | 305.6 |
| Group net income | 382.2 | | 4.3 | 270.7 | 167.0 | 154.1 |
| Earnings per share in EUR | 3.17 | | 0.04 | 2.24 | 1.52 | 1.59 |
| Retention | 84.9% | | 85.9% | 83.0% | 72.2% | 62.7% |
| Combined ratio | 98.4% | | 112.8% | 97.2% | 96.0% | 96.3% |

¹⁾ On a US GAAP basis

In the casualty lines, too, developments were relatively satisfying: with certain exceptions prices here largely held stable on the reinsurance front. All in all, market conditions in property and casualty reinsurance were still commensurate with the risks and hence attractive.

Gross premium by business group in %



Rates on the retrocession market, through which reinsurers obtain protection covers for peak exposures, surged exceptionally vigorously, as a consequence of which risk transfers to the capital market took on even greater importance for reinsurers: in 2006 alone catastrophe ("CAT") bonds with a volume of around EUR 4 billion were issued worldwide.

Hannover Re, which has been a pioneer in this field since 1994, also increasingly supplemented traditional retrocessions with risk transfers to the capital market in the year under review as part of its risk management approach. Our largest-volume transaction to date – a capital substitute worth USD 414 million – was placed predominantly with institutional investors in North America. We thus secured additional underwriting capacity so as to be able to enjoy an appropriate share of the available market opportunities. The portfolio underlying the "K5" securitisation consists of non-proportional reinsurance treaties in the property catastrophe, aviation and marine (including offshore) lines.

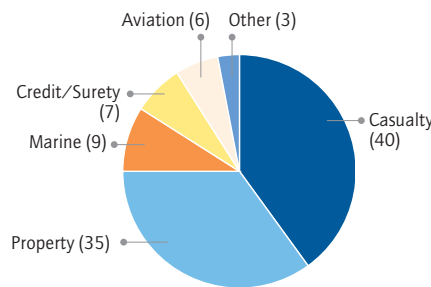
In July of the year under review we issued a traditional catastrophe bond, the first time our

company had used such an instrument: with a volume of USD 150 million the "Eurus" CAT bond covers windstorm events in seven European countries (Belgium, Denmark, Germany, France, the United Kingdom, Ireland and the Netherlands). In this way we obtained protection on the capital market against one of our peak exposures in natural catastrophe business while at the same time further improving the diversification of our risk management.

Additional risk transfer to the capital market

Thanks to this advantageous positioning, Hannover Re was able to profit from the attractive market conditions that opened up. Another factor here was an aspect of our treaty negotiations with clients known as "showing" and "signing". What this means is that as an established and financially strong reinsurer with excellent ratings we are offered and awarded virtually the entire spectrum of reinsurance business. This is a clear competitive edge inasmuch as we are able to select the business that best lives up our profitability standards.

Percentage breakdown of gross premium income in property and casualty reinsurance by line of business

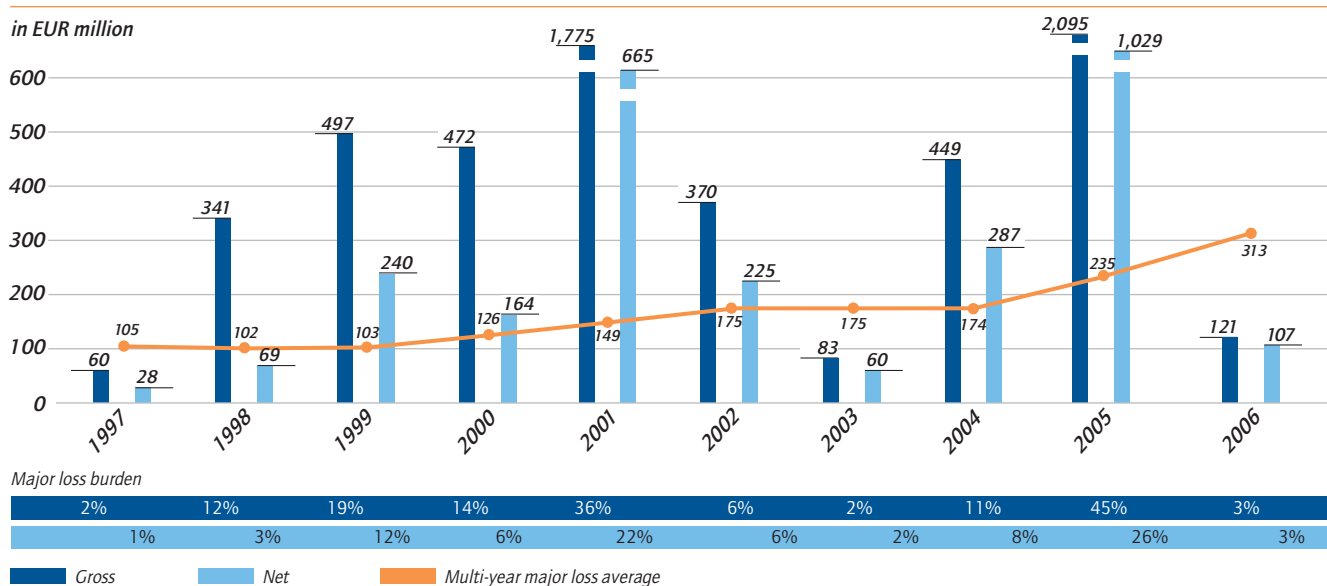


Despite the reduction of peak exposures in the year under review, gross written premium in property and casualty reinsurance came in on a par with the previous year at EUR 4.6 billion (EUR 4.6 billion). At constant exchange rates, especially against the US dollar, growth of 0.1% would have been booked. The level of retained premium showed a minimal decrease of one percentage point to stand at 84.9% (85.9%). The net premium earned of EUR 3.9 billion was also nearly unchanged year-on-year (EUR 3.9 billion).

Unlike in the two previous years, the loss expenditure was well below average in the year under review. Although we incurred a number of major claims, including for example a satellite loss, two fire claims in Germany and cyclone "Larry" in Australia, the total burden of major losses for net account amounted to a satisfactory EUR 107.3 million (EUR 1.0 billion). This is equivalent to 2.7% of net premium in property and casualty reinsurance and is thus well below the multi-year average of 8%. In the previous

year the corresponding figure had been as high as 26.3% due to the extraordinary burden of losses from the hurricane events. The combined ratio stood at 98.4% (112.8%) in the year under review. This value reflects our current portfolio mix. We continue to set aside prudent levels of reserves, especially for more recent years in long-tail casualty business. It was, however, also necessary to make allowance for belated claim notifications in marine business.

Major losses below the multi-year average*



* 1997–2004: 5%, 2005: 6% and 2006: 8% of net earned premium in property and casualty reinsurance

In view of the modest burden of catastrophe losses, the underwriting result surged sharply after the hurricane-impacted 2005 financial year to reach EUR 63.9 million (-EUR 500.5 million). Thanks to a strong underwriting cash flow, net investment income improved on the previous year by 27.2% to EUR 693.1 million (EUR 544.8

million). The operating profit (EBIT) in property and casualty reinsurance amounted to EUR 670.0 million (-EUR 28.3 million) in the year under review, while Group net income totalled EUR 382.3 million (EUR 4.3 million). Earnings per share reached a gratifying EUR 3.17 (EUR 0.04).

Germany

Insurance market under pressure

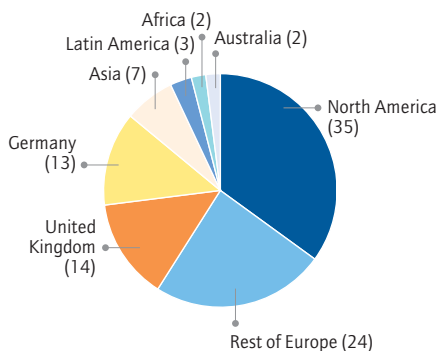
In Germany the good results of recent years served to intensify competitive pressure on the primary insurance sector. Industrial fire and fire loss of profits insurance were particularly hard hit by the sharp decline in prices. Even major claims running into the triple-digit millions of euros failed to halt this trend in the year under review,

and with sufficient capacity available worldwide this market situation is unlikely to change significantly in the medium term. The motor market, an important segment for our company, is also experiencing a fierce competitive struggle for market shares in primary business, causing prices to crumble.

The market environment on the reinsurance side nevertheless remained positive in the year under review, with adequate rates and conditions. Exceptions here were the fire and fire loss of profits lines, in which proportional treaties saw double-digit premium erosion. The reinsurance commissions in proportional motor business, on the other hand, remained largely stable, while commissions for excess of loss arrangements even increased somewhat. Despite a slightly poorer overall business performance, we were still able to generate clearly positive results and achieved our defined profit target.

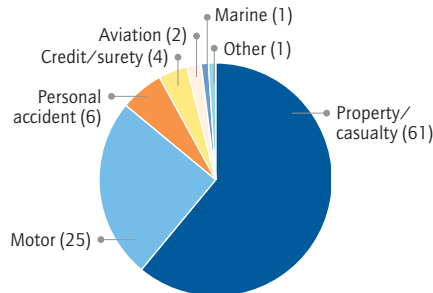
As one of the leading reinsurers in Germany we succeeded in further expanding our position in the year under review. This was due not least to new customer relationships, which we were able to acquire despite continuing market consolidation. What is more, we increased our treaty shares under long-standing accounts, thereby boosting our overall market share. Particularly among mutual insurers we were able to enlarge our portfolio – an especially gratifying achievement in view of our already high market share.

Geographical breakdown of property and casualty reinsurance in % of gross premium income



The rate decline as well as the tense claims situation in industrial fire and fire loss of profits business produced an overall unsatisfactory result for our account. In contrast, the performance of motor liability insurance, our largest line, and liability insurance was highly positive; prices remained stable. As far as major losses were concerned, we principally incurred two fire claims in Germany with a net strain of some EUR 29 million.

Percentage breakdown of gross written premium in Germany by line of business



Our subsidiary E+S Rück, which operates as a specialist reinsurer for the German market, is highly valued by its clients thanks primarily to its excellent financial standing and the continuity of its business relationships. E+S Rück continues to rank second in Germany, the second-largest non-life reinsurance market in the world.

Our position further strengthened

In addition to professional reinsurance protection, we offer the clients of E+S Rück a wide-ranging array of services: among other things, we assist our clients with product development (especially in the field of insurance offerings for senior citizens), portfolio analysis and innovative projects such as the "Pay as you drive" system. A feature of this system is permanent monitoring via a recording/transmission device installed in the vehicle that logs mileage and individual driving habits, thereby making it possible to calculate the premium according to the driver's behaviour behind the wheel. In concrete terms, this means that as a policyholder adopts progressively less risky driving habits, so his or her premium is reduced.

Reinsurance market still adequate

Overall, we were satisfied with the development of business in our domestic market.

Profitability

Every shot a bull's eye. With deadly accuracy the archer fish shoots down its prey from the plants along the nearby river banks. Its ammunition: water.

With the same accuracy we continue to pursue our overriding strategic principle: we do not aspire to be one of the largest, but rather one of the best reinsurers – in other words, one of the three most profitable in the world. We measure this not only by our return on equity, but also by consistent growth in our earnings per share.



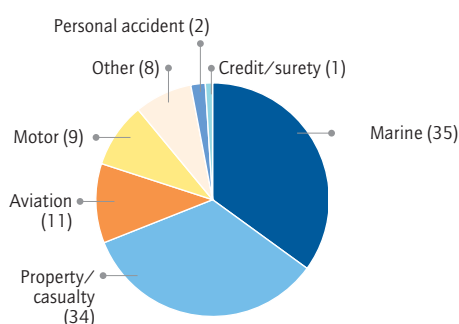
Significant rate increases for catastrophe-exposed business

Rest of Europe

United Kingdom and Ireland

The basic environment on the UK and Irish insurance markets remained unchanged from the previous year: while the primary insurance sector is seeing appreciable competition, conditions on the reinsurance market are largely stable.

Percentage breakdown of gross written premium in the United Kingdom by line of business



Property catastrophe covers in the United Kingdom benefited in the year under review from the adjustment of pricing models in the wake of the 2005 hurricanes, enabling rate increases of up to 20% to be obtained. As part of our risk management we nevertheless scaled back our windstorm-exposed business.

Rates in motor insurance held stable for upper layers, while they moved higher for lower and middle layers following an increase in claims.

In the casualty sector Hannover Re profited from its very good rating. Rates were largely stable, with only a few segments seeing modest reductions – although these declines were somewhat more marked in professional indemnity and directors' and officers' (D&O) covers.

Owing to the enormous losses associated with the 2005 hurricanes, the international property catastrophe business written on the London Market showed particularly significant rate increases. Prices up to 150% higher were obtained due to the shortage of capacity. This development went hand-in-hand with appreciably im-

proved conditions for reinsurers. As part of our strategic risk management we nevertheless scaled back our peak exposures. On the claims side, we did not incur any sizeable loss events in the year under review.

The London Market is also a prominent centre for the underwriting of marine and aviation risks; Hannover Re ranks among the market leaders here.

Due to the massive surplus capacity in *aviation insurance* rates softened again appreciably in comparison to the previous year. On the reinsurance side, however, the excess capacities are limited because ceding companies continue to attach considerable importance to their reinsurer's financial standing. Against this backdrop the price erosion was moderate. We wrote our business selectively, i.e. guided strictly by profitability considerations, and we retained our leading position in aviation reinsurance despite reducing our market shares. We continued to improve the diversification of our portfolio, thereby further scaling back the dominant role played by fleet business. All in all, the performance of our aviation reinsurance portfolio was satisfactory.

The market climate in *marine reinsurance* in the year under review was heavily influenced by the substantial losses from the 2005 hurricanes, which not only prompted rate hikes and increased retentions at ceding companies but also ushered in extensive restructuring of the reinsurance programmes; risks relating to the Gulf of Mexico, for example, were removed entirely and separately reinsured. Many programmes now distinguish between catastrophe-exposed regions (Gulf of Mexico) and risks that have no correlation with natural catastrophe events. The market hardened appreciably in catastrophe-exposed business, on both the insurance and reinsurance sides. Conditions for other reinsurance business were stable.

In offshore and energy business Hannover Re achieved appreciable rate rises, although price increases were also obtained for the rest of the

marine portfolio. As part of our risk management activities we restricted the limit of liability for windstorm-exposed programmes; it is often the case, for example, that reinstatements of liability after such losses are now excluded. We write the bulk of our business on a non-proportional basis and only accept proportional arrangements in segments that promise high margins.

With insured market losses of roughly EUR 6 to 8 billion each for hurricanes "Katrina" and "Rita" 2005 went down as by far the most costly year in the history of marine reinsurance; the year under review, by contrast, passed off quietly without any major losses.

All in all, we were very satisfied with the results of our marine business written on the London Market; this was also true of the business development in other European countries. Although premium erosion was observed here in the primary sector, especially in cargo insurance, the rate level in reinsurance remained stable. Unlike on the London Market, marine business in these regional segments is focused mainly on freight and hull exposures. Our market share in other European markets is relatively low compared to our involvement in the London Market, since improvements in conditions were few and far between here – not least due to the favourable loss experience of recent years. The countries of Eastern and Central Europe were an exception in this regard.

Thanks to falling insolvency figures and the improved state of the economy, loss ratios in *credit and surety insurance* in Europe retreated to a record low. The sustained good results of late led to pressure on commissions in the reinsurance sector, which – unlike in the previous year – it proved impossible to entirely resist. Large insurance groups, in particular, were able to push through their demands owing to a surplus of capacity. On the other hand, clients continued to focus on reinsurers noted for their financial soundness and professionalism, a situation from which Hannover Re benefited.

In the year under review we thus maintained our position as one of the market leaders and

made up for volume lost as a consequence of cedants carrying higher retentions by acquiring new business and enlarging our existing shares. For reasons of diversification we stepped up our surety business and our acceptances of political risks. Credit and surety reinsurance therefore generated further outstanding results in the year under review, and for the first time returned to growth. No major losses were incurred in these lines either.

