



Münchener Rück
Munich Re Group

MUNICH RE GROUP

EUROPEAN EMBEDDED VALUE 2006

**SUPPLEMENTARY INFORMATION REGARDING LIFE AND MEDICAL
EMBEDDED VALUE RESULTS 2006**

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1 Introduction

1.1 Scope of disclosure

In May 2004 the CFO Forum, a group representing the Chief Financial Officers of major European insurers, published the European Embedded Value Principles (EEVP). The Munich Re Group has adopted the EEVP from the reporting year 2005 on.

This document includes the following:

- The European Embedded Value as at 31 December 2006
- An analysis of the value added (embedded value earnings) during 2006
- A detailed description of the embedded value methodology applied
- A reconciliation of the embedded value with the IFRS equity
- An analysis of the sensitivities of the embedded value as at 31 December 2006 and 2006 value added by new business to changes in certain key assumptions

1.2 Covered business

The embedded value is reported for the following covered business:

- All business written in life reinsurance entities excluding medical reinsurance business
- Business written in all major primary life and German medical entities

German medical primary business is long-term business similar to life business and is therefore included in the embedded value. Medical reinsurance business is short-term in nature and therefore excluded from the embedded value.

The reinsurance companies writing the covered life reinsurance business are listed in the following table:

Australia	Munich Reinsurance Company of Australasia Ltd
Germany	Münchener Rückversicherungs-Gesellschaft AG
Italy	Münchener Rück Italia S.p.A.
South Africa	Munich Reinsurance Company of Africa Ltd
Switzerland	New Reinsurance Company
U.S.A.	Munich American Reassurance Company

Life reinsurance business written by branch offices of the above companies is also included. Major branch offices writing life reinsurance business are:

Canada	Munich Reinsurance Company Canada Branch (Life)
United Kingdom	Munich Reinsurance Company United Kingdom Life Branch

The covered business represents 100% of the life reinsurance business written in the Munich Re Group. The stand-alone embedded value figures are fully reflected in the embedded value figures at the Munich Re Group level.

The primary insurance companies writing the covered life and medical primary insurance business are listed in the following table:

Austria	VICTORIA-VOLKSBANKEN Versicherungsaktiengesellschaft
Belgium	Hamburg-Mannheimer N.V./S.A.
Estonia	ERGO Elukindlustuse AS
Germany	DKV Deutsche Krankenversicherung Aktiengesellschaft
	Hamburg-Mannheimer Versicherungs-Aktiengesellschaft
	KarstadtQuelle Lebensversicherung AG
	VICTORIA Lebensversicherung Aktiengesellschaft
	VICTORIA Krankenversicherung Aktiengesellschaft
Italy	ERGO Previdenza S.p.A.
Latvia	ERGO Latvija dzīvība AAS
Lithuania	ERGO Lietuva gyvybes draudimo UAB
Poland	Sopockie Towarzystwo Ubezpieczeń na Życie ERGO Hestia S.A.
Portugal	VICTORIA-Seguros de Vida S.A.
Spain	ERGO Vida Seguros y Reaseguros, Sociedad Anónima

The covered business includes more than 90% of the total primary life and medical business written in the Munich Re Group, measured by premium income. The consolidation of the stand-alone embedded value figures into the embedded value figures at the Munich Re Group level takes into account the dilution of earnings through minority shareholders and policyholders, where applicable.

1.3 Definition of embedded value

The embedded value is the present value of shareholders' interests in the earnings distributable from assets allocated to the covered business after sufficient allowance for the aggregate risks in the covered business.

The embedded value consists of the following components:

- Present value of future shareholder cash flows from in-force business (PVIF)
- Cost of holding required capital (CoC)
- Adjusted net worth (ANW), broken down into free surplus (FS) and required capital (RC)

The embedded value methodology makes allowance for the aggregate risks in the covered business through the following measures:

- A required capital derived from internal risk capital models and additional regulatory restrictions
- A market-consistent assessment of the time value of financial options and guarantees

- A deduction for the cost of capital, which is comprised of the cost of double taxation and investment expenses on the required capital, a frictional cost of capital, and the cost of capital due to the profit sharing of investment income on shareholder funds for German primary life and medical business

The embedded value is calculated on a local statutory basis. The results are presented net of minority interests and policyholder participations.

A detailed description of the embedded value methodology is given in section 3.

1.4 Disclaimer

This report contains forward-looking statements that are based on current assumptions and forecasts of the management of the Munich Re Group companies mentioned in section 1.2. Known and unknown risks, uncertainties and other factors could lead to material differences between the forward-looking statements given here and the actual development, in particular the results, financial situation and performance of our company. The Munich Re Group assumes no liability to update these forward-looking statements or to conform them to future events or developments.

2 Embedded value results 2006

2.1 Reinsurance

The most important European Embedded Value components for reinsurance business as at 31 December 2005 and 31 December 2006 are shown in the following table:

All figures in €m	31.12.2006	31.12.2005
European Embedded Value	5,962	5,920
- PVIF	4,479	4,342
- CoC	-901	-960
- ANW	2,384	2,538
CoC	-901	-960
- Tax and investment expense CoC	-281	-324
- Frictional CoC	-620	-636
ANW	2,384	2,538
- Required capital	1,808	1,889
- Free surplus	576	649
Financial options and guarantees		
- European EV before FOG	5,998	5,968
- Value of FOG	-36	-48
- European EV	5,962	5,920

The embedded value shows a small increase of 1% over the year 2006. Detailed explanations follow later in this section.

The total required capital as at 31 December 2006 of EUR 1,808m exceeds the capital required at the group level to cover all minimum local and group solvency requirements by EUR 543m.

