Equity Research
Europe

Quick Comment
Insurance

Swiss Re

STOCK RATING	OVERWEIGHT
Price (Dec 8, 2003)	SFr 82
Price Target	SFr 98

Stock ratings are relative to the analyst's industry (or industry team's) coverage universe.

Quick Comment

December 8, 2003

Innovative Mortality-Based Security

Swiss Re has launched an innovative fixed income security, the first of its kind, related to "extreme mortality risk". While relatively modest in size, the details of the structure provide us with an insight into Swiss Re's thinking on capital requirements within life reinsurance — and we think demonstrate the company's ability to benefit from capital arbitrage within this business.

A Swiss Re-sponsored Special Purpose Vehicle (SPV) called Vita Capital has raised $400mn from bond investors who will be remunerated by way of a quarterly coupon set at US LIBOR plus 135bp. The term of the bond is four years and the principal is at risk should mortality of the general population based on a weighted average of the US, UK, France, Italy and Switzerland exceed 130% of the actual 2002 level. The principal would be exhausted should the same measure exceed 150% of the 2002 level. In actual fact, mortality has been improving consistently over recent decades and a situation even breaching the low end of this range 130-150% of 2002 should be considered extremely unlikely — possibly on the scale of the 1918 influenza epidemic - and necessarily of global (or at least US and European) proportions.

Why has Swiss Re done this?

Understanding the true economic capital requirements of life reinsurance business is not straightforward — there is little guidance on the subject from rating agencies or regulators — and we think it is the corporates themselves — especially the global market leader Swiss Re (market share ~25%) - that probably have the best insight and therefore potential ability to benefit from arbitrage opportunities. *Swiss Re must be taking a view that the cost of capital that is relieved via this transaction exceeds the effective net cost of servicing the bond.*

If we assume that Swiss Re invests the proceeds of the bond in a risk-free manner then we might regard the annual cost to Swiss Re as being 135bp of $400mn or $5.4mn. Assuming a cost of capital of 9%, then we might suggest that at least $60mn (5.4/0.09) of capital is relieved as a result of the transaction, say SFr 100mn.

Looking at the embedded value disclosure, we note adjusted net shareholders worth of SFr 7.7bn at end 2002. Thus this is not especially material — a relief of only 1.3% of the existing capital base.

Looked at another way, we know Swiss Re had claims of SFr 10,084mn in its life business in 2002 — equal to around 32bp of the sum at risk of ~$2trillion. Observed mortality in the range 130-150% of this base would give claims of SFr 13.1bn to SFr 15.1bn — a range of SFr 2,017mn or $1,260mn. Thus protection for around one-third of this range is afforded by the new security — opening the possibility for future tranches of similar securities — at this range (130-150%) or other ranges of observed mortality at the adverse end of the tail. We understand that appetite for this security from investors was strong.

We might additionally infer that Swiss Re's economic capital model says that there is a probability of at least ~4% (1,260/400 x 1.3%) that the bottom end of this range is breached in any year (i.e. this represents a one in twenty-five year event). Intuitively this perhaps suggests that the capital model is relatively conservative.