Western and Southern Europe

The French insurance market suffered a further contraction in premium volume in motor lines; with accident numbers falling, insurers again posted good results in the year under review, leading to greater pressure on rates. On the reinsurance side rates proved to be inadequate in the year under review: although the number of accidents was down, spending on seriously injured victims of traffic accidents moved higher. The situation was exacerbated by the entry of new providers: in order to gain market shares they were even willing to accept insufficient rates, thus depressing the level even further – when in fact rate increases were needed.

Hannover Re is the second-largest provider of reinsurance coverage in *France* and the market leader for personal accident and builder's risk insurance. Overall, we do not pursue any specific growth targets here, preferring to ensure that terms and conditions are commensurate with the risks. In segments offering attractive conditions we extend our involvement. In builder's risk insurance, too, we vigorously grew our portfolio in the year under review; this strategy of consistent expansion is pursued as a long-term objective. The very good cooperation between our facultative and treaty reinsurance sections generated a good performance and increased premium volume, while at the same time cementing our position in the market.

No significant loss events were recorded in the year under review; not least due to the situation in motor insurance, our result for the French market nevertheless failed to live up to expectations in 2006.

Very good results in credit and surety

Good results and an increased premium volume in Spain

Competition in *Spain and Portugal* intensified in the year under review, as new reinsurers increasingly forced their way into European markets. This was especially true of Spain, where property catastrophe coverage is provided by the state. We nevertheless succeeded in expanding our non-proportional portfolio. Very good results were generated in the fire and motor lines. We achieved our goal of boosting our market share in the casualty sector in builder's risk and professional indemnity insurance. All in all, we enlarged our premium volume and posted very good results in Spain. In Portugal, too, we recorded good results in 2006 on the whole, although a number of mid-sized claims cut into profits in fire insurance. The development of motor business was not satisfactory, as a consequence of which we were very cautious in our acceptances.

Minimal growth in Italy, but highly satisfactory results

A hallmark of the insurance market in the *Benelux countries* in the year under review was increased competition from foreign companies, especially in the *Netherlands*. The insurance industry here enjoyed healthy profits in recent years, leading to fierce competition and declining rates – especially in industrial property business and the motor line. Some insurers have already begun to implement the European Motor Liability Directive, which provides for an increase in the previous standard minimum insured limit of EUR 2.5 million to EUR 5.0 million for bodily injury per claim and EUR 1 million per person. In *Belgium* our business progressed according to plan in both motor and, most notably, worker's compensation insurance.

In the *Netherlands* Hannover Re concentrates on clients among the ranks of mid-sized insurers and mutual insurance societies. Especially as far as this target group is concerned, our business is geared to long-term relationships. The year under review saw an increasing competitive struggle over property catastrophe covers due to the arrival of additional capacities from Bermuda. No major losses were incurred in this segment. Property business, on the other hand, incurred a sizeable number of claims, prompting a modest rise in the loss ratio. All in all, we were satisfied with the business development.

Good results put pressure on prices in Northern Europe

The *Italian* non-life market again produced very weak growth in the year under review owing to the sluggish state of the economy – albeit without significant implications for our business. The period of consolidation, which probably reached its peak in 2006, similarly had no effects on Hannover Re's portfolio thanks to our clear client and market segmentation. Our focus is on small and mid-sized ceding companies. In addition to enjoying professional reinsurance protection, special target clients can look forward to additional services such as training activities and consulting support.

As in other markets, it has become increasingly important for a reinsurer in Italy to have an above-average rating, enabling Hannover Re to tap into additional business opportunities. We are the fourth-largest reinsurer in Italy.

Aside from a motor liability claim and a fire loss, with a resulting market loss in the lower double-digit million euros, Italy was spared major claims and natural disasters. Rates consequently came under appreciable pressure in some lines, including for example motor and industrial fire insurance. The premium volume contracted slightly in the year under review, although the result was once again thoroughly satisfactory.

Northern Europe

Hannover Re is well positioned in the markets of Northern Europe; we are a leading partner for mutual insurers, an area where our business is geared to long-term relationships. The *Danish* and *Norwegian* markets experienced a construction boom in the year under review. In general terms, the insurance industry in this region generated good results. In Denmark, our largest market in Northern Europe, this triggered more intense competition in private business. On the reinsurance side rates came under modest pressure in all segments where programmes had been loss-free. Following the strain caused by winter storm "Erwin" in the previous year, natural catastrophe covers were spared any significant losses. The property lines recorded a higher claims frequency after two years of virtually no losses. We achieved good results in the motor segment, and

personal accident business largely passed off without significant losses in the year under review.

Eastern Europe

The insurance markets of Central and Eastern Europe continued to grow disproportionately strongly relative to Western European markets, although price competition is extremely intense; this is even the case in markets – such as Russia – with a higher than average number of major and basic claims.

With insurers carrying higher retentions, competition among reinsurers intensified. Still, the general environment for reinsurers remained very largely stable, and rates only came under appreciable pressure in a few programmes. All in all, however, reinsurance margins were adequate.

North America

The North American (re-)insurance market is the largest and most important single market for Hannover Re and indeed for all players worldwide. It accounts for 41.5% of our total premium volume.

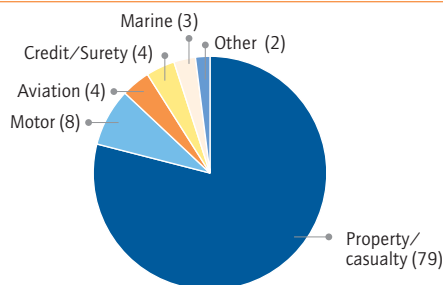
The considerable strains from the 2005 hurricanes did not cause a lasting disruption in the financial recovery of US insurers. The companies were able to further enlarge their equity capital over the past three years, and the modest rate cuts in some segments – e.g. in casualty business – can therefore come as no surprise. All in all, the situation on the US primary market was therefore rather mixed. There was a drastic shortage of capacity for natural hazards covers, as a consequence of which prices continued to rise – sometimes by considerably more than 50%. Almost all major insurers substantially reduced their own catastrophe exposures and increased their retentions appreciably. On the other hand, in property insurance without any natural catastrophe exposure, for example in the case of policyholders in the Midwest, there was a tendency towards price reductions.

For Hannover Re, the markets of Central and Eastern Europe offer considerable growth potential. We are one of the four key reinsurance players in these regions. We write business in all lines, albeit with a strict eye to profitability considerations. Our underwriting policy is therefore opportunistic in approach. We continued to reorganise our portfolio in favour of more profitable non-proportional treaties at the expense of high-volume, low-margin proportional business. The premium volume contracted marginally. In property business we incurred a significant number of claims relating to individual risks, but overall we were satisfied with the achieved result.

Basic environment for reinsurance in Eastern Europe stable

Particularly in the case of major (so-called Fortune 1000) accounts, casualty business saw rate reductions – most notably for casualty umbrella covers. Prices in directors' and officers' (D&O) insurance stabilised in the second half of the year, albeit on a low level. In large areas of the standard casualty market rates held stable, with modest reductions and slight increases balancing each other out. The claims frequency in the year under review was somewhat lower in certain segments, including for example workers' compensation, medical malpractice and D&O covers.

Percentage breakdown of gross written premium in the USA by line of business



Continued positive trend in property catastrophe business

Property catastrophe business developed particularly favourably for reinsurers. In the aftermath of the previous year's severe hurricane events this segment was notable for an imbalance between supply and demand. The marked capacity shortage and the updating of pricing and rating models to include hitherto neglected or inadequately reflected components led to substantial price hikes on the reinsurance side. Particularly in the July 2006 renewals – once the catastrophe modelling agencies had recalibrated their models –, Hannover Re obtained another appreciable increase in rates under programmes impacted by the hurricanes. Some of these rate rises even exceeded 100%. At the same time, as part of our strategic risk management, we scaled back our peak exposures – for example in coastal regions – and thereby significantly improved our risk profile: were another hurricane on the scale of "Katrina" to occur in 2007, the burden of losses for our company would be only half the size.

Property business with no natural catastrophe exposure was for the most part characterised by premium erosion in the year under review. For this reason we write this business opportunistically and with the aid of systematic cross-marketing: when we accept our clients' catastrophe covers, we expect them to cede other attractive business to us at the same time. What is more, we continuously strive to identify sectors where profitability is no longer satisfactory – and in such cases we reduce our shares and/or stop writing new business. In light of the softening market we are instead turning to special segments in which rate movements are less volatile, for example regionally based mutual insurers.

Having substantially enlarged our market share in the aftermath of the events of 11 September 2001, we continued to slightly reduce the business volume as the market softened. Nevertheless, in a number of different segments – such as property, specialty liability and other casualty business – we continue to be one of the leading reinsurers.

We maintain business relations with more than 500 companies in the United States. Our

market penetration is already high; nevertheless, in view of the fact that the USA is currently home to around 1,100 insurance groups, there is still sufficient scope to selectively enlarge our market share. In cooperation with a number of brokerage firms we have therefore successfully undertaken marketing activities aimed at acquiring further new clients and extending our already very strong position.

In the casualty sector our underwriting policy is geared primarily to non-proportional business. Only a few proportional treaties that promise satisfactory profitability have been continued. Based on our very good ratings and the associated positive assessment of our financial strength, we are one of the few reinsurers that clients can consider for placement of their long-tail casualty risks. In this segment Hannover Re writes risks highly selectively and was again able to generate attractive business in the year under review. Despite rate decreases in some casualty lines, the market was more stable than initially anticipated.

In *credit and surety reinsurance* we again made the most of the favourable business opportunities; Hannover Re is the market leader here.

The primary market in credit insurance continues to enjoy double-digit growth and very good results. Surety business is stable, although conditions came under pressure due to a low claims frequency and the absence of major losses. On the reinsurance side too business again developed very favourably; the rate level in the surety line – the dominant business for Hannover Re – was particularly attractive. We maintained – and in some instances even extended – our influential market position, while recording above-average profitability. Our volume in the area of political risks was significantly enlarged.

We were thoroughly satisfied with results in credit and surety reinsurance, although we were unable to repeat our very good result of 2005. No significant loss events were recorded in the year under review.

Bearing in mind that the bulk of our worldwide *marine and aviation portfolio* is written on the London Market, the development of this business is discussed in the section on the United Kingdom (see pages 30 and 31).

Our US business is written almost exclusively through brokers. It was therefore all the more gratifying that for the second time in succession Hannover Re emerged as the best reinsurer overall in a survey conducted by the highly respected US Flaspöhler Research Group in the year under review. 366 experts from leading brokerage

houses participated in the survey, evaluating 28 reinsurers active on the US market. This achievement takes on even greater significance in view of the fact that the bulk of North American reinsurance business is normally handled by brokers.

Good business year in North America overall

All in all, we can look back on a good financial year in North America that was notable for an exceptionally low loss burden. Market conditions were broadly attractive.

Other international markets

Latin America

Mexico, Colombia, Venezuela, Ecuador and *Argentina* are the most important Latin American markets for our company. The very low inflation rate in all these countries in 2006 was also of indirect benefit to the insurance industry. Consumption was boosted by the opportunity to obtain low-interest loans, thereby generating stronger demand for insurance products – especially motor, mortgage protection and life insurance. Yet in overall terms, too, the premium volume on the aforementioned markets grew.

Motor business profited inter alia from a drop in auto thefts. In part, this is doubtless attributable to the improved state of the economy in Colombia and Ecuador. Loss ratios improved to reach an acceptable level.

Hannover Re did not incur any natural catastrophe burdens in its most significant Latin American markets, and reinsurance prices consequently came under pressure in the treaty renewals.

In accordance with our strategic objectives we enlarged our portfolio of profitable, non-proportional business and also slightly increased our overall premium volume.

The results generated from Latin American markets were highly satisfactory.

Africa

Our most important market on the African continent is *South Africa*, where we are represented by our Johannesburg-based subsidiary, Hannover Re Africa.

The South African insurance market was characterised by further appreciable softening tendencies in the year under review. With margins declining, profitability also deteriorated in motor insurance. Thanks to the sustained discipline of market players in 2006, the reinsurance market was not substantially affected by the downward cycle in the insurance sector and remained stable.

In South Africa Hannover Re writes predominantly specialty business, i.e. niche risks accepted by specialised companies. In this segment Hannover Re Africa writes both proportional and non-proportional treaties, whereas commodity business in South Africa is accepted solely on a non-proportional basis. Overall, we boosted our premium volume in the South African market. Hannover Re Africa is a sought-after partner for all lines, not least because of its quick and flexible handling.

In other African markets we are standing by our strategy of enlarging our portfolio of profitable non-proportional business. It remains the case that this goal can only be achieved incre-

Very satisfactory results in Latin America

Premium volume boosted in South Africa

mentally, since on the African continent treaties are preferably placed together in bouquets.

Hannover Re Africa's loss ratio increased slightly owing to a number of sizeable claims. Our clear strategic positioning and disciplined underwriting policy nevertheless enabled us to generate a highly gratifying underwriting result in the year under review; overall, Hannover Re Africa enjoyed the best year in its history.

Asia

Japan is by far our largest Asian market. After years of economic stagnation, business activity here has picked up. The associated positive side-effects have also benefited the insurance industry. Thanks to our presence in Tokyo, where we maintain a service company, we are able to stay in constant contact with our clients. We enjoy the status of "core reinsurer" with most of the country's major insurers.

Our most important single line in Japan is natural catastrophe reinsurance, which we write predominantly on a non-proportional basis. In the year under review we obtained rate rises of up to 10% for both windstorm and earthquake covers. This increase was made possible primarily by the recalibration of simulation models following the severe hurricanes of 2005 in the USA. Against this backdrop we modestly expanded our windstorm and earthquake portfolio.

In personal accident insurance the market proved to be stable. We enlarged our premium volume in light of attractive business opportunities and wrote profitable business in virtually all programmes. What is more, due to changes in the regulatory framework we were able to begin writing private insurance business in the so-called *Kyosai* market (small mutual aid societies) in the year under review, thereby putting in place an additional pillar for the diversification of our business in Japan.

The Japanese casualty market also proved to be relatively stable; we modestly expanded our portfolio here. Especially in the case of overseas covers and pharmaceutical risks, there is a need for greater data transparency in order to opti-

mise risk assessment. All in all, our business in Japan developed very favourably. Our result was not affected by any significant major claims.

Southeast Asian markets witnessed rate reductions in both the primary and reinsurance sectors. Particularly in Malaysia, Indonesia and Pakistan, the year under review was notable for the establishment of *takaful* companies ("takaful" is an Arabic term meaning "guaranteeing each other"). This business model – which has similarities to that of a mutual insurance society – takes full account of Islamic standards. Since *takaful* insurers are required to reinsure their business primarily with Sharia-compliant, so-called *retakaful* companies, the establishment of new *retakaful* players in the year under review came as no surprise. Hannover Re sees considerable potential in this emerging market and has set up a subsidiary in Bahrain which will serve the Islamic insurance market on an exclusive and worldwide basis.

Our strategic objective throughout the entire region continues to be the expansion of our non-proportional portfolio. We are, however, also focused on writing profitable proportional business in lines with no correlation to natural catastrophe exposures. In this respect, the year under review offered us additional attractive opportunities. With the exception of the Surat flooding in *India* in August 2006, our account was spared any major losses. In *India* we grew our business against a backdrop of rising premiums. We achieved a very good result here despite the flood damage.

The strongest growth market in Asia after *India* is *China*. This is especially true of motor insurance, although the reinsurance density of this business is not yet particularly marked. *China* continues to be a target market for the international insurance and reinsurance industry, and competition is correspondingly intense. This situation is further exacerbated by the fact that the *China* Insurance Regulatory Commission (CIRC) requires at least 50% of all reinsurance cessions to be placed with locally licensed reinsurers. The *Chinese* market is still dominated by proportional treaties – although developments in the year

under review demonstrated that non-proportional business is slowly gathering momentum. We maintain good business relations with Chinese insurers and are keeping a very close eye on the market. Our involvement in this region is, however, still limited because rates are generally inadequate.