The change in embedded value in 2006 is shown in the following table:

All figures in €m	EV	PVIF	CoC	ANW
Opening embedded value	5,920	4,342	-960	2,538
Embedded value earnings	578	500	-17	95
Currency movements	-471	-363	76	-184
Value of acquired / (divested) business	0	0	0	0
Capital movements	-65			-65
Closing embedded value	5,962	4,479	-901	2,384

The change in embedded value in 2006 was driven by strong embedded value earnings (9.8% of opening embedded value) and by negative currency movements (-8.0% of opening embedded value). The currency movements are mainly due to the weakening of the US and Canadian dollars versus the euro in 2006.

The breakdown of the 2006 embedded value earnings is shown in the following table:



		EV	PVIF	CoC	ANW
Expected return	€m	286	177	40	69
Expected transfer from PVIF to ANW	€m	0	-303	0	303
Experience variances	€m	-83	84	-8	-159
Operating assumption changes	€m	94	-20	61	53
Value added by new business	€m	228	557	-120	-209
Operating embedded value earnings	€m	525	495	-27	57
- as % of embedded value	%	8.9			
Tax variances/assumption changes	€m	46	28	2	16
Investment variances	€m	15	-9	1	23
Economic assumption changes	€m	-8	-14	7	-1
Total embedded value earnings	€m	578	500	-17	95

The strong 2006 embedded value earnings are due to both in-force and new business results.

The expected return plus the value added by new business amount to EUR 514m or 8.7% of the opening embedded value, which is within the range of the embedded value target of 8–9%. The total embedded value earnings of 9.8% exceed the embedded value target.

The good results from new and in-force business are reflected in the following key profitability ratios:

New business		2006	2005
Value added by new business (VANB)	€m	228	247
Present value of new business premiums (PVNBP)	€m	5,349	5,185
Annual premium equivalent (APE)	€m	571	625
Opening embedded value (EV)	€m	5,920	4,526
VANB / PVNBP	%	4.3	4.8
VANB / APE	%	39.9	39.5
VANB / EV	%	3.9	5.5
Total business			
Operating embedded value earnings / Opening embedded value	%	8.9	11.3
Total embedded value earnings / Opening embedded value	%	9.8	16.6

Currency movements and the increase of risk free rates caused a slight decrease of value added by new business from EUR 247m to EUR 228m.

The development of required capital in 2006 is shown in the following table:

All figures in €m

Required capital as at 31 December 2005	1,889
Change in required capital for in-force business	-138
Required capital for 2006 new business	188
Currency movements	-131
Required capital as at 31 December 2006	1,808

The change in required capital in 2006 is driven by two factors. Firstly, the required capital for new business (EUR 188m) is higher than the required capital released by the run-off of existing business (EUR 138m). Secondly, changes in foreign exchange rates decrease the required capital in the reporting currency by EUR 131m.

Please note that these numbers differ from the stand-alone economic capital requirements disclosed in the Munich Re Group Analysts' conference presentation on 04 May 2007. The figures differ mainly because the stand-alone economic capital numbers are derived on a fully economic basis, whereas the required capital numbers used in this EEV disclosure make additional allowance for regulatory restrictions.

2.2 Primary insurance

The covered primary insurance business consists of the three business segments

- German primary life insurance
- International primary life insurance
- German primary medical insurance

Embedded value results 2006 for the entire covered primary insurance business are presented in section 2.2.1. Embedded value results 2006 for the three business segments are presented in sections 2.2.2, 2.2.3 and 2.2.4.

2.2.1 Primary insurance in aggregate

The most important European Embedded Value components for primary insurance business as at 31 December 2005 and 31 December 2006 are shown in the following table:

All figures in €m	31.12.2006	31.12.2005
European Embedded Value	4,154	2,865
- PVIF	3,755	2,504
- CoC	-1,253	-1,253
- ANW	1,652	1,614
CoC	-1,253	-1,253
- Tax and investment expense CoC	-109	-70
- CoC for policyholder participation	-639	-596
- Frictional CoC	-505	-587
ANW	1,652	1,614
- Required capital	1,677	1,673
- Free surplus	-25	-59
Financial options and guarantees		
- European EV before FOG	4,244	3,201
- Value of FOG	-90	-336
- European EV	4,154	2,865

The significant increase in EEV in 2006 is mainly due to the German life businesses and results from a combination of higher interest rates, an increase in the shareholders' share of gross surplus and the ongoing improvements in asset liability management.

The CoC has not changed over the year, mainly as the significant increase in the PVIF was counterbalanced by the reduction in the frictional cost rate from 100bp to 50bp for the German primary life business. This change is discussed in section 3.6.

For German primary life and primary medical insurance companies required capital and thus ANW are set to statutory net worth. In accordance with the European Embedded Value look-through principle, differences between the IFRS and statutory pension liabilities are included in the EEV as an adjustment to the net assets resulting in a negative Free Surplus.

The total required capital as at 31 December 2006 of EUR 1,677m exceeds the capital required to cover all minimum solvency requirements by EUR 1,269m.

For German primary life insurance companies the increased interest rates in combination with risk mitigation by management action reduced the time value of options and guarantees considerably. Especially the extensive swaption program we put in place in 2005 and further supplemented in 2006 provides protection against decreasing interest rates. The exposure to financial options and guarantees of the German primary medical insurance business is limited due to the ability to increase premiums in the event of adverse developments.