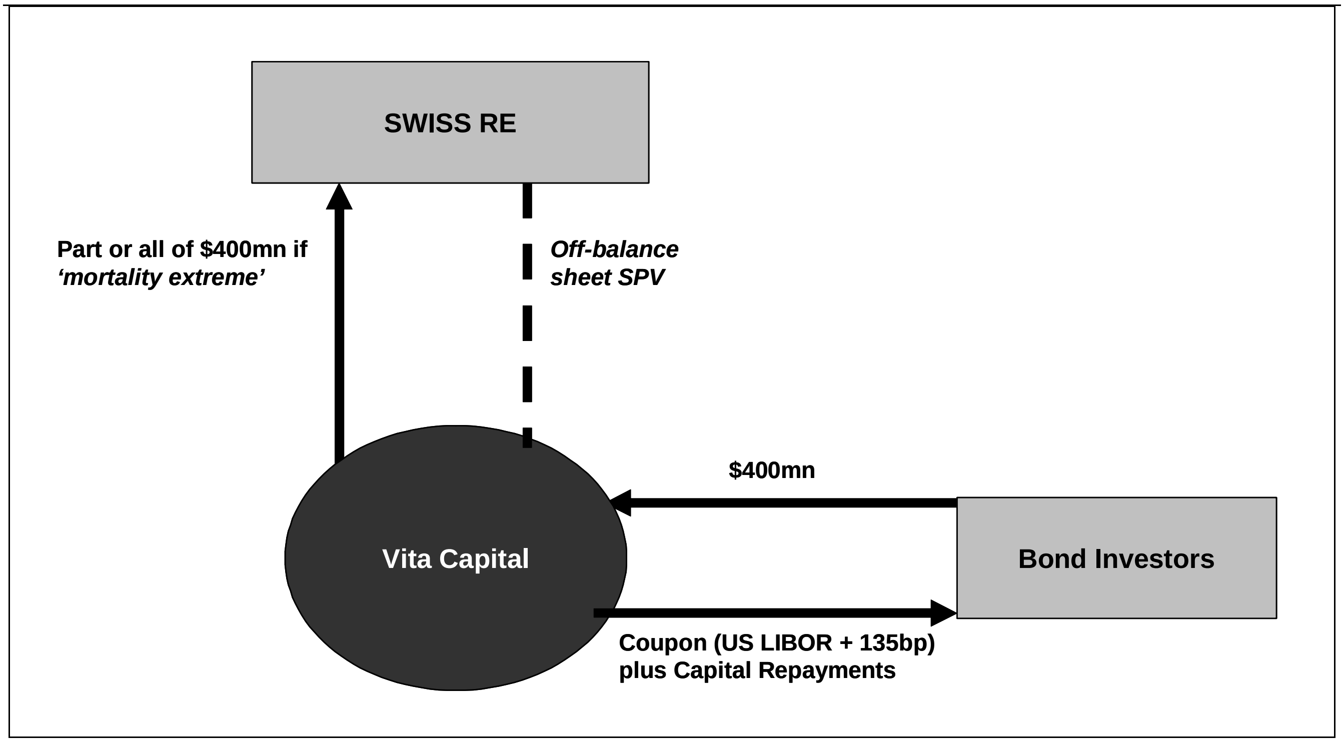
Please see analyst certification and other important disclosures starting on page 3.

Swiss Re's life reinsurance business accounted for 43% of group revenues in 2002, up from 38% in 2001. The return on operating revenues was 9.1% in 2002, in line with management's target of 9%, based on an operating result of SFr 1,344m and operating revenues of SFr 14,751m.

We rate Swiss Re Overweight with a price target of SFr 98, upside potential of 20%.

Exhibit 1

Mortality-Based Security



Source: Company data, Morgan Stanley Research

Valuation rationale/risk discussion: We value the non-life reinsurance businesses at 11x earnings, assuming a combined ratio over the cycle of 102% and a 'normalised' investment return of 5%. We value the resulting normalised earnings on a P/E multiple reflecting the longer term excess returns generated through these assumptions. We value the life business at a 7x multiple of new business. Non-life/reinsurance is a business of risk transfer, and as such, stocks with high exposure to non-life and reinsurance may be adversely affected by large and unexpected losses, especially from natural catastrophes, or positively affected in years of unusually low severity of major claims. Further adverse development of reserves, particularly relating to accident years 1997-2000, would also have negative impact upon the stock concerned. In addition, significant movements in equity and bond markets can reflect materially on the results and balance sheets of the stocks.

Industry view: In-line. Fundamentals have improved helped by markets and corporate actions.

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(as of November 30, 2003)

	Coverage Universe		Investment Banking Clients (IBC)		
Stock Rating Category	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight	578	31%	237	39%	41%
Equal-weight	861	47%	283	46%	33%
Underweight	404	22%	93	15%	23%
Total	1,843		613		

Data include common stock and ADRs currently assigned ratings. For disclosure purposes (in accordance with NASD and NYSE requirements), we note that Overweight, our most positive stock rating, most closely corresponds to a buy recommendation; Equal-weight and Underweight most closely correspond to neutral and sell recommendations, respectively. However, Overweight, Equal-weight, and Underweight are not the equivalent of buy, neutral, and sell but represent recommended relative weightings (see definitions below). An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley or an affiliate received investment banking compensation in the last 12 months.

Analyst Stock Ratings

Overweight (O). The stock’s total return is expected to exceed the average total return of the analyst’s industry (or industry team’s) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Equal-weight (E). The stock’s total return is expected to be in line with the average total return of the analyst’s industry (or industry team’s) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Underweight (U). The stock’s total return is expected to be below the average total return of the analyst’s industry (or industry team’s) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

More volatile (V). We estimate that this stock has more than a 25% chance of a price move (up or down) of more than 25% in a month, based on a quantitative assessment of historical data, or in the analyst’s view, it is likely to become materially more volatile over the next 1-12 months compared with the past three years. Stocks with less than one year of trading history are automatically rated as more volatile (unless otherwise noted). We note that securities that we do not currently consider "more volatile" can still perform in that manner.