In *Taiwan* we stepped up our focus on non-proportional business, thereby further optimising the structure of our portfolio. Similarly, in *South Korea* and *Hong Kong* we write almost exclusively non-proportional covers. In view of the attractive prices in personal accident and casualty insurance we continued to grow our premium volume in these lines.

All in all, we were highly satisfied with our results in Asia.

Australia and New Zealand

For fifteen years now Australia has been enjoying an economic boom. After years of a hard market, growth in the insurance sector was flat in the year under review against a backdrop of fierce local competition; in primary insurance this was especially true of the property lines and casualty business, most notably professional indemnity. On the reinsurance side, however, the

price level largely held stable and premiums were still commensurate with the risks.

Hannover Re ranks third in the Australian non-life reinsurance market. We are a reliable and attractive partner for our clients because we not only have a very good rating, but we are also locally represented through our branch office in Sydney.

In this region too we concentrate first and foremost on non-proportional business and write only a very small number of proportional covers. Cyclone "Larry" was a catastrophe event that caused an estimated market loss of some AUD 500 million in the year under review. It nevertheless also had positive repercussions on the renewals as at 1 October 2006: price increases of up to 30% were obtained for the affected programmes – even though the cyclone only cost Hannover Re net loss expenditure in the single-digit million euro range. We were thus satisfied with our result on the Australian continent. The expansion of our activities in 2004 to include facultative business produced a sharp surge in premium for the year under review and ensured good market penetration, and Hannover Re has therefore further optimised its position in this market.

Australian market delivers good results

Life and health reinsurance

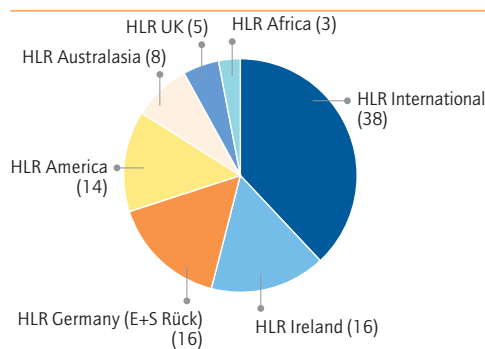
The 2006 financial year passed off very favourably for us. Life and health reinsurance (encompassing life, health, annuity and personal accident business) is driven by very similar demand factors in many markets around the world. Decisive here are, on the one hand, demographic influences – especially the significant rise in longevity – and, on the other, the growing imbalance between the actively employed and pensioners. In addition, the generally low level of interest rates is necessitating early efforts to accumulate savings for retirement.

This starting scenario tends to create a very advantageous climate for the products marketed by private life, health and annuity insurers – not least because in many markets tax incen-

tives are provided to encourage consumers to take out such policies.

Pace of growth in life and health reinsurance undiminished

Breakdown of gross premium by business centers in % (before consolidation)

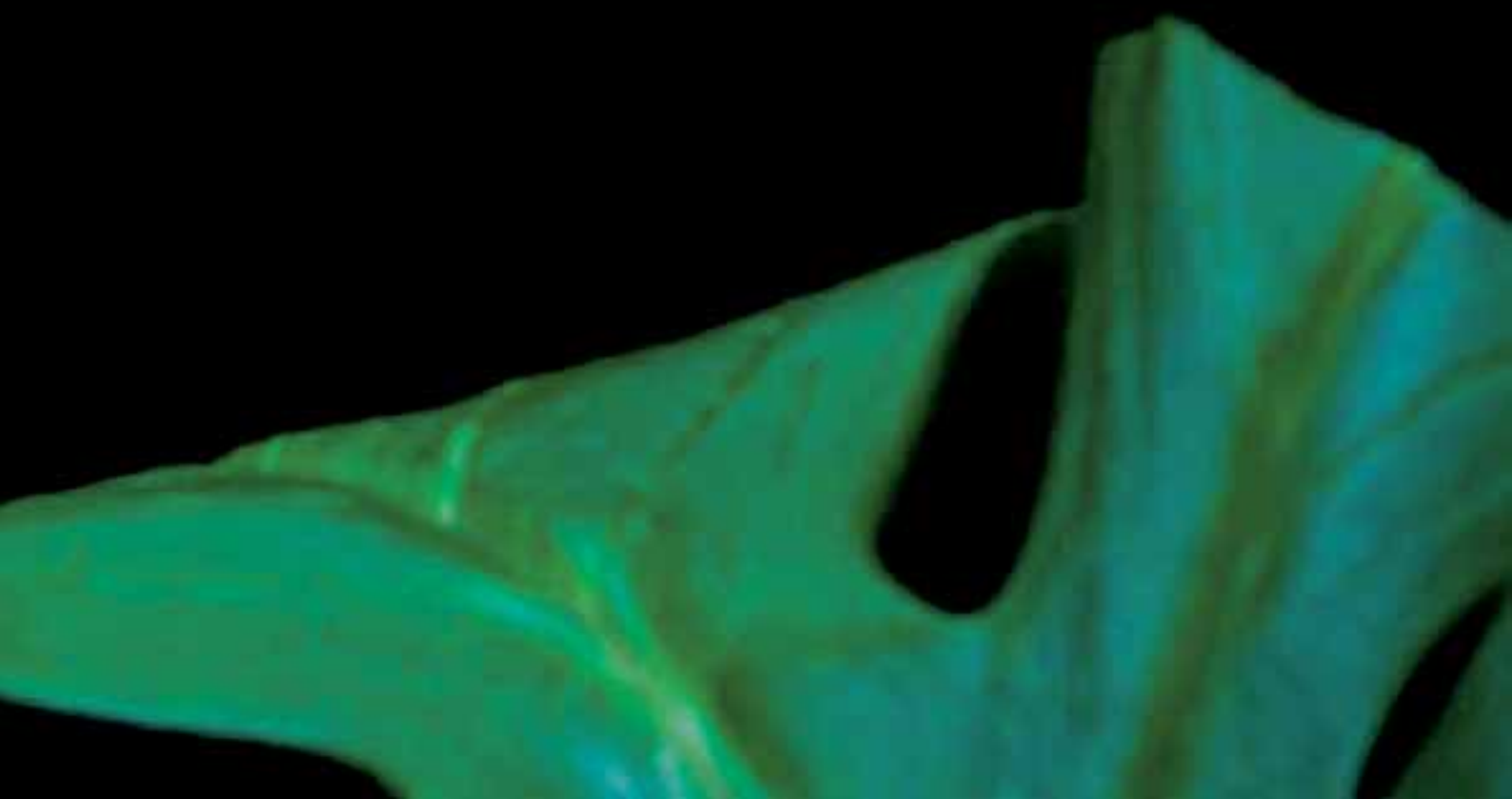




Different by nature

It is the only member of its species to take to the air. Wallace's flying frog uses its long webbed toes to glide over considerable distances and actively control its "flight path".

Not for nothing do we consider ourselves "the somewhat different reinsurer". That we are different by nature is demonstrated impressively by our rapid, flexible and undogmatic maximisation of business opportunities. In so doing, our focus is not on rankings or market share, but wholly and exclusively on profitability.



On the German life insurance market demand normalised in the year under review. In retrospect, German life insurers consider 2004 and 2005 to be exceptional years: following the tax-induced boom of 2004, 2005 proved – as anticipated – to be a difficult year for new business.

The product mix shifted markedly in favour of annuity insurance in 2006. State-subsidised "Riester" pensions, which are available in numerous variants – both the conventional form with

the customary interest rate guarantees and in the form of unit-linked products –, are now playing the central role. Sales of risk-oriented covers for individual provision or surviving dependants also remain brisk.

In the international arena we have not seen any let-up in the pace of growth in personal lines year-on-year, hence establishing a promising platform for a reinsurer such as ourselves.

Hannover Life Re – the international life and health reinsurer

The life and health reinsurance business group within the Hannover Re Group is transacted by a network of seven reinsurance companies based in Hannover, Virginia Water/London, Dublin, Johannesburg, Orlando/Florida, and Sydney.

In this context the Hannover-based Hannover Life Re International performs a special steering function by handling the integrated risk management of the business group. It is supported

by foreign branches in Paris, Stockholm, Kuala Lumpur and Hong Kong.

Our strategically important business in the Far East, encompassing the Chinese-speaking economic region as well as Japan and the Korean market, is to be strengthened by the addition of a branch office in China. We were given the green light to establish this office in November 2006 by the China Insurance Regulatory Commission (CIRC) in Beijing.

Retrocessions

We maintain long-standing relationships with a small number of professional reinsurers for the passing on of proportional retrocessions, which as a matter of principle we place directly (i.e. not through reinsurance brokers). The retrocessionaires are major companies with first-class ratings, typically AA from Standard & Poor's and A+ from A.M. Best.

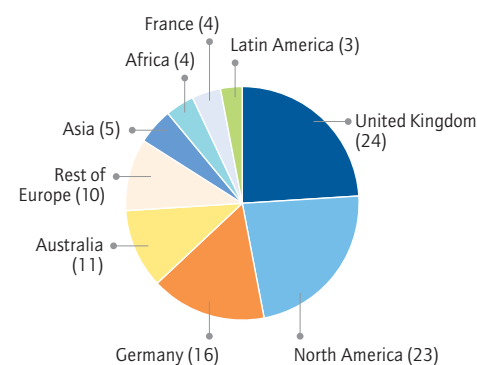
We closed the "L2" financing transaction – placed in 1999 – early with effect from 31 December 2006 and withdrew it from the retrocessionaires. This gave rise to one-off expenditure running into the mid-double-digit million euros.

With this withdrawal we have now terminated all four of the "L" series transactions placed in the years 1998 and 1999 ("L1" to "L4") and integrated the residual portfolios into our retention.

The "L6" transaction, which we placed on the capital market effective 31 December 2005

with a volume of EUR 100 million, developed according to plan in 2006. This securitisation consists of an in-force portfolio of unit-linked policies from Germany and Austria.

Geographical breakdown of life and health reinsurance as % of gross premium



Development of premium income

Gross written premium from our worldwide cedants grew to EUR 2.8 billion in the year under review – an increase of 15.2% on the previous year (EUR 2.4 billion).

We generated enlarged premium volumes from a number of regions. In Europe, the United Kingdom (risk-oriented covers and enhanced annuities) and France (bancassurance) emerged as particularly strong drivers of growth, whereas premium in Germany and Scandinavia was slightly lower owing to the expiry of sizeable life and disability portfolios that had been acquired in earlier years.

Asian business, particularly from China and Korea, was sharply higher thanks to new treaty relationships, while US life business recorded only modest growth. In this respect it should, however, be borne in mind that under the applicable accounting rules of SFAS 113 a growing portion of our US business no longer has any influence

on the reported premium income. The allocation to premium deposits, on the other hand, rose sharply in 2006. This can be attributed not only to US health business but also to large-volume financing transactions from Luxembourg, which are booked as deposit accounting contracts.

We enjoyed gratifying growth rates in South Africa, where we now rank among the market leaders for the reinsurance of individual life products.

In the year under review, with the aim of optimising the product mix, we expanded our cessions to North American retrocessionaires. Allowing for the new "L6" transaction placed at the end of 2005, the level of retained premiums fell 7.4 percentage points year-on-year to 85.4%. Net premium earned consequently totalled EUR 2.4 billion, a gain of 5.1% on the previous year (EUR 2.3 billion).

Premium volume boosted again

Key figures for life and health reinsurance

| Figures in EUR million | 2006 | +/- previous year | 2005 | 2004 | 2003 ¹⁾ | 2002 ¹⁾ |
|--------------------------------------|---------|-------------------|---------|---------|--------------------|--------------------|
| Gross written premium | 2,793.6 | +15.2% | 2,425.1 | 2,176.6 | 2,276.3 | 2,471.5 |
| Premium deposits | 1,166.2 | +278.5% | 308.1 | 311.4 | 257.9 | 255.8 |
| Gross premium incl. premium deposits | 3,959.8 | +44.9% | 2,733.2 | 2,487.9 | 2,534.2 | 2,728.3 |
| Net premium earned | 2,373.4 | +5.1% | 2,257.6 | 1,956.3 | 1,936.3 | 2,142.3 |
| Premium deposits | 1,084.4 | +295.1% | 274.5 | 267.2 | 213.4 | 115.2 |
| Net premium incl. premium deposits | 3,457.8 | +36.6% | 2,532.1 | 2,223.5 | 2,149.7 | 2,257.5 |
| Investment income | 305.4 | +10.9% | 275.3 | 221.6 | 179.4 | 268.4 |
| Claims expenses | 1,495.3 | +5.7% | 1,415.2 | 1,212.6 | 1,270.4 | 1,218.7 |
| Expenses for benefit reserves | 192.8 | -25.3% | 258.0 | 241.2 | 297.8 | 574.1 |
| Commissions | 823.9 | +20.4% | 684.1 | 589.6 | 414.4 | 453.0 |
| Own administrative expenses | 50.0 | -15.8% | 59.3 | 55.9 | 44.9 | 56.6 |
| Other income/expenses | 22.7 | -198.1% | (23.1) | (2.0) | 13.8 | (34.5) |
| Operating result (EBIT) | 139.5 | +49.8% | 93.1 | 76.7 | 61.0 | 48.5 |
| Net income after tax | 102.6 | +72.2% | 59.6 | 38.0 | 46.6 | 30.0 |
| Earnings per share in EUR | 0.85 | | 0.49 | 0.32 | 0.43 | 0.31 |
| Retention | 85.4% | | 92.8% | 90.2% | 85.1% | 86.9% |
| EBIT margin ²⁾ | 5.9% | | 4.1% | 3.9% | 3.2% | 2.3% |

¹⁾ On a US GAAP basis

²⁾ Operating profit (EBIT)/net premium earned

The portfolio mix by individual lines continued to improve in accordance with our strategic planning; the proportion of the total assumed portfolio generated by our preferred lines of life and annuity stood at almost 87% (82%).

Results

The performance of the life and health reinsurance business group is primarily determined by the following factors:

- development of the biometric risks of mortality, morbidity and longevity,
- development of the structural risk associated with the persistency of the business in force,
- movements on the international capital markets, especially in the relevant currencies of EUR, USD, GBP, ZAR and AUD,
- our own administrative expenses.

In addition, on the level of individual cedant relationships – especially where financing transactions are involved –, it is important to monitor the development of the customer-specific credit risk.

The mortality factor is the most significant biometric risk for our portfolio – in this respect our most notable exposures are in the United Kingdom, South Africa, Australia and Asia. The overall experience was satisfactory in the year under review, although certain regional differences cannot be overlooked. The claims experience within the year also exhibits a seasonal pattern, especially in the case of substantial death benefits – which occurred predominantly in the first half of 2006.

The biometric risk of morbidity, which manifests itself in lines as different as health, long-term care annuity, critical illness and disability, is assumed primarily in the United States (in the form of Senior Health Medicare Supplement plans), Singapore (as long-term care annuities), the United Kingdom and South Africa (as critical illness covers), Germany (in the form of disability

No sizeable loss events were incurred in the year under review.

covers) and Australia (as critical illness covers and disability annuities). Results continued to be favourable overall, although margins were slimmer than in previous years due to more intense competition, especially in the USA and Australia.

The longevity factor is of considerable relevance to our company due to our market leadership in the field of UK single-premium enhanced annuities. Our actuarial analyses indicate that this business is progressing in line with our projections.

The risk associated with the persistency of the in-force reinsured portfolios, which can be regarded as the dominant risk with respect to our financing transactions in Europe, the USA and South Africa, developed largely as expected in the year under review.

Movements on international capital markets had a neutral effect on the business result of Hannover Life Re in the year under review, although income from self-managed assets increased by around 0.9% due to the enlarged investment portfolio.

The cost and reporting structures in life and health reinsurance continue to be lean and efficient. With an expense ratio of 1.8% in relation to the gross written premium, we have the lowest figure among all comparable internationally operating reinsurers.

The credit risk associated with ceding companies did not materialise in the year under review; we are not aware of any instance in which the corporate rating of a client of Hannover Life Re significantly deteriorated or where the responsible supervisory authority was compelled to take

steps to safeguard the interests of policyholders. We attribute this state of affairs, which has prevailed for many years now, to our prudent scrutiny of client quality as part of our marketing approach supported by customer relationship management.