The change in embedded value in 2006 is shown in the following table:

All figures in €m	EV	PVIF	CoC	ANW
Opening embedded value	2,865	2,504	-1,253	1,614
Embedded value earnings	1,447	1,252	-1	196
Currency movements	1	0	1	0
Value of acquired / (divested) business	-1	-1	0	0
Capital movements	-158			-158
Closing embedded value	4,154	3,755	-1,253	1,652

The breakdown of the embedded value earnings in 2006 is shown in the following table:

		EV	PVIF	CoC	ANW
Expected return	€m	102	62	33	7
Expected transfer from PVIF to ANW	€m	0	-207	0	207
Experience variances	€m	202	53	165	-16
Operating assumption changes	€m	313	427	-118	4
Value added by new business	€m	125	226	-50	-51
Operating embedded value earnings	€m	742	561	30	151
- as % of embedded value	%	25.9			
Tax variances/assumption changes	€m	7	5	0	2
Investment variances	€m	320	283	-6	43
Economic assumption changes	€m	378	403	-25	0
Total embedded value earnings	€m	1,447	1,252	-1	196

The 25.9% operating embedded value return in 2006 is considerably higher than the target return of the primary insurance business of 8–9% of the opening embedded value. Besides the increased value of new business this is due to lower frictional costs and a projected increase in the shareholders' share of gross surplus. The total embedded value earnings are positively influenced by higher than expected investment returns during the year and the higher interest rates at the year end.

The following table shows key profitability ratios:

New business		2006	2005
Value added by new business (VANB)	€m	125	72
Present value of new business premiums (PVNBP)	€m	6,988	6,520 ¹
Annual premium equivalent (APE)	€m	734	696 ¹
Opening embedded value (EV)	€m	2,865	2,980
VANB / PVNBP	%	1.8	1.1
VANB / APE	%	17.0	10.3
VANB / EV	%	4.4	2.4
Total business			
Operating embedded value earnings / Opening embedded value	%	25.9	14.7
Total embedded value earnings / Opening embedded value	%	50.5	0.4

The value added by new business increased significantly from 2005 to 2006. This increase is mainly due to the improved profitability of German primary life insurance business as a result of the higher shareholders' share of gross surplus and also due to the higher interest rates.

2.2.2 German primary life insurance business

The most important European Embedded Value components for German primary life insurance business as at 31 December 2005 and 31 December 2006 are shown in the following table:

¹ The methodology to derive new business volumes was changed in 2006 to be aligned with published annual reports. For comparative purposes, the 2005 new business volumes are restated here while at 9 May 2006, a PVNBP of EUR 5,721m and an APE of EUR 649m were published.



All figures in €m	31.12.2006	31.12.2005
European Embedded Value	2,211	1,174
- PVIF	1,808	730
- CoC	-583	-534
- ANW	986	978
CoC	-583	-534
- Tax and investment expense CoC	-46	-25
- CoC for policyholder participation	-391	-328
- Frictional CoC	-146	-181
ANW	986	978
- Required capital	1,055	1,047
- Free surplus	-69	-69
Financial options and guarantees		
- European EV before FOG	2,278	1,590
- Value of FOG	-67	-416
- European EV	2,211	1,174

The EEV of the German primary life insurance business has almost doubled during 2006. The low interest rates at the end of 2005 depressed the EEV due to the interest rate guarantees. The increase in interest rates during 2006 substantially increased the EEV. Furthermore, the ALM strategy now places increased importance on protecting the shareholders against falling interest rates.

The proportional increase in the CoC is much lower than the increase in PVIF as result of the reduction in the frictional cost rate from 100bp to 50bp (see section 3.6).

The change in embedded value in 2006 is shown in the following table:

All figures in €m	EV	PVIF	CoC	ANW
Opening embedded value	1,174	730	-534	978
Embedded value earnings	1,122	1,078	-49	93
Currency movements	0	0	0	0
Value of acquired / (divested) business	0	0	0	0
Capital movements	-85			-85
Closing embedded value	2,211	1,808	-583	986

The breakdown of the embedded value earnings in 2006 is shown in the following table:



		EV	PVIF	CoC	ANW
Expected return	€m	55	32	21	2
Expected transfer from PVIF to ANW	€m	0	-133	0	133
Experience variances	€m	136	23	125	-12
Operating assumption changes	€m	369	507	-141	3
Value added by new business	€m	82	133	-23	-28
Operating embedded value earnings	€m	642	562	-18	98
- as % of embedded value	%	54.7			
Tax variances/assumption changes	€m	9	5	0	4
Investment variances	€m	227	242	-6	-9
Economic assumption changes	€m	244	269	-25	0
Total embedded value earnings	€m	1,122	1,078	-49	93

The ERGO Group's requirements for the profitability of the primary life insurance business have been increased. The projected shareholders' share is now dependent on the development of each scenario instead of a fixed shareholders' share of gross surplus of 10%. The resulting average shareholders' share is almost 14% and is consistent with the ERGO Group's focus on increasing shareholder returns.

The better capital market environment in 2006 has led to positive investment variances and economic assumption changes.

Changes in new business mix and volume (+14%) together with an increased shareholders' share lead to a significant rise in new business value. The development of key profitability ratios in the following table shows the commitment to achieve higher profitability for German primary life business:

New business		2006	2005
Value added by new business (VANB)	€m	82	37
Present value of new business premiums (PVNBP)	€m	4,070	3,577
Annual premium equivalent (APE)	€m	498	462
Opening embedded value (EV)	€m	1,174	1,206
VANB / PVNBP	%	2.0	1.0
VANB / APE	%	16.5	8.0
VANB / EV	%	7.0	3.1
Total business			
Operating embedded value earnings / Opening embedded value	%	54.7	24.8
Total embedded value earnings / Opening embedded value	%	95.6	3.1

2.2.3 International primary life insurance business

The most important European Embedded Value components for international primary life insurance business as at 31 December 2005 and 31 December 2006 are shown in the following table:



All figures in €m	31.12.2006	31.12.2005
European Embedded Value	599	560
- PVIF	451	428
- CoC	-72	-60
- ANW	220	192
CoC	-72	-60
- Tax and investment expense CoC	-26	-18
- CoC for policyholder participation	0	0
- Frictional CoC	-46	-42
ANW	220	192
- Required capital	152	157
- Free surplus	68	35
Financial options and guarantees		
- European EV before FOG	620	562
- Value of FOG	-21	-2
- European EV	599	560

The embedded value shows a moderate increase of 7% over the year 2006. The embedded value 2006 includes a negative impact of EUR -21m from the initial explicit valuation of financial options and guarantees via stochastic projection models for several entities in addition to Italy where they were already explicitly valued in 2005. Nearly all entities have calculated their embedded value 2006 on a stochastic basis.