Unless otherwise specified, the time frame for price targets included in this report is 12 to 18 months. Ratings prior to March 18, 2002: SB=Strong Buy; OP=Outperform; N=Neutral; UP=Underperform. For definitions, please go to www.morganstanley.com/companycharts.

Analyst Industry Views

Attractive (A). The analyst expects the performance of his or her industry coverage universe to be attractive vs. the relevant broad market benchmark over the next 12-18 months.

In-Line (I). The analyst expects the performance of his or her industry coverage universe to be in line with the relevant broad market benchmark over the next 12-18 months.

Cautious (C). The analyst views the performance of his or her industry coverage universe with caution vs. the relevant broad market benchmark over the next 12-18 months.

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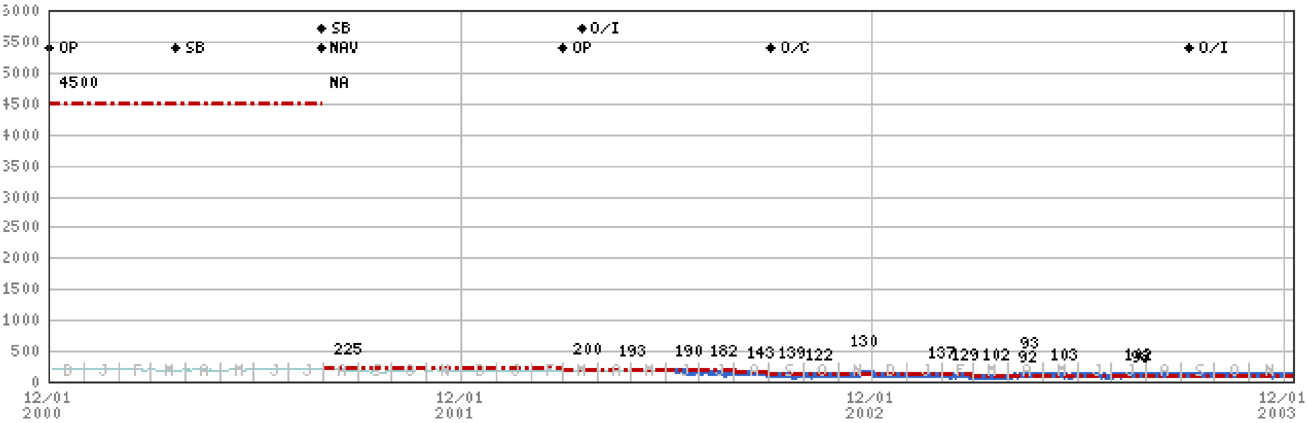
Stock Price, Price Target and Rating History (See Rating Definitions)

Swiss Re (RUKN.VX) - As of 12/8/03 in CHF
Industry : Insurance



Volatility (Introduced 3/9/01. Shading indicates "more volatile" (V) rating.)

Stock Rating History: 10/20/98 : OP; 3/23/01 : SB; 7/30/01 : NAV; 7/31/01 : SB; 3/1/02 : OP; 3/18/02 : O/I; 9/2/02 : O/C; 9/8/03 : O/I
Price Target History: 11/24/00 : 4500; 7/30/01 : NA; 8/1/01 : 225; 3/1/02 : 200; 4/11/02 : 193; 5/31/02 : 190; 7/1/02 : 182; 8/2/02 : 143; 8/30/02 : 139; 9/23/02 : 122; 11/1/02 : 130; 1/10/03 : 137; 1/31/03 : 129; 2/27/03 : 102; 3/31/03 : 92; 4/3/03 : 93; 4/29/03 : 103; 7/3/03 : 102; 7/10/03 : 98

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst) Stock Price (Covered by Current Analyst)
Stock Ratings abbreviated as below (Effective 3/18/02, ratings appear as Stock Ratings/Industry View) ◆
Stock Ratings as of 3/18/02: Overweight (O) Equal-weight (E) Underweight (U) More Volatile (V) No Rating Available (NAV)
Stock Ratings prior to 3/18/02: Strong Buy (SB) Outperform (OP) Neutral (N) Underperform (UP) No Rating Available (NAV)
Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

Other Important Disclosures

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