The consolidated operating profit (EBIT) in life and health reinsurance was again significantly boosted in 2006; at EUR 139.5 million it surpassed the previous year's figure by 49.8%. The

EBIT margin, calculated as a quotient of the operating profit (EBIT) and net premium earned, stood at 5.9%. It therefore exceeded the medium-term target of 5.0% for the first time.

Group net income came in at EUR 102.6 million, an increase of 72.2% over the previous year (EUR 59.6 million). This was equivalent to earnings of 0.85 EUR (0.49 EUR) per share.

Significantly higher net income

Germany

In 2006 the German life insurance industry returned to the modest long-term growth track seen in the early years of this decade, with the dual pillars of private and occupational annuity insurance with regular premium payments gaining considerable market shares – especially the so-called "Riester-Rente" pension product. Nevertheless, another pension product qualifying for tax assistance on inception of the policy – the "Rürup-Rente" – also showed appreciable growth. In comparison to earlier years, the appeal of single-premium business and traditional mixed life insurance products has diminished.

In the primary insurance sector our clients' resources are being taxed primarily by the new EU Mediation Directive as well as the change-over to the new actuarial interest rate of 2.25% per annum effective 1 January 2007.

E+S Rück, which bears responsibility for the German market within the Hannover Re Group, acquired inter alia a new account from the German bancassurance market in the year under review. The number of German cedants thus rose to 38 companies (26 life insurers, 5 personal accident insurers, 4 pension funds and 3 health insurers).

Premium income from the German market climbed by a gratifying 4.3% to EUR 447.3 million. The underwriting result was notable for a very good experience with the biometric risks. Under a personal accident financing transaction we did, however, see a deterioration in the lapse rate, which we neutralised in the fourth quarter of 2006 via an appropriate adjustment recognised in income.

Rest of Europe

United Kingdom

The United Kingdom continues to be Europe's most important life reinsurance market – UK life insurers traditionally make the most of the opportunities to ease their risk burden and also optimise their solvency through large quota share reinsurance arrangements.

As Hannover Life Re we are active in this key market through three risk carriers: Hannover Life Re UK, Hannover Life Re Ireland and the Group parent Hannover Re.

Our subsidiary Hannover Life Re UK based outside London handles conventional business from the United Kingdom, Ireland and the Isle of Man, with a focus on so-called protection business – i.e. the reinsurance of the biometric risks of mortality and critical illness. Health business has not been written to date, and the volume of disability business is minimal.

Hannover Life Re Ireland concentrates on a few key special accounts and continues to support its UK affiliate with quota share accept-

United Kingdom still the largest market

ances from the market. Hannover Re, on the other hand, has been active in the enhanced annuities market for many years – business that picked up considerably for our company in 2006.

Total gross written premium in the United Kingdom climbed by 28.3% to EUR 686.9 million (EUR 535.4 million); of this amount, 27% was attributable to Hannover Life Re UK, 26% to Hannover Re and the remaining 47% to Hannover Life Re Ireland. For the first time, therefore, the United Kingdom is Hannover Life Re's largest worldwide market – ahead of the USA, Germany, Australia and France.

Overall, the risk experience for mortality and critical illness was thoroughly satisfactory. Our annuity portfolio, which is dominated by the run-off of a previously acquired portfolio of enhanced annuities from the years 2000 – 2003, is developing according to plan.

Hannover Life Re UK delivered a record operating profit (EBIT) of EUR 16.9 million (+24.6%). The EBIT margin thus amounted to 20.6% of net premium earned, while net income after tax came in at EUR 11.6 million after EUR 9.2 million in the previous year.

Ireland

Our Dublin-based subsidiary Hannover Life Re Ireland writes worldwide treaty business with concentrations in the USA, UK, Canada, South Africa and a number of Asian markets.

Staffed by a small expert team, it can respond flexibly to our clients' needs and offer solution models that either involve a full risk transfer or are booked as so-called deposit accounting contracts.

The company booked a sharp surge of 19.9% in gross written premium to EUR 597.6 million in 2006, while net premium earned grew by 15.1% to EUR 524.6 million.

Results were influenced by two special effects, namely the commutation of an earlier large contract with a North American cedant and the establishment of an additional reserve for persistency risks from the United Kingdom associ-

ated with the amendment of tax arrangements for term life policies in occupational retirement provision (pension fund "A-Day" in May 2006). On balance this gave rise to extraordinary income of EUR 32.5 million in the year under review.

The operating profit (EBIT) amounted to EUR 72.8 million after EUR 15.0 million in the previous year. The EBIT margin thus stood at 13.9%, while net income totalled EUR 63.7 million (EUR 13.3 million).

France, Italy, Spain and Arab countries

Our life branch in Paris and the service offices in Milan and Madrid serve cedants in a sizeable European market zone encompassing France, Spain, Portugal, Italy, Malta, the countries of the former Yugoslavia, Albania and Greece. In addition, the Paris branch services accounts in the Near East, Maghreb and French-speaking Canada.

Through enlargement of the business volume – new clients were acquired and existing accounts in the area of bancassurance expanded – premium income from this region was boosted to EUR 366.7 million (EUR 180.3 million) in the year under review. The Paris branch contributed the lion's share of EUR 289.4 million.

Results in this region continued to be highly gratifying.

Scandinavia, Eastern Europe, Israel and Turkey

Marketing and underwriting responsibility for these markets rests with our life branch in Stockholm. It writes predominantly risk-oriented business, although the portfolio also includes a significant financing transaction with a Swedish insurance group.

In the year under review we substantially extended our market position in Scandinavia and Israel. The Turkish market, which offers considerable potential especially in the bancassurance sector, has increasingly become a focus of our marketing activities.

The premium volume fell by 10% compared to the previous year and totalled EUR 83.6 million. Profitability nevertheless continued to be satisfactory.

Business volume
in bancassurance
enlarged

North and Central America

The US market, the largest life reinsurance market in the world, is served by our Orlando/Florida-based subsidiary Hannover Life Re America with the support of an underwriting office for group risks on Long Island/New York.

We continue to concentrate on non-traditional areas of the market, including block assumption transactions, Medicare Supplement business and facultative risks from Latin America.

We are scarcely active in the conventional individual risk reinsurance market, where business typically consists of large-volume quota share cessions on an original premium basis, since in our assessment the level of prices and conditions prevailing on the market is still not adequate.

Gross premium totalled EUR 503.3 million in 2006, a modest increase of 1.7%. Net premium earned remained virtually unchanged at EUR 215.6 million, while the level of premium retained by Hannover Re Life America stood at 42.9%.

Other international markets

Africa

Our subsidiary Hannover Life Re Africa, which is based in Johannesburg with a branch office in Cape Town, has concentrated on individual business in recent years and writes predominantly life, critical illness and – to a lesser extent – disability covers. The markets served are South Africa and certain English-speaking African markets.

The company has built up special expertise in innovative individual life products and ranks among the market leaders for reinsurance of these products.

In the spring of the year under review we supported the market launch of a new life insurer in South Africa which relies entirely on direct customer canvassing over the Internet or by telephone. The experience to date with this distribution model, which is backed by customised

competition in the Medicare Supplement market has intensified sharply in the past year and a half as a consequence of the favourable results booked over the last four years. We noticed appreciable pressure on profitability in some parts of our portfolio.

All in all, therefore, Hannover Life Re America's operating profit (EBIT) retreated somewhat from EUR 17.4 million in the previous year to EUR 15.9 million. Net income after tax declined to EUR 8.7 million (EUR 10.5 million).

Our office in Mexico City writes business from its domestic Mexican market as well as other Central American countries. Based on our service orientation, with the special importance that we attach to underwriter training, we have succeeded in building a loyal customer base. Gross premium in the year under review amounted to EUR 27.5 million, and results were again satisfactory.

underwriting software that we developed in-house, has comfortably exceeded expectations in both qualitative and quantitative terms.

The company's gross written premium climbed by 12.2% to EUR 105.4 million and net premium earned – boosted by an increased retention from 1 January 2006 onwards – grew by as much as 18.8% to EUR 63.3 million.

Results in all lines were within the planned actuarial limits. The operating profit (EBIT) totalled EUR 3.2 million (-18.2%); this produced an EBIT margin of 5.2% of net premium earned.

Net income after tax fell by EUR 0.3 million to EUR 2.1 million.

Successful new distribution model in South Africa

Asia

We traditionally serve the Asian region from two Hannover Life Re branches: the branch office in Kuala Lumpur is responsible for the ASEAN markets and South Asia, while the branch office in Hong Kong handles the Chinese-speaking economic region as well as Japan and Korea. We write largely risk-oriented business in the life, critical illness and personal accident lines.

Gross premium income surged by a vigorous 51.4% to EUR 103.6 million in the year under review. Growth is currently driven first and foremost by the markets of China and Korea.

Results in all markets can be described as good to very good.

In November 2006, as already mentioned, we received a licence from the China Insurance Regulatory Commission to establish a life office in China. This gives us excellent prospects of being able to tap into the impressive growth of the Chinese life insurance market to the fullest extent.

Australia and New Zealand

Our Sydney-based subsidiary Hannover Life Re Australasia is responsible for business in the markets of Australia, New Zealand and Oceania. We have been market leader in this region for many years.

The company concentrates on writing life, critical illness and disability annuities. A special feature of its business is that it also assumes mortality and morbidity risks in connection with occupational retirement provision.

The gross premium volume enjoyed strong growth of 11.7% to reach EUR 302.7 million. Net premium earned climbed by 13.7% to EUR 188.8 million.

Profitability varied: results in the life and critical illness lines were very favourable, but higher inflation in Australia necessitated an adjustment of the reserves for current disability annuities with a corresponding strain on the result.

Directly written group life business, on the other hand, delivered a highly gratifying performance with non-recurring income in the high single-digit million euros from the commutation of IBNR reserves.

All in all, the operating profit (EBIT) of EUR 26.3 million came in 55.6% higher than the previous year's figure of EUR 16.9 million. Net income after tax stood at EUR 20.9 million (EUR 11.1 million).

Good growth rates in Australia

Financial reinsurance

The difference between financial reinsurance and traditional property/casualty reinsurance principally rests in the nature of the individual client's reinsurance needs: whereas property and casualty reinsurance involves an unlimited risk transfer between insurer and reinsurer in the context of a single portfolio or various lines of business, financial reinsurance contains additional components alongside the risk transfer: the optimisation of the client's overall balance sheet situation with the aid of structured reinsurance products. Requirements such as these – which are usually of a highly specific nature – give rise to

solutions that are specially tailored to the particular client.

When it comes to underwriting the risks, however, financial reinsurance uses the same actuarial models and contract constructions as those found in traditional property and casualty reinsurance. Following several years of uncertainty, the year under review brought positive news: a sharp fall-off in negative headlines ushered in increasing normalisation in demand for structured products in the United States. Yet there is still uncertainty among our clients and

potential buyers, as a consequence of which the number of inquiries and actual contracts closed still cannot be compared with the period prior to the probe launched by the New York Attorney General and the Securities and Exchange Commission (SEC) into the activities of some reinsurers.

The adoption of the EU's "Reinsurance Directive" must be assessed positively. European Union member states are now in the process of drawing up specific regulations and definitions governing financial reinsurance business. As a result, we are seeing a resurgence in acceptance of our products among our European clients.

The debate surrounding convergence of different accounting standards continues to move forward at a brisk pace and will likely affect some cedants' results in the future. We see here an opportunity for structured covers to become established across accounting borders.

The redefinition of risk transfer standards for financial reinsurance is expected to bring by far the most significant developments in this mapping out of the way ahead. All major supervisory bodies, legislative organs and industry representatives have formed working groups that are exploring various conceptual ideas relating to the scope and measurement of risk transfer.

Following the contraction in premium volume in recent years, signs of growing interest in structured covers could be discerned in the year under review. All three main products, namely surplus relief, aggregate excess of loss and spread loss contracts, were in demand.

In Eastern Europe and Asia we generated profitable new business. The portfolio in Latin America also developed favourably, and here too we were able to renew all important contracts.

New business generated in Eastern Europe and Asia

Key figures for financial reinsurance

| Figures in EUR million | 2006 | +/- previous year | 2005 | 2004 | 2003 ¹⁾ | 2002 ¹⁾ |
|---------------------------|-------|-------------------------|-------|---------|--------------------|--------------------|
| Gross written premium | 878.5 | -4.9% | 924.1 | 1,183.3 | 1,632.7 | 1,242.6 |
| Net premium earned | 698.3 | -16.2% | 833.8 | 1,206.1 | 1,563.4 | 1,211.0 |
| Net investment income | 104.6 | -55.4% | 234.7 | 342.2 | 438.3 | 357.2 |
| Operating result (EBIT) | 72.2 | -6.0% | 76.8 | 123.3 | 148.2 | 47.8 |
| Net income after tax | 55.3 | +11.8% | 49.4 | 88.9 | 99.1 | 39.7 |
| Earnings per share in EUR | 0.46 | | 0.41 | 0.74 | 0.90 | 0.41 |
| Retention | 89.8% | | 90.6% | 93.3% | 94.3% | 95.2% |
| EBIT margin ²⁾ | 10.3% | | 9.2% | 10.2% | 9.5% | 4.0% |

¹⁾ On a US GAAP basis

²⁾ Operating profit (EBIT)/net premium earned

We are one of the world's three largest providers of traditional structured reinsurance products. The brand name Hannover Re Advanced Solutions underscores our expertise in developing individually tailored customer solutions. Based on our considerable experience, technical expertise and not least our proven financial track record, we enjoy numerous long-term client relationships in the United States, by far our largest

market. We work together with large and specialist brokerage houses, with whom we maintain similarly close relations. Most of our business contacts in the United Kingdom are with Lloyd's syndicates and London-based brokerage firms. The German market is served by our subsidiary E+S Rück.

Increased net income
in the financial
reinsurance business
group

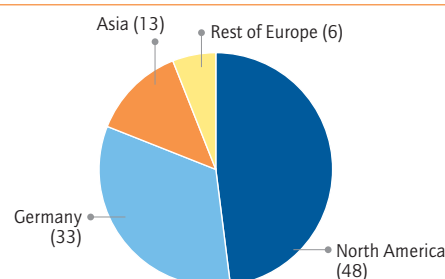
Internal cooperation within our organisation across business groups enables us to calculate an adequate premium according to the risk content of the business. The Hannover Re Group's risk assessment tools are applied consistently by all underwriters in the financial reinsurance and property/casualty reinsurance business groups. This competitive edge opens up further market potential for our company.

By and large, we can look back on a satisfactory financial year in financial reinsurance. Gross written premium contracted by 4.9% to EUR 878.5 million (EUR 924.1 million). At constant exchange rates the decrease would have been 4.6%. With the level of retained premium slightly lower than in the previous year, net premium declined by a more appreciable 16.2% to EUR 698.3 million (EUR 833.8 million).

Due to the commutation or expiry of numerous old contracts over the past two years, resulting in a substantial decrease in technical provisions and an associated contraction in interest

income, net investment income declined sharply. The operating profit (EBIT) consequently fell by 6.0% to EUR 72.2 million (EUR 76.8 million). Nevertheless, we were thus still able to achieve our medium-term goal of generating an EBIT margin of at least 7.5% in the year under review. Group net income gained 11.8% to EUR 55.3 million (EUR 49.4 million) due to a significant reduction in minority interests. The financial reinsurance business group therefore contributed earnings of 0.46 EUR (0.41 EUR) per share to Group net income.

Geographical breakdown of financial reinsurance in % of gross premium income



Specialty insurance

We use the term "specialty insurance" to designate a form of primary insurance which concentrates on closely defined, homogeneous portfolios of niche or other non-routine business that is not normally offered or adequately covered by traditional insurers. Major aspects of the business (from acquisition through the issuing of policies and premium collection to claims settlement) are normally outsourced and handled by specialised managing general agents (MGAs) or third-party administrators (TPAs).