The change in embedded value in 2006 is shown in the following table:

All figures in €m	EV	PVIF	CoC	ANW
Opening embedded value	560	428	-60	192
Embedded value earnings	35	24	-13	24
Currency movements	1	0	1	0
Value of acquired / (divested) business	-1	-1	0	0
Capital movements	4			4
Closing embedded value	599	451	-72	220

The change of embedded value over the year 2006 relates almost exclusively to embedded value earnings. Currency movements, capital actions and acquisitions and divestments play only a marginal role.

The breakdown of the embedded value earnings in 2006 is shown in the following table:



		EV	PVIF	CoC	ANW
Expected return	€m	19	15	1	3
Expected transfer from PVIF to ANW	€m	0	-38	0	38
Experience variances	€m	-6	-10	-3	7
Operating assumption changes	€m	-40	-44	4	0
Value added by new business	€m	21	53	-8	-24
Operating embedded value earnings	€m	-6	-24	-6	24
- as % of embedded value	%	-1.1			
Tax variances/assumption changes	€m	-2	0	0	-2
Investment variances	€m	7	6	-1	2
Economic assumption changes	€m	36	42	-6	0
Total embedded value earnings	€m	35	24	-13	24

The negative operating assumptions changes are mainly due to a change in the expense allocation of the Italian entity.

In the following table key profitability ratios are shown:

New business		2006	2005
Value added by new business (VANB)	€m	21	7
Present value of new business premiums (PVNBP)	€m	383	306
Annual premium equivalent (APE)	€m	44	39
Opening embedded value (EV)	€m	560	492
VANB / PVNBP	%	5.5	2.3
VANB / APE	%	47.7	17.9
VANB / EV	%	3.8	1.4
Total business			
Operating embedded value earnings / Opening embedded value	%	-1.1	11.4
Total embedded value earnings / Opening embedded value	%	6.3	12.0

The value added by new business shows a strong increase from EUR 7m to EUR 21m. The increase of new business volume as well as new business profitability stems mostly from the Belgian operation while new business in Italy is still below expectations.

2.2.4 German primary medical insurance business

The most important European Embedded Value components for German primary medical insurance business as at 31 December 2005 and 31 December 2006 are shown in the following table:



All figures in €m	31.12.2006	31.12.2005
European Embedded Value	1,344	1,131
- PVIF	1,496	1,346
- CoC	-598	-659
- ANW	446	444
CoC	-598	-659
- Tax and investment expense CoC	-37	-27
- CoC for policyholder participation	-248	-268
- Frictional CoC	-313	-364
ANW	446	444
- Required capital	470	469
- Free surplus	-24	-25
Financial options and guarantees		
- European EV before FOG	1,346	1,049
- Value of FOG	-2	82
- European EV	1,344	1,131

The embedded value shows a growth of more than 18% over 2006 with earnings of 25.6% relative to the opening embedded value. The change in embedded value in 2006 is shown in the following table:

All figures in €m	EV	PVIF	CoC	ANW
Opening embedded value	1,131	1,346	-659	444
Embedded value earnings	290	150	61	79
Currency movements	0	0	0	0
Value of acquired / (divested) business	0	0	0	0
Capital movements	-77			-77
Closing embedded value	1,344	1,496	-598	446

The breakdown of the embedded value earnings in 2006 is shown in the following table:

		EV	PVIF	CoC	ANW
Expected return	€m	28	15	11	2
Expected transfer from PVIF to ANW	€m	0	-36	0	36
Experience variances	€m	72	40	43	-11
Operating assumption changes	€m	-16	-36	19	1
Value added by new business	€m	22	40	-19	1
Operating embedded value earnings	€m	106	23	54	29
- as % of embedded value	%	9.4			
Tax variances/assumption changes	€m	0	0	0	0
Investment variances	€m	86	35	1	50
Economic assumption changes	€m	98	92	6	0
Total embedded value earnings	€m	290	150	61	79

The operating earnings, investment variances and economic assumption changes have contributed roughly equal amounts to the total embedded value earnings. The experience variances are dominated by the positive impact of an improved model for management action and the negative impact of an improved model of the policyholder behaviour to

move to a less comprehensive product following an upward adjustment to the premium rates. To allow for more realistic shareholder dividends, the shareholders' participation in gross surplus is now assumed to vary dependent on the economic conditions.

The main operating assumption changes relate to higher expense assumptions. Higher interest rates are reflected in both the investment variances and the economic assumption changes. Furthermore, the investment variances are also positively influenced by high equity returns.

The following table shows the development of key profitability ratios:

New business		2006	2005
Value added by new business (VANB)	€m	22	28
Present value of new business premiums (PVNBP)	€m	2,535	2,637
Annual premium equivalent (APE)	€m	192	195
Opening embedded value (EV)	€m	1,131	1,282
VANB / PVNBP	%	0.9	1.1
VANB / APE	%	11.5	14.4
VANB / EV	%	1.9	2.2
Total business			
Operating embedded value earnings / Opening embedded value	%	9.4	6.4
Total embedded value earnings / Opening embedded value	%	25.6	-6.6

3 Embedded value methodology

3.1 General remarks

The embedded value methodology adopted is in accordance with the European Embedded Value Principles as published by the CFO Forum in May 2004. We applied the market-consistent methodology as described in sections 3.5 and 3.12, which leads in particular to a market-consistent assessment of the time value of financial options and guarantees.