In the year under review Hannover Re's activities in the specialty insurance business group were conducted principally through four subsidiaries: by far the largest share of the total portfolio was written by the New York-based Praetorian Financial Group, Inc. and Clarendon Insurance Group, Inc. We are also represented in the European market by the UK-based International Insurance Company of Hannover Ltd. (Inter Hannover), Bracknell/Berkshire, and in

South Africa Compass Insurance Company Ltd., Johannesburg.

Rates on the American primary insurance market were stable in our preferred lines. Competition nevertheless intensified markedly for sizeable accounts, especially in casualty business. On the other hand, substantial rate increases were obtained in catastrophe-exposed property business, especially for hurricane-exposed risks on the US Gulf Coast and in southern states as well as earthquake risks in California. Particularly with regard to the latter, however, it should also be noted that prices for reinsurance covers were appreciably higher than in the previous year.

Numerous new players entered the specialty insurance market in the year under review. This can come as no surprise, since in past years too insurers were happy to use the distribution channel of MGAs – through which the bulk of Praetorian's in-force business is written – as an anti-

cyclical source of new business during soft market phases with low rates. This process now appears to be repeating itself.

In March of the year under review we completed the final steps in the restructuring of our specialty insurance business group in the United States: in order to create clearly defined areas of responsibility, we transferred all US specialty

business to the newly established Praetorian Financial Group, Inc.; this was preceded by an internal organisational separation of functions. The Clarendon Insurance Group, Inc., which had previously been responsible for this business, will henceforth concentrate on the management of terminated programs and the remaining commodity business.

Restructuring of specialty insurance business group completed

Key figures for specialty insurance

| Figures in EUR million | 2006 | +/- previous year | 2005 | 2004 | 2003 ¹⁾ | 2002 ¹⁾ |
|---------------------------|--------------------|-------------------------|---------------------|---------|--------------------|--------------------|
| Gross written premium | 1,047.7 | -28.2% | 1,459.3 | 2,121.1 | 2,646.7 | 2,729.1 |
| Net premium earned | 108.6 | -78.1% | 496.5 | 955.1 | 1,155.9 | 832.9 |
| Underwriting result | (98.3) | +74.6% | (56.3) | (146.2) | 20.0 | 51.9 |
| Net investment income | 34.0 | -26.1% | 46.0 | 37.5 | 60.4 | 46.9 |
| Operating result (EBIT) | (71.7) | +44.4% | (49.7) | (141.5) | 57.1 | 69.0 |
| Net income after tax | 41.2 ²⁾ | | (2.4) ³⁾ | (90.7) | 42.2 | 43.3 |
| Earnings per share in EUR | 0.34 | | (0.02) | (0.75) | 0.39 | 0.45 |
| Retention | (0.6%) | | 22.5% | 40.6% | 46.4% | 37.8% |
| Combined ratio | 190.6% | | 111.3% | 115.3% | 98.3% | 93.8% |

¹⁾ On a US GAAP basis

²⁾ Thereof from discontinued operations: EUR 88.2 million

³⁾ Thereof from discontinued operations: EUR 24.8 million

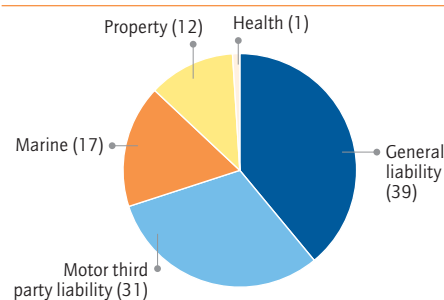
Praetorian Insurance group

Praetorian's new management concentrated on internal company structures: its immediate task was to review existing partnerships with an eye to their quality and the type of business written. Profitable partnerships were continued, whereas cooperation with producers of commodity business was discontinued. Selected specialty contracts were taken over from Clarendon. Praetorian's management team also introduced a new organisational structure based on a matrix of line-of-business specialists and program managers. In January 2006 the rating agency A.M. Best, which is of particular relevance to US business, confirmed its rating of "excellent" ("A-").

Praetorian is one of the few US insurers to concentrate exclusively on specialty insurance. With licences covering all federal states it is one

of the market's leading providers. The contracts are written by around 50 managing general agents (MGAs) that have links with Praetorian. However, in what is currently an attractive market climate we also renewed commodity business on an opportunistic basis, including for example workers' compensation covers.

Praetorian's gross written premium by line of business in % (before consolidation)



Praetorian delivers
very healthy profit
contribution

In December 2006 we announced that we had reached agreement with the leading Australian insurer on the sale of Praetorian. The purchase price of around USD 800 million was equivalent to 2.1 times Praetorian's expected shareholders' equity excluding goodwill as at the end of the year under review. The transaction is still subject to regulatory approval in the USA; we expect to receive this approval and hence close the transaction in the second quarter of 2007. Hannover Re intends to systematically invest the released risk capital of roughly EUR 600 million in the expansion of its property/casualty and life/health reinsurance business.

Praetorian generated gross premium income of EUR 1.6 billion before consolidation in the year under review – an increase of 164% on

the previous year (EUR 0.6 billion). In view of the agreement reached in December 2006 regarding the sale of Praetorian, this company's business is referred to as "discontinued operations" in the Notes to this annual report. For further explanation please see item 5.2 of the Notes "Disposals and discontinued operations". Net premium grew also impressively owing to a further rise in the level of retained premium, climbing by 104.9% to EUR 417.2 million (EUR 203.6 million). The operating result (EBIT) reached EUR 106.1 million (EUR 30.5 million) thanks to an outstanding combined ratio of 78.6%.

Clarendon Insurance Group

In accordance with our strategic planning, Clarendon was transformed in the year under review from an active insurer to a company that manages almost exclusively terminated contracts. In the course of the year Clarendon also transferred to the newly established Praetorian the portfolio of specialty business that is to be continued. Business that was not already in run-off or had not been transferred to Praetorian (such as certain hurricane-exposed property programs in Florida) was actively terminated wherever possible. The company has not yet, however, been able to scale back the residual catastrophe-exposed business to the desired extent due to regulatory restrictions, including state-imposed moratoria. For this reason we were compelled to re-

tain the programme of protection cover for the remaining natural catastrophe exposures – albeit now at considerably increased costs.

The gross premium income booked by Clarendon before consolidation totalled EUR 771.0 million (EUR 1,128.1 million) in the year under review. The bulk of this volume derived from fronting transactions for Praetorian. Net premium therefore totalled a mere EUR 0.2 million. On account of considerable strains from protection covers that had to be purchased one last time to protect expiring windstorm business in Florida, Clarendon's operating result (EBIT) in the year under review was heavily in the red (-EUR 94.6 million).

International Insurance Company of Hannover

Inter Hannover consolidated its existing portfolio from cooperations with various managing general agents in the year under review. New business was, however, selectively expanded – most notably in Spain, Italy and France. Overall, though, rate declines in primary insurance on Europe's main markets had a negative impact on the premium volume and results. The company booked gross premium income of EUR

227.0 million (EUR 279.5 million) and net income of EUR 1.5 million (EUR 4.1 million).

Compass Insurance Company

Our South African subsidiary Compass again benefited from new business relationships in the year under review and extended its premium volume accordingly. Gross premium income climbed to EUR 57.1 million (EUR 45.0 million), while the after-tax profit stood at EUR 1.1 million (EUR 1.1 million).

Total business

The gross premium income booked by all companies transacting specialty insurance contracted by a substantial 28.2% in the year under review to EUR 1.0 billion (EUR 1.5 billion). At constant exchange rates the decline would have been 27.7%.

The operating result (EBIT) deteriorated to -EUR 71.7 million (-EUR 49.7 million) on account of the expensive programme of protection cover purchased for Clarendon. This also explains why the combined ratio surged to 190.6 % – after 111.3 % in the previous year – and should not be considered as having any informational value. Due to the inclusion of Praetorian's very good profit contribution as a discontinued operation, Group net income nevertheless climbed to EUR 41.2 million (-EUR 2.4 million). This corresponded to earnings of 34 cents (-2 cents) per share.

South African subsidiary Compass expands its business

Investments

Aside from a brief but pronounced corrective phase from the middle of May to June, international equity markets enjoyed a consistent upward trend. The Dax put on 22.0% for the year, reaching its highest level of 6,611 points on 28 December 2006. The German bellwether index thus outperformed the DJ EuroStoxx 50 (+15.1%), the S&P 500 (+15.8%) and the Nikkei (+7.9%).

Prime rates moved sharply higher by 100 basis points in both the USA (to 5.25%) and the Eurozone (to 3.50%). The yield curve in the Eurozone flattened gradually in the course of the year, albeit without inverting markedly as was the case in the USA. Ten-year US treasury bonds yielded average returns of 4.8%, while the average yield in the Eurozone was a mere 3.8%. The corporate bond market saw only isolated increases in the risk premium for selected instruments, while the overall market generally moved within a very tight spread. The euro closed the year at USD 1.3181.

Hannover Re's investment policy is guided by the following core principles. We seek to:

- generate stable, plannable and tax-optimised returns while at the same time maintaining the high quality standard of the portfolio;

- ensure the Hannover Re Group's liquidity and solvency at all times;
- diversify risks within the scope of our investment strategy;
- act in accordance with the principle of matching currencies when managing our currency exposures.

Active risk management on the basis of balanced risk/return analyses

Investments



¹⁾ 2002–2003 on a US GAAP basis

Partnership

In so-called "fungus farms" leaf-cutting ants help to cultivate fungus by themselves cutting up leaves for use as substrate, which the fungus needs to grow. Such fungus colonies are only able to function so smoothly and efficiently because the diverse range of activities – from transportation of the leaves to creation of the substrate – is closely harmonised. What is more, they are geared to generating maximum benefit for the entire colony.

The Hannover Re Group focuses on the rapid, flexible and undogmatic maximisation of business opportunities. Spread across more than 100 subsidiaries, branches and representative offices in roughly 20 countries, our 2,000 employees cooperate perfectly so as to make the most of every available opportunity. Thanks to our partners, we have evolved into one of the most profitable reinsurance groups in the world in the space of just 30 years.

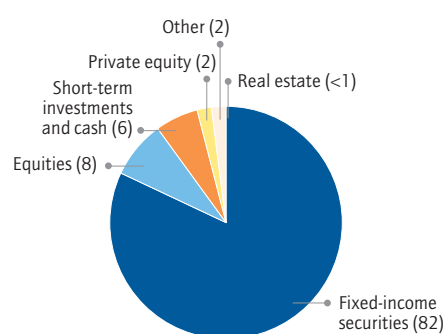




Net investment income improves by 5.9%

With these goals in mind we engage in active risk management on the basis of balanced risk/return analyses. In this context we observe centrally implemented investment guidelines and are guided by dynamic financial analysis based on the latest scientific insights. These ensure that at all times we are able to meet our payment obligations in light of our liabilities profile.

Breakdown of investments in %



Within the scope of our asset/liability management activities, the allocation of investments by currency is determined by the development of underwriting items on the liabilities side of the balance sheet. We are thus able to achieve extensive currency matching of assets and liabilities, thereby ensuring that our result is not significantly affected by fluctuations in exchange rates. As at year-end 41.5% of our asset portfolio was held in US dollars, 42.6% in euros and 6.6% in pounds sterling.

Quality of fixed-income securities consistently high

Our performance was in line with the planned parameters thanks to the neutral/defensive posture of our bond portfolio. Based on the strong cash inflow from the technical account, our portfolio of self-managed assets grew to EUR 19.2 billion (EUR 19.1 billion) despite the weak US dollar and rise in average yields. Ordinary income, which was positively affected by the increased average yields, came in considerably higher than in the previous year at EUR 784.8 million (EUR 654.6 million).

Deposit interest and expenses contributed EUR 221.9 million (EUR 351.6 million) on balance to net investment income. Gains of altogether EUR 305.1 million were realised on disposals in the reporting period as part of our active man-

agement approach, as against losses of EUR 87.7 million. The positive balance of EUR 217.4 million thus came in higher than in the previous year (EUR 162.2 million). Net investment income consequently improved by 5.9% year-on-year to EUR 1,181.2 million (EUR 1,115.8 million).

As in previous years, we actively managed the duration of our *fixed-income portfolio*, thereby not only optimising our returns but also conserving our shareholders' equity. The modified duration of our bond portfolio was kept stable over the reporting period, standing at 4.0 as at year-end 2006.

Our portfolio of fixed-income securities as at 31 December 2006 was virtually unchanged at EUR 15.7 billion, a rise of 0.4%. The increase in yields in Euroland led to the realisation of losses in the bond portfolio totalling EUR 24.1 million (EUR 44.2 million) on balance. In view of the low interest rate level and the minimal yield advantages of corporate bonds over government bonds we attached special importance to high quality in the year under review. Our holdings of corporate bonds were consequently not significantly expanded. Our preferred asset classes in Europe were debt securities issued by semi-governmental entities and jumbo mortgage bonds. New investments were made primarily in short- or medium-duration instruments. Unrealised losses in our portfolio of fixed-income securities totalled EUR 133.1 million, compared to gains of EUR 56.2 million in the previous year.

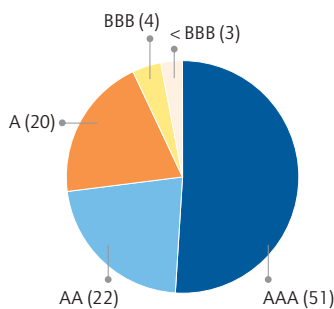
The quality of our fixed-income securities – measured in terms of the average rating of the instruments – was maintained on a consistently high level. The proportion of securities rated "A" or better – at 93.3% – was higher than in the previous year (91.8%).

As at 31 December 2006 we held a total amount of EUR 721.3 million in short-term assets, including overnight money and time deposits, and EUR 351.8 million in current assets. Funds held by ceding companies climbed to EUR 9.3 billion (EUR 8.4 billion).

In light of the favourable trend on stock markets we again realised increased gains on *equities*. The equity allocation increased slightly

to around 8% (6%), while in absolute terms the equity portfolio grew to EUR 1,596.3 million (EUR 1,213.3 million). New equity investments were made predominantly in index-tracking instruments from the Eurozone. By using targeted option strategies we exploited market volatilities in order to optimise our portfolio.

Percentage breakdown of fixed-income securities by rating categories



Of our total holdings of *alternative investments* that have been accumulated steadily over a number of years, an amount of EUR 529.1 million (including uncalled capital) was apportionable to investments in private equity funds, EUR

307.7 million to high-return bond funds and loans, EUR 110.5 million to structured real estate investments and EUR 69.4 million to CDO equity tranches. The fair value of the portfolio showed favourable growth.

Equity allocation slightly higher at 8%

Within our *real estate portfolio* altogether eight buildings and undeveloped sites belonging to Hannover Re and E+S Rückversicherung AG worth EUR 110.5 million were sold effective 31 August 2006, thereby realising net gains of EUR 1.8 million.

In addition, shares held by our subsidiary Hannover Re Real Estate Holding Ltd. in US real estate companies based in Washington, D.C. and Jacksonville were sold on 13 July and 22 December respectively for a total price of USD 115.3 million. Profits of USD 43.3 million were realised. These transactions were effected in order to profit from the attractive conditions currently prevailing on the real estate market. Hannover Re will continue to invest in real estate in the future; in the current year we shall begin to assemble an international portfolio.