3.2 In-force and new business

Reinsurance new business is comprised of:

- New individual cessions on either new or existing treaties
- New group schemes on either new or existing treaties
- Net increments to existing group schemes
- New and renewed annually renewable treaties

For primary insurance, the new business is defined as the business arising from the sale of new contracts during the reporting period. The value of new business includes the value of expected renewals on those new contracts and expected future contractual alterations to those new contracts. For German primary life business, the new business includes the current year's increments on existing policies.

The in-force business definition is consistent with the definition of new business.

3.3 Look-through principle

The assets related to the covered business are mainly managed by Munich Re Group asset management units. The costs as well as profits from managing these assets are included in the embedded value on a look-through basis.

Costs of other service companies, such as administration and IT, are included in the embedded value on a look-through basis.

Costs of holding companies related to the covered business have been allowed for in the embedded value calculations.

3.4 Adjusted net worth

The adjusted net worth (ANW) is defined as follows:

- For pure life reinsurance entities: the local regulatory net worth adjusted to reflect the market value of assets
- For composite reinsurance entities: the allocated required capital
- For primary insurance entities: the local regulatory net worth

The ANW is adjusted to reflect any pension fund deficits.

3.4.1 Required capital

The required capital (RC) is defined as follows:

- For reinsurance entities RC is derived from internal risk models and additional regulatory restrictions.
- For German primary insurers RC is equal to statutory net worth.
- For international primary insurers RC is equal to 100% of EU minimum. This simplifying assumption has little impact on Munich Re Group's EEV.

3.4.2 Free surplus

The free surplus (FS) is defined as the difference between the ANW and the RC.

3.5 Present value of in-force business

A bottom-up approach to allow for risk is adopted for the calculation of the present value of in-force business. The economic assumptions and the risk discount rates used are calibrated applying a market-consistent methodology to allow for financial risk. In principle, each cash flow is valued according to its inherent financial risk.

For business without significant financial options and guarantees, the certainty-equivalent technique is used. Under this valuation approach the individual cash flows are adjusted to remove the effects of financial risks. The resulting stream of risk-adjusted profits is then discounted at the risk-free rate.

For business with significant financial options and guarantees, a stochastic model using risk-neutral scenarios is applied to determine the present value of in-force business, and the time value of financial options and guarantees. The stochastic models allow for interaction of the assets and liabilities and include expected management behaviour, e.g. regarding the investment strategy, the management of unrealised capital gains and the determination of bonus rates for participating business. In addition, dynamic policyholder behaviour with respect to lapses and surrenders has been allowed for.

For the German primary life business it is assumed that in case of financial distress, approval from the regulator is granted to cover policyholder guarantees by the free RfB and the Terminal Bonus Fund.

For the German primary medical business, the development of health care costs are based on general inflation assumptions adjusted for a higher medical inflation for some parts of the business. Premium rates are assumed to increase in line with these developments.

Stochastic models are used for primary life and medical insurance businesses in Germany, Belgium, Italy and most of the other countries covering more than 99% of embedded value for primary insurance business.

The stochastic model is run using 1,000 scenarios based on the econometric model described in section 3.12.

3.5.1 Time value of financial options and guarantees

The financial options and guarantees (FOG) valued in the EEV are comprised of all material financial options and guarantees embedded in the covered business. A key feature of FOG is that they can create asymmetric returns for shareholders.

It is predominantly primary life business that is exposed to FOG. The following FOG are of particular relevance:

- Policyholder options, such as full or partial surrender, premium discontinuance, and annuitisation, combined with policyholder guarantees, such as interest rate guarantees, guaranteed surrender values or guaranteed annuity rates
- Options for companies, such as determination of bonus policy for participating life business

German primary medical business is exposed to a lesser extent to policyholder options than the primary life business. The main reasons are:

- Technical interest rates are not guaranteed for the whole contract term, but can be changed through a premium adjustment process. In case of an interest rate reduction this leads to higher premium rates for the policyholder.
- In the absence of any surrender values, policyholder options are more limited. A reduced premium increase for high inflation scenarios has been allowed for.

The life reinsurance portfolio of Munich Re is exposed to FOG only in a very limited way.

The time value of financial options and guarantees is determined as the difference between the average present value over all stochastic scenarios and the present value for the certainty equivalent scenario as described above.

3.5.2 Participating business

Participating life business, predominantly the German, Belgian and Italian primary business, is generally characterized by the following key features:

- A minimum interest rate or a minimum level of bonus is guaranteed to the policyholder. Hence, whenever the investment return on the allocated assets does not exceed the necessary minimum and other means of funding the guarantees are depleted, the shareholder will bear the cost of maintaining the guarantees.
- Generally bonuses and crediting rates exceed minimum guaranteed levels. In this case, the amount credited will be based on profit sharing rules which involve a degree of management discretion.

The participating features are usually a combination of contractual or legal constraints, and management discretion based on competitive pressure or market practice. The participating business has been modelled to reflect both contractual and regulatory constraints as well as internal management rules. Projected surrender rates depend dynamically on the difference between the risk free rate and the credited rate.

For participating German primary medical business, minimum profit-sharing rules are set according to current legal requirements. Management discretion is relevant for the use of free policyholder means in order to reduce future premium increases necessary to cover the assumed development of health care costs. Further, management decisions on how to proceed with changes of technical interest rates have to be taken into account.

Given the above, it is essential that the stochastic framework allows for management actions in the following areas:

- Determination of bonus policy for participating life business
- Timing of realisation of unrealised capital gains
- Dynamic asset allocation, in particular management of the equity backing ratio
- Dynamic adjustment of technical interest rates for German medical business

In addition, surrender rates dependent on the capital markets have been allowed for.

The shareholder share of unrealised capital gains at the end of the projection period is included in the present value of future profits.

3.6 Cost of holding capital

The cost of holding capital consists of the following components which are deducted from the embedded value:

- Cost of double taxation on the required capital (Tax CoC)
- Cost of asset management related to the assets covering required capital (Investment expense CoC)
- Cost of profit sharing of investment income on shareholder funds for German primary life and medical business (CoC for policyholder participation)
- Frictional cost on the embedded value less free surplus to allow for non-financial risks (Frictional CoC)

The frictional cost represents an allowance for non-financial risks not reflected in the market-consistent valuation of the PVIF. The frictional cost rate is 1% p.a. for all businesses except primary life business in Germany for which it is 0.5% p.a. The major portion of risk based capital for primary life business in Germany is held for adverse capital market risks which are explicitly modelled in the EEV. Thus it is appropriate to reduce the spread which should mainly account for non-modelled non-financial risks and modelling error.

For hedgeable financial risks, it is not necessary to add an allowance for frictional costs where a market-consistent approach has been used. This is because the cost of hedging, as given by the market value of those instruments that the insurer would need to buy in

order to fully hedge its position, already includes expected and unexpected loss costs, transaction fees etc.

3.7 Change in embedded value

The change in embedded value from one valuation date to the next is comprised of the following elements:

- Embedded value earnings
- Currency movements
- Value of acquired / divested business
- Capital movements

The embedded value earnings are explained in more detail in the following section.

The currency movements represent the impact of changes in currency exchange rates on the embedded value. The embedded value is reported in euros.

The value of acquired / divested business represents the value of business acquired or divested during the reporting year. In this position, the impact of changes of the participation rates in Munich Re Group's subsidiaries is included.

The capital movements are calculated as the amount of capital contributed to the covered business less the amount of capital released from the covered business during the reporting year.

3.8 Embedded value earnings

The embedded value earnings can be split into the following components:

- Expected return on embedded value
- Experience variances
- Operating assumption changes
- Value added by new business
- Tax variances and tax assumption changes
- Investment variances
- Economic assumption changes

The sum of the first four components of the embedded value earnings are referred to as operating embedded value earnings.

The return expectation in a market-consistent framework is based on risk-free interest rates. Therefore the expected return on embedded value is calculated assuming a risk-free roll-forward of the embedded value at the beginning of the year plus the unwind of the frictional costs included in the embedded value.

The experience variances reflect the difference between the actual operating experience in the reporting year and the operating result assumed in the previous embedded value calculation.

The operating assumption changes reflect the aggregate impact of changes in the operating assumptions within the reporting year on the embedded value. All operating assumptions are subject to an active review at each valuation date.

The value added by new business is explained in detail in the following section.

The tax variances and tax assumption changes reflect the aggregate impact of changes in the tax legislation during the reporting year on the embedded value. All tax assumptions are subject to an active review at each valuation date.

Investment variances reflect the differences between the actual investment return in the current year and the investment return assumed in the previous embedded value calculation.

The economic assumption changes reflect the aggregate impact of changes in the economic environment in the reporting year on the embedded value. All economic assumptions are subject to an active review at each valuation date.

3.9 Value added by new business

Value added by new business (VANB) is the present value as at the end of the reporting year of the future regulatory after-tax profits arising on new business written in the reporting year plus the after-tax regulatory profits arising on this business during the reporting year, reduced by the value of financial options and guarantees and the CoC associated with new business.

The value of new business written in the reporting year is calculated consistently with the methodology outlined in section 3.5.

For reinsurance business, the value of new business can be calculated on a stand-alone basis, as there are only limited or no interactions between in-force and new business. For primary insurance business, however, a marginal approach has been used to calculate the time value of FOG for new business as the difference between an in-force calculation with and without new business, in order to allow for the various effects of new business on the in-force business.

3.10 Operating assumptions

Operating assumptions describe expected future operating experience. They refer mainly to mortality, morbidity, persistency, expenses and policyholder participation in primary insurance business.

The operating assumptions are based on best estimate assumptions derived from company experience and/or market experience. They are in line with management expectations and reflect recent operating experience of the entities concerned.

All costs related to the covered business are split into acquisition, maintenance and investment-related expenses and are fully allowed for in the embedded value. There are no expenses excluded as development costs.

Future productivity gains are not anticipated in the embedded value calculations.

3.11 Tax assumptions

Taxation assumptions included in the embedded value models reflect local taxation rates and bases, including future changes that are at an advanced stage of legislative implementation. Tax modelling also includes the valuation of existing tax losses carried forward. No withholding taxes on dividends from subsidiaries have been allowed for.

3.12 Economic assumptions

The economic assumptions are derived following a market-consistent valuation approach. A large number of asset classes and economic assumptions are modelled stochastically. This includes equities, bond yields, property, and inflation.

The construction of risk neutral economic scenarios requires a careful calibration to the underlying market parameters to ensure that the valuation replicates the market prices of assets. The key areas for calibration are the initial yield curves, the implied market-consistent volatilities of all relevant asset classes, and the correlations between asset classes and currencies. The interest rate model used considers both parallel shifts and twists to the yield curve.

The economic scenarios have been calibrated to the market conditions at the valuation dates, i.e. risk-free rates, swaption prices and equity options prices. Swap rates are used as an approximation of the risk-free yield curve. The parameters used for year-end 2005 and year-end 2006 are shown in section 6.4.

The economic scenarios are constructed using a proprietary economic scenario generator developed by Barrie & Hibbert. Barrie & Hibbert is a financial risk consultancy based in Edinburgh. The Barrie & Hibbert economic scenario generator is widely used in the insurance industry.