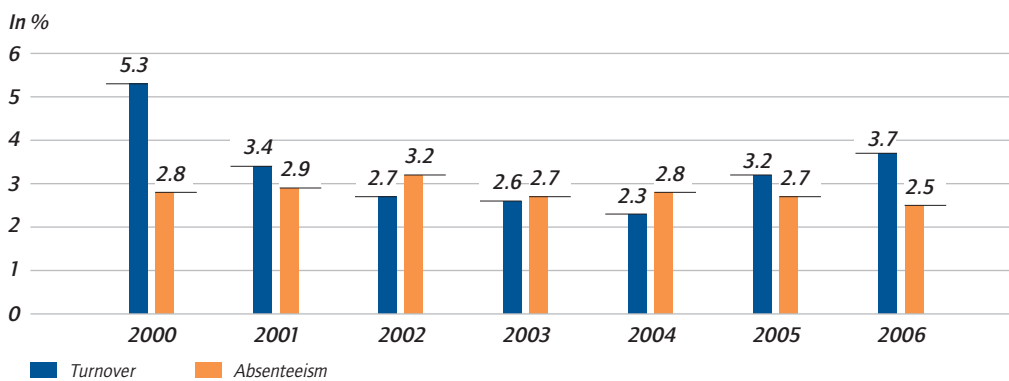
Human resources

Key personnel data

The Hannover Re Group employed 2,002 (1,989) staff as at 31 December 2006. The turnover ratio at Home Office in Hannover of 3.7% (3.2%) – measured in relation to the average

workforce of 881 – was on a par with previous years. The rate of absenteeism fell to its lowest level since 2000 at just 2.5%.

Staff turnover and absenteeism



Low staff turnover and absenteeism demonstrate employee satisfaction

The turnover and absenteeism figures once again clearly demonstrate that employee satisfaction is also reflected in key personnel data – even allowing for the fact that the difficult state of the labour market in Germany undoubtedly also plays a role here. Absentee rates serve as a seismograph for detecting the existence of in-house conflicts. By holding our conflict management seminar for executives and employees we help to defuse any tensions that may arise.

More than half the workforce at our Home Office in Hannover can draw on a rich store of professional experience based on their age. The average length of service of nine years in combination with an average age of 39.4 indicates that new recruits regularly join our company shortly after completing their university studies.

Balance between career and leisure

Employee loyalty is also fostered by flexible working-time models. This is impressively underscored by our various models for part-time working arrangements, which are used by more than 16% of our workforce. They harmonise the company's interests with those of our staff in a broad

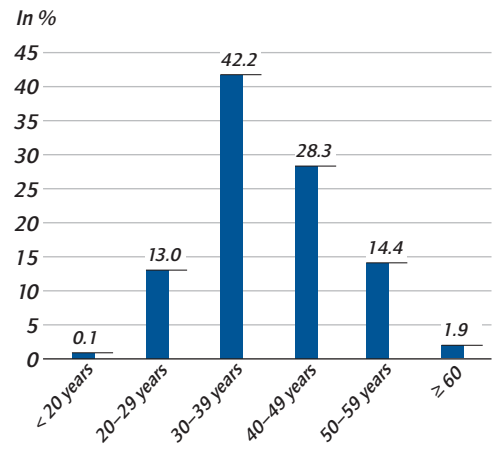
Part-time working models offer considerable flexibility for staff

University marketing activities

Hannover Re energetically maintains a tightly knit network of contacts with German universities. Our focus is directed firstly towards local (technical) universities, such as the Leibniz University of Hannover, the University of Lüneberg and Hannover University of Applied Sciences, and secondly at prominent institutions of higher learning nationwide, such as Cologne University of Applied Sciences. A lively dialogue between scientific theory and business practice takes place within the scope of these contacts, first and foremost in the form of joint events held on campus or at our offices. In addition, Hannover Re contributes to a chair for insurance and financial mathematics at the Leibniz University of Hannover.

In the year under review we participated in nine recruitment fairs: in addition to "Campus Chances" in Cologne, Hamburg, Mannheim and

Age structure



range of life situations. 70 employees – almost 8% of our team at Hannover Home Office – work from home as telecommuters, thereby also playing their own modest part in helping the environment.

Münster, we again attended "Career Dates" in Hannover. Not only that, Hannover Re participated in an industry-specific workshop entitled "Financial Services & Risk Management", the Congress of Business Mathematicians in Ulm, the "Praxisbörse" in Göttingen and the Graduates Congress in Cologne.

We continue to feel a lasting commitment to personnel development. Over the past three years an average 5% of our workforce participated in personnel development workshops: the total investment in further and advanced training amounted to six days for each staff member per year.

Total investment in further training: six days for each staff member per year

Staff participation in the company's success – the Group Performance Bonus

In 2004 we had launched the Group Performance Bonus, a performance-based compensation system for staff at our Hannover Home Office. This tool was geared to the earnings per share and hence directly linked to the company's performance; it replaced salary components that were previously guaranteed.

Participation of staff in the Group Performance Bonus (Hannover Home Office)

| 2006 | Number |
|---|--------|
| Senior executives | 64 |
| Managerial levels up to the rank of Chief | 317 |
| Total participants | 381 |
| Proportion of the total workforce | 42.7% |

Discussions with staff and the Employee Council ultimately led to the adoption of a new calculation base, namely the minimum return on

equity of 750 basis points above the risk-free interest rate (moving five-year average on 10-year government bonds). This was applied for the first time in the year under review and generated additional performance-based compensation due to the favourable development of business.

For information concerning the compensation received by members of the Executive Board and Supervisory Board and their shareholdings please see the remuneration report provided as part of our Corporate Governance report.

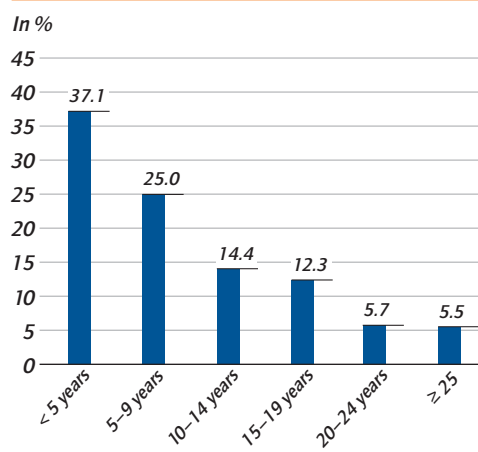
Performance-based compensation system for staff in Hannover

The remuneration report is based on the recommendations of the German Corporate Governance Code and contains information that is also mandatory in accordance with the requirements of § 315 Para. 2 No. 4 German Commercial Code (HGB). This information is discussed as a whole in the remuneration report. Consequently, we have not provided any further explanation in the present management report.

Our range of training opportunities

We attach considerable importance to the training of young people, as borne out by the excellent qualifications obtained by our trainees. Personnel development involves the timely recognition of opportunities and risks on the labour market. After a protracted demand-driven job market, we expect the supply side to take the lead in the coming years. This can be deduced from the demographic population trend for the next 20 years in Germany. We consider a differentiated, medium-term training initiative to be an appropriate, well-timed instrument for preempting this trend. So far, training has only been available for the occupational profile of certified insurance practitioner. Going forward, we intend to take a close look at other areas where opportunities for professional qualification may be available, including for example the Bachelor's degree in business informatics.

Length of service



Range of training opportunities to be expanded

Breakdown of employees by country

| Country | 2006 | | | 2005 |
|----------------|--------------|------------|--------------|--------------|
| | Total | Male | Female | Total |
| Germany | 877 | 430 | 447 | 857 |
| USA | 568 | 264 | 304 | 564 |
| South Africa | 140 | 62 | 78 | 157 |
| United Kingdom | 91 | 46 | 45 | 87 |
| Sweden | 78 | 32 | 46 | 82 |
| Australia | 50 | 23 | 27 | 50 |
| France | 38 | 20 | 18 | 42 |
| Malaysia | 31 | 14 | 17 | 32 |
| Ireland | 34 | 17 | 17 | 28 |
| Mexico | 19 | 11 | 8 | 19 |
| Bermuda | 19 | 13 | 6 | 17 |
| China | 18 | 5 | 13 | 20 |
| Italy | 12 | 5 | 7 | 12 |
| Japan | 7 | 5 | 2 | 7 |
| Spain | 6 | 1 | 5 | 6 |
| Canada | 5 | 1 | 4 | 6 |
| Bahrain | 4 | 3 | 1 | – |
| Taiwan | 4 | 2 | 2 | 2 |
| Korea | 1 | 1 | – | 1 |
| Total | 2,002 | 955 | 1,047 | 1,989 |

Word of thanks to our staff

We would like to thank our employees for their initiative, dedication and performance. Our staff identified with the company's defined objectives and pursued them purposefully at all

times. We would also like to express our appreciation to the representatives of staff and senior management for their critical yet always constructive cooperation.

Sustainability report

Our strategy, like our actions in daily business, is founded on high ethical and legal standards. As a service provider, we recognise that the public image of the Hannover Re Group is crucially shaped by the manners, actions and conduct of every member of staff.

Sustainability and social responsibility are in no way at odds with our strategic objective of being one of the best, i.e. most profitable, reinsurers in the world. On the contrary, successful business management establishes the basis for playing a positive role in society, consistently fos-

tering and advancing staff and supporting projects that are in the public interest.

The responsible underwriting of risks and diligent risk management are vital preconditions for safeguarding the quality of our business over the long term and for preserving and multiplying the value of our company. Based on the sustainability of its actions since its establishment in 1966, Hannover Re has never had to report a deficit, i.e. it has never lost capital. Our goal is to continue to act with this level of responsibility.

Profitability and sustainability not a contradiction

Social commitment

Hannover Re responds to its social responsibility with active involvement: we run a foundation that benefits the Sprengel Museum Hannover, thereby supporting the advancement of contemporary art in Hannover. Opened in 1979, the Sprengel Museum – with its extensive collection and diverse programme of rotating exhibitions – ranks among the leading museums for twentieth-century art. The Hannover Re Foundation was launched in 1991 to mark the occasion of Hannover Re's twenty-fifth anniversary. The foundation's mission is to promote Hannover as a centre for art through the acquisition of contemporary artworks that are loaned to the Sprengel Museum; the foundation is also charged with funding accompanying publications and events.

In addition, we support young musicians at Hannover University of Music and Drama. In cooperation with the university E+S Rück organises so-called "examination concerts". Three or four of the university's "master students" perform at

these concerts each year accompanied by a large orchestra and are thereby able to satisfy the requirements for embarking on a career as a soloist. Were it not for the involvement of E+S Rück these advanced students would face a long wait until their final examination, since opportunities for them to play with a large orchestra are few and far between. At the same time E+S Rück is able to offer its clients a musical highlight as part of the "Hannover Forum" seminar event.

The reinsurance of catastrophe risks is part of our core business; a constant knowledge transfer between business and research that enables our company to apply the very latest insights is indispensable. With this in mind Hannover Re supports the highly respected Geo Research Center in Potsdam. The institute conducts systematic research into earthquakes and their early identification. We also seek to maintain an ongoing dialogue with universities. Our own experts are welcome speakers at conferences and institutions of higher learning.

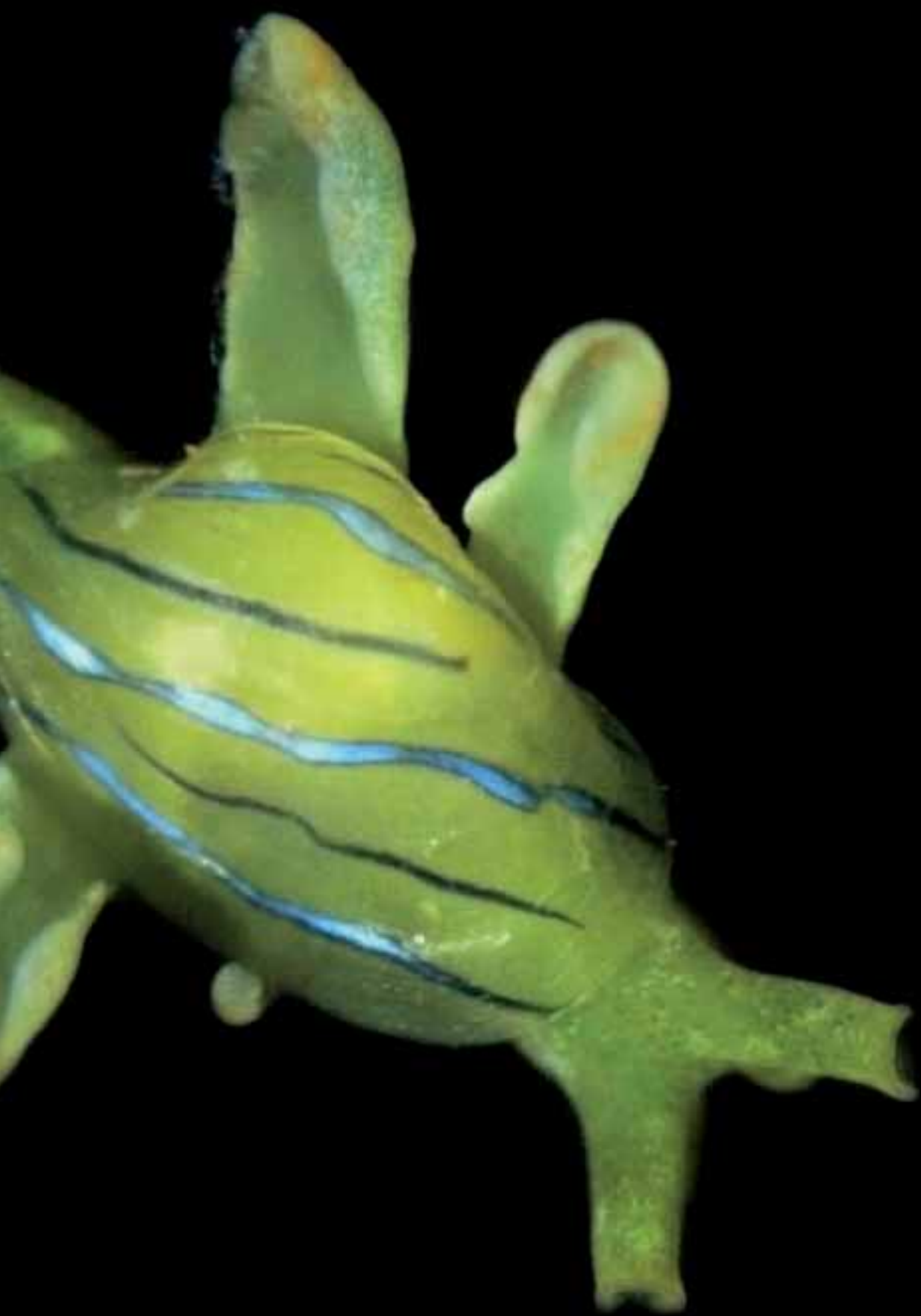
We take our social responsibility seriously



Independence

Instead of taking up chloroplasts through its food supply like any other mollusc, the vivid green sap-sucking slug simply produces them itself. By going against every rule of biology – since photosynthesis is a job for plants –, it thereby frees itself of dependence on cutaneous respiration.

We too shall strive to continue operating with a similar level of independence and economic autonomy. This means that we shall finance our further growth as the Hannover Re Group solely with self-generated profits. We are equally dedicated to ensuring that we avoid any financial imbalances that might necessitate contributions from shareholders.



Performance Excellence is a holistic management system

Performance Excellence

Performance Excellence (PE) is a forward-looking, holistic management system for the entire Hannover Re Group, with the aid of which we seek to sustainably increase the value of our company. It takes its lead from the "Excellence Model" of the European Foundation for Quality Management (EFQM) and is based on the evaluation and enhancement of methods, practices and procedures used, supported by external expert assessments. This comprehensive approach encompasses inter alia concepts such as the Balanced Scorecard, Customer Relationship Management, Leadership Feedback and Management by Objectives (MbO).

Performance Excellence serves as our guideline and is a particularly effective means of consistently enhancing our customer orientation. By way of this holistic management system, we strive to continuously improve our steering tools of leadership, policy and strategy, people as well as resources and process management. In so doing, our goal is to achieve optimal results in terms of customer and employee satisfaction as well as business performance.