3.13 Consolidation

The embedded value results are presented on a consolidated Munich Re Group level. The results are presented net of minority interests and policyholders interests.

Intra-Group reinsurance ceded from primary insurers to reinsurers is shown in the reinsurance segment.

3.14 Valuation of pension fund liabilities

Pension fund deficits are allowed for in the EV consistently with the valuation under IFRS. Any pension fund deficits are reflected by adjusting the ANW.

3.15 Foreign currency translation

The embedded value reporting currency is the euro.

Calculations are undertaken in the original currency of the covered business and converted to euros for consolidation purposes.

In converting original currency embedded values and their components into euros, the exchanges rates as at the relevant valuation dates are used. Changes in the embedded value due to changes in foreign exchange rates are disclosed as currency movements, which are excluded from the embedded value earnings.

In converting original currency embedded value earnings into euros, average of year exchange rates are used.

4 IFRS reconciliation

The embedded value of the covered business as at 31 December 2006 exceeds the corresponding IFRS equity excluding goodwill by EUR 3,663m. As the embedded value does not include the value of future new business, goodwill is excluded from the IFRS equity for this comparison.

4.1 Reinsurance

All figures in €m	31.12.2006	31.12.2005
IFRS equity	3,875	3,951
- thereof goodwill	0	0
IFRS equity excluding goodwill	3,875	3,951
Embedded value	5,962	5,920
Value not recognised in IFRS equity	2,087	1,969

The value not recognized in IFRS equity increased in 2006 by EUR 118m.

4.2 Primary insurance

All figures in €m	31.12.2006	31.12.2005
IFRS equity	3,743	3,853
- thereof goodwill	1,165	1,165
IFRS equity excluding goodwill	2,578	2,688
Embedded value	4,154	2,865
Value not recognised in IFRS equity	1,576	177

The value not recognized in IFRS equity increased in 2006 by EUR 1,399m. This increase was mainly driven by the increase in embedded value in 2006.

5 Sensitivities

Sensitivities of the embedded value as at 31 December 2006 and the 2006 value added by new business are presented in this section. The presentation follows the Additional Guidance on European Embedded Value Disclosures as published by the CFO Forum in October 2005. The sensitivity "100bp p.a. increase in the yield on equity/property assets" is not meaningful in the context of a market-consistent valuation and is therefore omitted in accordance with the CFO Forum's Additional Guidance.

5.1 Reinsurance

Sensitivities for the embedded value as at 31 December 2006:

All figures in €m	EV	Difference	Change
Base case	5,962		
Doubled frictional cost rate	5,452	-510	-9%
No frictional costs	6,582	620	10%
Mortality/morbidity (life business) -5%	6,718	756	13%
Mortality (annuity business) -5%	5,935	-27	0%
No mortality improvements (life business)	4,752	-1,210	-20%
Lapse rates -10%	6,068	106	2%
Maintenance expenses -10%	6,008	46	1%
Interest rates -100bp	6,436	474	8%
Equity/property values -10%	5,946	-16	0%
Minimum solvency capital	5,969	7	0%

Sensitivities for the 2006 value of new business:

All figures in €m	VANB	Difference	Change
Base case	228		
Doubled frictional cost rate	160	-68	-30%
No frictional costs	312	84	37%
Mortality/morbidity (life business) -5%	323	95	42%
Mortality (annuity business) -5%	228	0	0%
No mortality improvements (life business)	64	-164	-72%
Lapse rates -10%	241	13	6%
Maintenance expenses -10%	235	7	3%
Interest rates -100bp	239	11	5%
Equity/property values -10%	228	0	0%



5.2 Primary insurance

Sensitivities for the embedded value as at 31 December 2006:

All figures in €m	EV	Difference	Change
Base case	4,154		
Doubled frictional cost rate	3,741	-413	-10%
No frictional costs	4,659	505	12%
Mortality/morbidity (life business) -5%	4,184	30	1%
Mortality (annuity business) -5%	4,092	-62	-1%
Lapse rates -10%	4,191	37	1%
Maintenance expenses -10%	4,241	87	2%
Interest rates -100bp	3,098	-1,056	-25%
Equity/property values -10%	3,889	-265	-6%
Minimum solvency capital	4,655	501	12%

Sensitivities for the 2006 value of new business:

All figures in €m	VANB	Difference	Change
Base case	125		
Doubled frictional cost rate	104	-21	-17%
No frictional costs	149	24	19%
Mortality/morbidity (life business) -5%	129	4	3%
Mortality (annuity business) -5%	121	-4	-3%
Lapse rates -10%	134	9	7%
Maintenance expenses -10%	132	7	6%
Interest rates -100bp	78	-47	-38%
Equity/property values -10%	115	-10	-8%

6 Summary of assumptions

6.1 Shareholders' share

In %	Shareholders' share	
	Primary insurance	
	31.12.2006	31.12.2005
Germany - Life	14*	10
Germany - Medical	15*	15
Italy	18-20**	18-20**

* On average

** As a % of investment return, before the effect of guarantees.

6.2 Tax rates

In %	Tax rate			
	Reinsurance		Primary insurance	
	31.12.2006	31.12.2005	31.12.2006	31.12.2005
EUR - Germany	40	40	40	40
EUR - Italy	38	38	38	38
USD	35	35	na	na
CAD	35	35	na	na
GBP	30	30	na	na

6.3 Currency exchange rates

1EUR = ... foreign currency	Currency exchange rates		
	31.12.2006	average of year 2006	31.12.2005
USD	1.31865	1.25580	1.17955
CAD	1.53450	1.42445	1.37790
GBP	0.67375	0.68179	0.68710

6.4 Economic assumptions

6.4.1 Risk-free interest rates

The economic scenarios have been calibrated to the market conditions at the valuation dates. Swap rates have been used as an approximation of the risk-free yield curves.