Hannover Re's headquarters demonstrated its sophisticated quality management by delivering a superb result in the first external IBEC

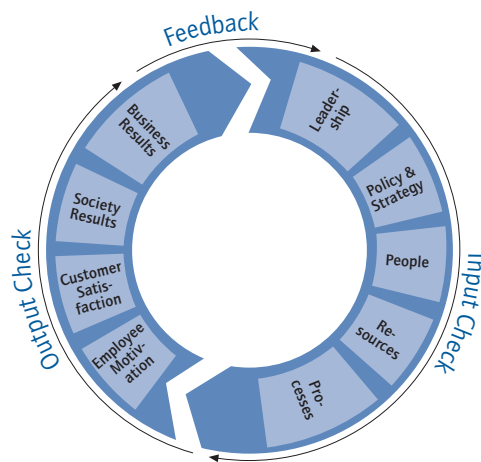
Employee responsibility

As a large employer in the Hannover area, Hannover Re creates a high-calibre environment for its employees that facilitates a harmonious balance between work and leisure and makes the company one of Germany's best employers. Hannover Re offers ambitious and performance-minded people attractive jobs, combined with continuous skills enhancement, motivation and an entrepreneurial mindset on every level.

By means of company-wide guidelines, including for example our business principles, we have defined standards that are valid for all employees worldwide. They are intended to help our staff successfully cope with the often complex ethical and legal challenges facing them in their

assessment (IQNet Business Excellence Class) covering several areas of the company. Our Home Office in Hannover was praised for its excellent management. With this advanced management system we also have at our disposal an outstanding tool that will enable us to fully satisfy future requirements. Yet not only at the company's main location in Hannover is Performance Excellence a high-priority issue: Hannover Life Re US in Orlando was our first non-German subsidiary to undergo external assessment – and it hit the ground running with a very good result.

Integrated assessment (IBEC)



daily tasks. What is more, all members of staff undertake to conduct themselves vis-à-vis their colleagues and clients in a manner that is honest, fair and law-abiding. These guidelines are regularly updated in order to keep them in tune with changing socio-political standards.

Criteria for establishing a balance between career and leisure are also applied at Hannover Re: not least in the form of a varied range of part-time working and telecommuting arrangements as well as a flexi-time system for flexible structuring of working hours. Among other things, this puts in place an optimal foundation for enabling staff to harmoniously balance personal and professional matters at their own responsi-

bility. A family-friendly approach is also reflected in the assistance offered for childcare and in job-sharing opportunities. Furthermore, active steps

are taken to promote healthy living, ranging from company sports to the availability of a mobile massage service and flu shots.

International reputation

Hannover Re is held in high international esteem. In the year under review a survey conducted by the respected US Flaspöhler Research Group ranked us the best reinsurer in the North American broker market for the second time in succession. Compared to the outcome of the last survey two years ago, the results showed further substantial improvement. Special reference was

made to the cordial personal relationships with underwriters in Hannover and our prompt case handling. This is all the more remarkable if we remember that Hannover Re writes its entire North American portfolio from Hannover. As far as market know-how and customer orientation are concerned, geographical distance is evidently no obstacle for Hannover Re.

Best reinsurer in North America for the second time in succession

Risk report

Overall system of risk monitoring and management

We always take our opportunities by weighing up the associated risks. Only if an increase in the value of the company is to be expected do we systematically and purposefully enter into these risks. Risk management is an integral component of our value-based enterprise management. Risk management is therefore accorded a special status in Hannover Re's strategy. In the year under review we adjusted the risk management approach that has been in place at Hannover Re for many years. The key qualitative and quantitative elements of risk management were – under the leadership of the Chief Risk Officer (CRO) – concentrated in the newly created Central Division Group Risk Management so as to be able to control our assets-side and liabilities-side risks on a holistic basis going forward. In addition, we have set up a Risk Committee which is charged with bringing transparency to the entire risk situation and highlighting the essential action fields. In this context, the Risk Committee's decision-making power is limited to the degree of risk defined by the full Executive Board. In functional terms, the Risk Committee is composed of the Chairman of the Executive Board, the Chief Financial Officer, the members of the Board with primary responsibility for worldwide life and non-life reinsurance business, the Central Divisional Manager Controlling and the Chief Risk Officer. The Risk Committee meets

quarterly and on an ad hoc basis when needed. The following elements are the hallmarks of our risk management organisation:

- Hannover Re's risk management is centrally coordinated, but based on local responsibility in the various areas.
- The essential components of risk management are documented in binding instructions that are applicable to the entire Hannover Re Group.
- In light of the information currently available, all conceivable risks that could jeopardise the Group's net income or survival are recorded thoroughly and systematically.
- The up-to-date status of our risk portfolio is ensured by defined reporting procedures and an annual risk inventory.
- We have at our disposal various indicators geared to individual risks that immediately flag any potential imbalances.
- We have a large number of efficient steering and controlling systems. The structure of the systems and the granularity of the reporting depends on the nature of the risk in question.
- The systems are constantly reviewed in light of efficiency considerations and they are ad-

Risk Committee charged with bringing transparency to the entire risk situation

justed in line with the prevailing business environment.

Our risk report reflects the requirements of German Accounting Standard DRS 5-20, supplemented

by further information in the Notes (Section 6 "Management of technical and financial risks"). The details provided in the Notes are based on the requirements of International Financial Reporting Standard (IFRS) 4.

Structure of our risk management



Risk Committee:

The members are the Chairman of the Executive Board, the Chief Financial Officer, the member of the Board responsible for life reinsurance, the member of the Board responsible for coordinating non-life reinsurance, the Central Divisional Manager Controlling and the Chief Risk Officer.

Group Risk Management:

attends – under the leadership of the Chief Risk Officer – to aggregate control, natural catastrophe modelling, actuarial claims analysis and dynamic financial analysis (DFA) and deals with operational risks and reporting.

Business groups:

Up to and including the year under review Hannover Re's business groups were as follows: property and casualty reinsurance, life and health reinsurance, financial reinsurance, specialty insurance and – from the risk management perspective – investments.

Risk categories

Global Risks

We take global risks to mean external risks that are beyond our direct sphere of influence. Global risks derive, inter alia, from changes in legislation and court practice, political developments and social changes, liability issues, natural disasters and environmental changes. Such sources of risk can scarcely be reduced and there are limits to the extent to which they can be avoided. Our risk management activities are therefore geared to early detection. We counter these potential risks, inter alia, by means of the following measures:

- monitoring of claims trends as well as analyses of claims and catastrophe losses (e.g. analysis of the frequency and extent of losses associated with natural disasters due to climate changes),
- review and, as appropriate, adjustment of the underwriting policy (e.g. through contractual exclusions, defined limits),
- close tracking of developments in
 - relevant legal areas (e.g. US casualty),

- regulatory requirements (e.g. Minimum Requirements for Risk Management [MaRisk], Solvency II),
- changes in accounting standards (e.g. IFRS),
- rating agency requirements (e.g. Enterprise Risk Management).

The additional information to be included in the management report pursuant to § 315 Para. 4 German Commercial Code (HGB) as a consequence of the Takeover Directive Implementation Act is provided in the section "The Hannover Re share."

Strategic risks

The hallmark of strategic risks is their causal relationship to the company's objectives. These risks derive primarily from an imbalance between the defined corporate strategy and the continually changing general economic conditions. We therefore regularly review our strategy and adjust our structures and processes accordingly. Every three years – most recently in 2005 – the assumptions underlying our corporate strategy

are systematically re-examined. Members of staff from various levels of the Group as a whole participate in the strategy review. In addition, within the framework of the annually held Global Management Forum – attended by all senior executives of the Hannover Re Group in Germany and abroad – strategic issues are explored and available courses of action discussed. In the year under review the risk management of the Hannover Re Group was one of the key topics under consideration.

Technical operating risks

The technical risk is primarily associated with the fact that cash flows which are essential for (re-)insurance business may diverge from their expected values. These risks can be subdivided into risks of random fluctuation, risks of error and risks of change.

The default risk on reinsurance recoverables is of relevance to our company because we do not always fully retain the business that we accept, but instead retrocede portions where necessary (e.g. peak exposures). The credit status of our retrocessionaires is therefore a criterion that assumes paramount importance in the selection process. As a further risk reduction measure, our receivables from reinsurance business are to some extent secured by deposits or letters of credit. What is more, in the case of most of our retrocessionaires we also have the possibility of offsetting against our own liabilities.

Property and casualty reinsurance

In property and casualty reinsurance the main methods used to reduce risks are as follows:

- Our loss reserves are determined on an actuarial basis. The point of departure for our calculations is the information provided by cedants, where necessary supplemented by additional reserves that may seem appropriate on the basis of our own loss estimations. Furthermore, we constitute an IBNR (incurred but not reported) reserve for losses that have probably already occurred but have not yet been reported to us. This applies primarily to claims in the liability lines. The adequacy of our own actuarial calculations is subject to annual

quality assurance reviews conducted by external actuaries and auditors.

- We pass on portions of our risks using traditional retrocession tools, on the one hand, and through transfers to the capital market, on the other. Both measures support diversification within the total portfolio and promote risk reduction with the goal of protecting our capital against peak exposures, such as those associated with natural disasters. In the year under review we not only completed our "K5" transaction but also placed a conventional catastrophe bond, the first time that we had used such a tool. The bond, which has a volume of USD 150 million, was placed with institutional investors from Europe and North America. It covers windstorm events in seven European countries for a period of roughly three years.
- In order to assess the risks posed by natural hazards the Hannover Re Group uses simulation models that were adjusted following the events of 2004 and 2005 in the USA. They now incorporate the latest expert insights of leading climatologists into possible changes in the frequency and intensity of such events due to climate changes. In addition, the natural hazards specialists within the Hannover Re Group continuously monitor the findings of all available scientific research with an eye to possible changes in the risk situation. In various segments we also determine additional safety loadings that are added to the output of the simulation models in order to adjust our calculation base to adequately reflect the risks.
- Within the scope of accumulation control – i.e. monitoring of the natural hazards exposure of Hannover Re's portfolio – maximum underwriting limits ("capacities") are defined for various scenarios (e.g. hurricanes in the USA) and return periods/probabilities on the basis of the company's overall risk strategy. The portfolio risk for the scenarios in question is then calculated in the form of probability distributions on a gross basis, in other words our simulation models for natural hazards are used to determine the expected loss for specific occurrence probabilities. As a final step,

Breakdown of technical operating risks into risks of random fluctuation, risks of error and risks of change

Our reserves are subject to constant internal and external review

this data based on individual scenarios is then collated for the portfolio as a whole, which is considered both on a gross basis and for net account after application of the existing retrocession structure. The data described here is also an integral component of our reporting to internal bodies, regulators and rating agencies.

- The extreme events caused by natural disasters in recent years have also demonstrated that it makes sense not only to use purely probabilistic natural hazards models for the purposes of accumulation control, but also to supplement the individual scenarios with the inclusion of realistic extreme loss scenarios. We are now in the process of progressively adding these deterministic scenario analyses and integrating their insights into probabilistic accumulation control.

Life and health reinsurance

Biometric risks (miscalculation of mortality, life expectancy and disability probabilities) as well as lapse and credit risks are of special importance in life and health reinsurance.

- We review the risk feasibility of new business activities and of the assumed international portfolio on the basis of a series of regularly performed, holistic analyses.
- New business is written in all regions in compliance with internationally applicable Global Underwriting Guidelines, which set out detailed rules governing the type, quality, level and origin of risks. These global guidelines are revised every two years and approved by the full Executive Board of the Hannover Re Group. They are supplemented by country-specific "Special Underwriting Guidelines" that cater to the special features of individual markets. Regular audits verify compliance with these guidelines.
- Further quality assurance measures are carried out at the level of the subsidiaries in the context of the actuarial reports and documentation required by local regulators as part of Corporate Governance.
- In addition, Home Office in Hannover conducts a number of relevant spot checks every year, for example regarding the amount of the tech-

nical provisions constituted for our worldwide health business. The findings of these checks are also submitted to the full Executive Board.

- In this connection we devoted special attention in the year under review to the risk of a worldwide pandemic (caused, for example, by avian influenza). Within the scope of the Enterprise Risk Management (ERM) analysis required by Standard & Poor's, the quantitative effects on our existing portfolio were modelled for the first time. We therefore took as our starting point a risk spectrum geared to scenarios that the US Centers for Disease Control and Prevention (CDC) designated as "severe" on the basis of the Spanish influenza from the years 1918/1919. It emerged that the financial repercussions of such a pandemic on the various parts of our portfolio differ greatly and are to some extent contradictory, producing a total financial strain in the order of EUR 130–150 million. In this context primary effects, such as deaths caused directly by the virus, were overlaid with secondary effects such as deaths caused by the excessive burden placed on healthcare systems (physicians, clinics) and the default of Hannover Life Re's retrocessionaires. The conclusion drawn from these calculations is that a pandemic on this scale would probably wipe out Hannover Life Re's operating profit (EBIT) for one year, but would not have a lasting negative impact on the portfolio's longer-term value creation.
- The interest guarantee risk, on the other hand, is of only minimal risk relevance due to contractual exclusions.

Financial reinsurance

Hannover Re's financial reinsurance business involves the development of individually structured covers for our clients with a view to stabilising their results and affording balance sheet protection. The primary emphasis here is on financial optimisation rather than a traditional risk transfer. Financial reinsurance as a whole acquired a bad name because some companies were accused of using it to "dress up" their books. Demand for financial reinsurance products crumbled – especially in the USA – as a consequence of this uncertainty and the protracted discussions surrounding the business practices of certain companies. In the year under view, however,

Qualitative effects
of a pandemic on
our existing portfolio
modelled

we are pleased to report that business once again developed according to plan. We have transacted financial reinsurance for more than 25 years and over time we have continuously enhanced our underwriting guidelines and specified them more closely in light of our experience. A specially created Compliance Committee monitors compliance with legal, accounting and underwriting standards and responds to official inquiries, among other tasks. In our assessment, our underwriting guidelines ensure that any potential instances of abuse can be prevented. The closing of contracts after a loss occurrence, backdating of transactions, informal understandings not documented in the contract and the booking of business with no risk transfer as reinsurance are all practices that are prohibited under our underwriting guidelines.

Specialty insurance

Our specialty insurance business group concentrates on niche and non-standard business involving small customer groups and special needs (e.g. unusual occupational risks and fine art collections). In contrast to our other business groups, traditional insurance functions – such as new business acquisition, underwriting and claims settlement – are handled by external specialised managing general agents (MGAs) and other third-party service providers. This very extensive outsourcing of functions gives rise to special risks. The corresponding control mechanisms include:

- regular checks to ensure that managing general agents and outside service providers are in compliance with our restrictive standards,
- on-site inspection of the implemented internal control system.

In the year under review all specialty business written by Clarendon Insurance Group, Inc. was concentrated in the hands of the newly established Praetorian Financial Group, Inc. Henceforth, Clarendon will focus on the management of terminated programs as well as the remaining commodity business. In December 2006 we sold Praetorian so as to be able to concentrate on our core business of reinsurance going forward. The transaction is still subject to the approval of regulators, which we expect to receive in the second quarter of 2007.

Investment operating risks

Since investment income is a major revenue source for a reinsurance enterprise, volatility on the capital markets can have serious repercussions for the statement of income. Risks in the investment sector primarily consist of market, credit and liquidity risks as well as currency exposures. The hallmarks of our risk strategy with respect to the investment portfolio are as follows:

- Risk limitation in the investment sector takes precedence over return maximisation. The goal is to generate an optimal contribution margin while adhering to defined maximum risk limits.
- Investments are guided by the requirements of the reinsurance business (e.g. with respect to currencies and maturities).
- Systematic adherence to the principle of matching currency cover.
- Asset management and liability management – and the synthesis of both segments under the umbrella of our asset/liability management approach – in order to optimise Hannover Re's overall position according to a single financial risk/return target.
- Definition of our investment guidelines on the basis of our asset/liability management approach.
- Clear distinction between trading, settlement and risk control based on the principle of separation of functions applied through to the level of management.
- The implemented management and control mechanisms take their lead from the standards adopted by the Federal Financial Supervisory Authority (BaFin) and foreign regulators as well as the risk preferences specified by the Executive Board.

Comprehensive risk strategy for the investment portfolio

Operational risks

In our understanding, this category encompasses the risk of losses occurring directly or indirectly because of inadequacy or failure of internal procedures, human error or system failure, organisational shortcomings and external events. The most significant operational risks include those of business interruption and system failure (e.g. due to a pandemic). As part of our examination of the consequences of a possible pandemic we have drawn up, inter alia, special contingency plans intended to minimise the effects of a disruption in our business.

Hannover Re's internal control system is a vital management tool for minimising operational risks. The system consists of organisational measures and checks that have been integrated into all key processes and workflows.

Irrespective of these fixed procedures, the application and effectiveness of the internal control system is reviewed by our Internal Audit unit on a company-wide and line-independent basis in all functional areas of the Group.

Assessment of the risk situation

As an internationally operating reinsurance group we are exposed to a diverse spectrum of potential risks that are not necessarily always directly correlated with our business activities. These risks can have a not inconsiderable impact on our assets, financial position and net income. Yet such risks always go hand-in-hand with opportunities, since opportunity and risk are two sides of the same coin. Only with the aid of effective controlling tools – that ensure risks can be identified and opportunities maximised in a timely manner – can practical realisation of our strategic objectives be safeguarded. Hannover Re has at its disposal sophisticated systems and methods which we use to steer our business over an appropriate planning horizon, thereby enabling us to satisfy the requirements of effective and holistic risk/opportunity management.

What is more, these mechanisms ensure that any potential need for improvement or adjustment can be proactively translated into concrete measures.

Based on our currently available insights arrived at from a holistic analysis of the risk situation, we cannot discern any risks that could jeopardise the continued existence of our company in the short or medium term or have a significant, lasting effect on our assets, financial position or net income.

Further information on our risk management system, and in particular quantitative data on individual risks, is provided in Section 6 of the Notes, "Management of technical and financial risks."

Sophisticated systems and methods used to steer our business

Forecast

The upturn in the industrialised nations, which had already lost impetus in the course of the year under review, is likely to slow still further in the current year. Monetary policy is expected to be neutral or modestly expansionary.

In 2007, as in the year under review, economic activity in the USA initially looks set to be weak, with only slow growth in gross domestic product. A cyclical cooldown will also curb con-

sumer spending. As capacity utilisation continues to decline, the US Federal Reserve Board will likely abstain from further interest rate hikes from the spring onwards – although solid data from the labour market and inflation worries do not suggest that appreciable interest rate cuts are to be anticipated in the near future.

Japan should enjoy a more robust rise in output and stronger domestic demand in 2007.

The economic momentum in the markets of East Asia is likely to be sustained, albeit at a somewhat more restrained pace. For China too a continued rapid expansion in gross domestic product is forecast.

Irrespective of the moderating influences of a strong euro and a rather restrictive monetary policy – the European Central Bank is expected to announce another modest rise in interest rates – the economy should be able to maintain

its upward momentum in Europe, albeit at a reduced tempo. Among other things, the increase in value-added tax in Germany, Europe's largest national economy, is likely to make itself felt here. Nevertheless, the improved state of the job market will help to stimulate private consumption and corporate spending should also serve as a positive stimulus. All in all, the German economy looks set to continue its upward trend in the current year.

Non-life reinsurance

We were broadly satisfied with the renewals as at 1 January – the date when around two-thirds of our treaties are renegotiated. Although the hard market has now peaked and ceding companies are increasingly running higher retentions thanks to improved capital resources, the rate level remained largely stable with only a few exceptions. In areas that did see significant rate reductions (e.g. in aviation business), they generally retreated on what were still rather high price levels. In other areas, such as catastrophe-exposed US property business, further sharp increases were obtained as anticipated. It is gratifying to report that underwriting discipline also held firm among our competitors, and we were therefore again able to achieve prices and conditions that were commensurate with the risks. The effects of the market softening that has begun to set in will not be reflected in our results before 2008/2009.

Winter storm "Kyrill", which swept across large parts of Europe in January 2007 and caused a market loss of EUR 4 to 7 billion, should favourably affect rates in European catastrophe business. For Hannover Re, "Kyrill" produced a net loss burden in the order of EUR 120 to 180 million.

The renewal season once again demonstrated that ceding companies are attaching ever-greater importance to their reinsurers' ratings. This is especially true of the underwriting of long-tail liability lines. In this case a very good rating is a precondition for even being able to

write the business. Hannover Re, with its very good ratings of "AA-" from Standard & Poor's and "A" from A.M. Best, is one of the few reinsurers to satisfy this condition without reservation; these favourable assessments of our financial strength have consequently put us in a position to profit disproportionately strongly from the attractive market climate.

The experience of the intense hurricane season in 2005 and its effects on pricing and rating models have changed the (re-)insurance industry much more profoundly than was the case with catastrophe events of earlier years. It may be assumed that current price levels for the provision of catastrophe reinsurance will be sustained in view of the updating of simulation models to reflect previously neglected or inadequately modelled components.

In marine reinsurance the market environment in the current financial year is stable. The hard market of recent years in catastrophe-exposed business should continue. We expect some cedants to raise their retentions in an attempt to scale back their increasingly expensive reinsurance protection. In offshore and energy business we similarly anticipate further attractive market conditions. What is more, the modelling of natural catastrophe exposures is likely to become more clearly and firmly established in marine (re-)insurance business; compared to the property lines, its use has hitherto been relatively underdeveloped. All in all, we anticipate a slight contraction in gross premium volume here.

Prices and conditions in property and casualty reinsurance largely commensurate with the risks

Significant price erosion is the hallmark of aviation (re-)insurance; after years of healthy profits, current market conditions are no longer attractive in some areas. We shall reduce our proportional acceptances and further diversify our non-proportional portfolio.

Credit and surety reinsurance is again faring well in the current financial year, although pressure on rates and conditions has intensified owing to the very good results posted so far. We were thoroughly satisfied with the outcome of the treaty renewals as at 1 January 2007, when around 85% of our portfolio was renewed. We were able to acquire new accounts and increase our shares under existing relationships, thereby offsetting some of the premium erosion. All in all, we expanded our position while maintaining a good level of profitability.

After a good year under review in facultative property and liability reinsurance, the renewal season – in which some 65% of the portfolio was renegotiated – also passed off very well. The decline in original rates has been felt more strongly here than in obligatory business. The broad geographical spread and large number of lines written will nevertheless enable us not only to make up for a large part of the contraction in premium volume but also to write profitable business.

The German non-life insurance market is seeing considerably fiercer competition and hence substantial rate cuts coupled with increased pressure on conditions. This was particularly noticeable in the industrial fire and motor lines. Although prices on the reinsurance side have not come under the same degree of pressure that they have on the original market, premium erosion has been observed across all lines. Rates also declined in German catastrophe business in view of the absence of severe windstorm events. We were not entirely able to cushion the effects of price erosion on the original market through adjustments in pricing for excess of loss covers. All in all, though, business in Germany developed highly satisfactorily: thanks to new accounts and increased shares under existing customer relationships we were able to further boost our already large market share and extend

our position as one of the leading reinsurers in the profitable German market.

In the *Northern European markets* we expect a continued positive trend, although the markets have softened overall. Rates for natural catastrophe covers also declined due to the absence of windstorm events in the year under review. In *the Netherlands* the total reinsurance volume contracted as ceding companies raised their retentions. In *France* we see further attractive business opportunities in builder's risk insurance, a line that we consequently intend to expand over the long term. Price increases were obtained in motor liability insurance.

Intense competition continues to prevail in the countries of *Central and Eastern Europe*, and rates therefore retreated in view of the capacity surplus. Nevertheless, it is our expectation that we will be able to modestly grow our premium volume in Russia and the countries of the former Soviet Union.

Following significant rate increases in property insurance last year in *North America* as a consequence of the severe hurricane losses, the market proved to be generally robust during the treaty renewals as at 1 January 2007. Despite the moderate hurricane losses incurred in the USA in 2006, the local market continued to develop favourably in view of the intense hurricane seasons of 2004 and especially 2005. Although rates in catastrophe-exposed property business fell somewhat short of the mid-year renewal date as at 1 July 2006, they were still highly gratifying and around 35% higher than the previous year's level. In light of the increase in natural disasters and the progressive concentration of values, these price increases are also likely to be sustained. Rates slipped back for programmes with no catastrophe exposure. We therefore stood by our strategy of requiring simultaneous cessions of other attractive business when writing catastrophe covers. We also keep an eye on special segments in which rate movements are less volatile. We pressed ahead with our policy of reorganising our portfolio in favour of more profitable non-proportional business at the expense of proportional arrangements. The capacity shortages that could still be observed

Market development
in North America
broadly favourable

Risk management
further optimised
through capital
market transactions

in the USA in the middle of 2006 have eased as capital markets brought additional solvency capital to the table.

In North American casualty business rates held stable in some segments, while slight price erosion made itself felt in other lines. In long-tail casualty business it was, however, possible to obtain price increases. A very good rating – something which few reinsurers can offer – is of considerable importance here. Hannover Re consequently enjoys a competitive edge. We have noted that insurers prefer to carry higher retentions than buy reinsurance protection from providers who do not have a first-class rating. All in all, we were satisfied with the treaty renewals in our largest and most important market.

The treaty renewals in *East Asian markets* take place predominantly as at 1 April. In Taiwan, on the other hand, most treaties are renewed as at 1 January. The Japanese market – where treaties are renewed almost exclusively as at 1 April – appears to be broadly stable, with rate increases expected for windstorm and hurricane covers. In Japan we shall enlarge our business with small mutual aid societies (known as the *Kyosai* market). Given the absence of catastrophe losses, Asian markets are likely to see progressive softening.

In *Australia* we shall continue to concentrate on niche business; we therefore again expect to generate stable income in the current financial year. The premium volume is forecast to come in slightly higher.

Risk management remains a high priority for our company. We have already made provisions across a broad front – and will continue to do so – in order to ensure that exceptional catastrophe losses do not affect our capital base. Our peak exposures have been further reduced while maintaining an unchanged premium volume, and we shall continue to make use of special securitisation transactions – i.e. the transfer of insurance risks to the capital market – so as to optimally protect our portfolio. With this in mind, we boosted our "K5" securitisation by an additional USD 106 million to altogether USD 520 million at the beginning of the current year. Not only

that, in March we successfully transferred credit risks associated with reinsurance recoverables to the capital market for the first time. This securitisation enables us to further reduce the default risk on reinsurance recoverables and hence improve the quality of our capital.

Despite the softening tendency on the markets, we consider conditions in non-life reinsurance to be broadly favourable: in view of our focus on profitable, non-proportional business, our opportunistic underwriting policy and our excellent ratings, we are in a position to generate attractive business. We continue to have our sights set firmly on profitable niche segments in non-life reinsurance, and we therefore expect our business to develop favourably in the current financial year and beyond.

Following the sale of Praetorian Financial Group, Inc., our company's US primary insurance subsidiary transacting specialty lines – the deal is expected to be completed in the second quarter of 2007 –, Hannover Re will concentrate exclusively on its core business of reinsurance. Sufficient scope for profitable growth is available to us here – including for example the continuing opportunities in US catastrophe business, in life reinsurance and in Germany as well as through the cultivation of new markets in Central and Eastern Europe and in Sharia-compliant reinsurance.

From 2007 onwards we shall limit our segmentation to two strategic business groups, namely "non-life reinsurance" and "life and health reinsurance". Non-life reinsurance will include not only property and casualty lines, but also financial reinsurance and specialty business. Against this backdrop the premium volume in this enlarged business group is expected to come in substantially higher.

We anticipate stronger demand for structured covers. In particular, the progressive change-over to IFRS accounting and the associated increased volatility in results are prompting our clients in Europe to make greater use of such products. The switch from US GAAP to IFRS planned for Japan in the years 2008 to 2010 consequently also offers considerable promise for

From 2007 onwards only two strategic business groups: non-life reinsurance and life and health reinsurance

our future business. Last but not least, the impending implementation of Solvency II – with its capital requirements for the European insurance industry – is also stimulating demand for structured reinsurance solutions.

Since 1 January 2007 we have written structured covers in Ireland solely through Hannover Re Ireland. This company has taken over the business written by E+S Re Ireland and Hannover Re Dublin, our two other providers previously active in this field.

The Group's premium income from primary insurance – what used to be its specialty insurance business – will be substantially reduced following the sale of Praetorian. The remaining volume is generated by the subsidiaries Clarendon Insurance Group, Inc. in the USA, Inter Hannover

in the United Kingdom and Compass in South Africa. Clarendon will continue to scale back the existing commodity business in the current financial year. Owing to the increased costs of protection cover incurred in the period until June for residual natural catastrophe risks, we expect this part of the Group to post a result in negative territory.

Total non-life reinsurance business is forecast to deliver a very healthy profit contribution, provided the burden of catastrophe losses and major claims remains with the expected value of 8% of net premium. In addition to winter storm "Kyrill", the major losses incurred to date consist of a modest windstorm loss in Northern Europe, flood damage in Indonesia and the crash of a satellite. All in all, net loss expenditure is still within the expected bounds.

Very healthy profit contribution in non-life reinsurance

Life reinsurance

Hannover Life Re is looking forward to a continued positive climate in both the current year and 2008 that should enable us achieve our growth targets on an organic basis. The reinsurance market remains fiercely competitive, but in recent years we have assured ourselves of a sufficient number of interesting and profitable market niches.

With our five-pillar model, encompassing – along with traditional life and health business – new business financing, the development of new markets and products, the bancassurance sector and partnerships with large multinational clients – we are well placed to share in the development of major life and annuity markets.

In Europe we anticipate significant stimuli from the United Kingdom (enhanced annuities) and France (bancassurance), while in the USA new opportunities will open up in the area of pri-

vate healthcare for seniors (referred to as Medicare Part D coverage). Our market prominence in South Africa is steadily growing, and we shall extend our positioning as the leading reinsurer for the new generation of risk products.

One area of concentration for our activities in 2007/2008 will be the expansion of our infrastructure in Asia – with a focus on the Chinese-speaking economic region (inter alia through the establishment of our life branch in China). In Australia we are looking to consolidate our role as the market's leading life reinsurer.

Overall, we expect 2007 to bring a further significant increase in our premium income and operating profit (EBIT), even allowing for the strong foundation that we already have in place following the above-average growth achieved in 2006.

Significant increase in premium income in life reinsurance

Overall business outlook

Bearing in mind the favourable market conditions and further optimisation of our risk management, we are looking forward to another good financial year in 2007: as things currently stand, we expect to generate a return on equity of at least 15%. This is subject to the premise that the burden of catastrophe losses does not significantly exceed the expected level and that there are no unforeseen adverse movements on capital markets. As for the dividend distribution, the company remains committed in this scenario to a payout ratio in the range of 35 to 40%.

In non-life reinsurance we are very well placed to operate profitably even as the market softens. Developments in life reinsurance promise further growth momentum. Our gross premium income in total business will contract appreciably following the sale of Praetorian Financial Group. Based on our improved capital position, however, we will be able to write an increased volume of attractive catastrophe business or enlarge our portfolio in other lines. In other words, the positive effect will more than outweigh the profit lost through the sale of Praetorian.

The expected positive underwriting cash flow should lead to further growth in our assets. Given a normal market environment, income from investments under own management is therefore likely to rise again. In the area of fixed-income securities we continue to stress the high quality of our portfolio. Combined with our other investments in equities and alternative asset categories, we should be able to generate a stable profit contribution.

Based on our current knowledge of market conditions in our two business groups and on the capital markets, we expect to enjoy further good business opportunities in 2008.

We define our long-term goals as follows:

In non-life reinsurance we are guided exclusively by profit rather than growth targets. Our goal here is to increase the operating profit (EBIT) by at least 10% each year.

In life reinsurance, on the other hand, we have set ourselves an annual growth target of 12%–15% for both gross premium income and the operating profit (EBIT). Only in this business group are we prepared to contemplate value-enhancing acquisitions.

On the Group level our return-on-equity target is at least 750 basis points above the risk-free interest rate.

Both the earnings per share and the book value per share also constitute central management ratios and performance indicators for our company: our strategic objective is to increase these key figures – together with the operating profit (EBIT) – by at least 10% every year (Triple 10 target).

Another good financial year anticipated in 2007