The table below shows the swap yield curves at the relevant valuation dates for the major currencies.



Swap yield curves	31 December 2006				31 December 2005			
	EUR	USD	GBP	CAD	EUR	USD	GBP	CAD
1 year	4.08%	5.33%	5.58%	4.32%	2.87%	4.79%	4.58%	4.08%
2 years	4.12%	5.17%	5.50%	4.18%	3.04%	4.80%	4.54%	4.11%
3 years	4.13%	5.10%	5.49%	4.17%	3.11%	4.77%	4.56%	4.14%
4 years	4.13%	5.09%	5.44%	4.20%	3.17%	4.79%	4.56%	4.16%
5 years	4.13%	5.10%	5.38%	4.24%	3.23%	4.81%	4.56%	4.19%
6 years	4.13%	5.12%	5.32%	4.28%	3.28%	4.80%	4.55%	4.21%
7 years	4.15%	5.13%	5.27%	4.33%	3.33%	4.80%	4.52%	4.25%
8 years	4.16%	5.15%	5.22%	4.38%	3.37%	4.80%	4.52%	4.27%
9 years	4.18%	5.17%	5.16%	4.42%	3.42%	4.80%	4.50%	4.30%
10 years	4.20%	5.19%	5.11%	4.47%	3.46%	4.80%	4.48%	4.33%
15 years	4.27%	5.27%	4.91%	4.63%	3.63%	4.89%	4.40%	4.51%
20 years	4.31%	5.31%	4.75%	4.69%	3.73%	4.95%	4.34%	4.59%
25 years	4.31%	5.32%	4.59%	4.68%	3.77%	4.99%	4.27%	4.58%
30 years	4.29%	5.32%	4.51%	4.67%	3.77%	5.01%	4.23%	4.59%

6.4.2 Volatilities

The interest rate scenarios have been generated so that they replicate at-the-money swaption prices with a swap tenor of 20 years. The implied volatilities for these swaptions are outlined in the following table:

Target swaption implied volatilities*	31 December 2006		31 December 2005	
	EUR	USD	EUR	USD
1 year	13.10%	12.70%	15.50%	16.90%
2 years	13.20%	13.30%	15.90%	16.70%
3 years	13.20%	13.50%	15.70%	16.50%
4 years	13.10%	13.50%	15.70%	15.90%
5 years	12.90%	13.30%	15.60%	15.50%
10 years	11.80%	11.30%	14.30%	13.50%
15 years	11.15%	10.60%	13.40%	12.00%
20 years	10.80%	10.60%	12.80%	11.10%
30 years	10.40%	10.40%	12.90%	9.70%

* For at-the-money swaptions with 20-year tenor.

The equity models have been calibrated to prices of at-the-money ten-year European equity index options observed in the OTC market. The implied volatilities of these option prices are shown in the table below.

Target implied equity volatilities	31 December 2006		31 December 2005	
	EUROSTOXX	S&P 500	EUROSTOXX	S&P 500
Equity index	22.5%	20.0%	23.6%	23.6%



Given the long-term nature of the financial risks embedded in life insurance contracts, the implied volatilities of swaptions and equity options of the longest available maturities have been taken as target volatilities.

7 External opinion

The scope of Tillinghast's review covered the results of Munich Re's European Embedded Value calculations as at 31 December 2006, the 2006 embedded value earnings and the 2006 value added by new business. It included a review of the methodology and assumptions used as described in sections 3 and 6 and of the compliance with the European Embedded Value Principles. The review covered also the sensitivities shown in section 5.

Tillinghast has concluded that the methodology and assumptions used comply with the European Embedded Value Principles and Guidance as published by the CFO Forum on 5 May 2004 and 31 October 2005, and in particular that:

- the methodology makes allowance for the aggregate risks in the covered business through the methodology set out in section 3, in particular by the use of
 - a level of required capital derived from internal risk models and additional regulatory restrictions,
 - a market-consistent assessment of the time value of financial options and guarantees, and
 - a deduction for cost of capital based on the cost of double taxation on the required capital plus frictional costs on the embedded value less free surplus;
- the operating assumptions have been set with appropriate regard to past, current and expected future experience;
- the economic assumptions used are internally consistent and consistent with observable market data; and
- for the primary participating business, the assumed bonus distribution, asset allocation, allocation of profit between policyholders and shareholders, and other management actions, are consistent with the other assumptions used in the projections, and with local market practice.

Tillinghast has also performed limited high-level checks on the results of the calculations and has confirmed that any issues discovered do not have a material impact on the disclosed embedded values and new business values. Tillinghast has not, however, performed detailed checks on all the models and processes involved. Tillinghast notes that for the German primary life business, the results depend on the realisation, in line with current management planning, of substantially increased shareholder payout ratios compared to past experience. In arriving at these conclusions, Tillinghast relied on data and information provided by the Munich Re Group.

8 Glossary

Acquired (divested) business	Business acquired (divested) through acquisition (sale) of stakes in insurance or reinsurance companies.
Adjusted net worth	The adjusted net worth (ANW) is also known as shareholders' net worth or adjusted net asset value (ANAV).
ANW	See adjusted net worth.
Best estimate assumption	An assumption that represents the expected outcome from the range of possible outcomes of future experience.
Capital movements	Dividends and capital contributions.
CoC	See cost of holding capital.
CoC for policyholder participation	Cost of profit sharing of investment income on shareholder funds for German primary business.
Cost of holding capital	The cost of holding capital, or CoC, represents the cost of holding the required capital. It includes an explicit allowance for non-financial risks.
Covered business	The business for which the embedded value is reported.
Currency movements	Aggregate impact of currency movements on the embedded value.
Economic assumption changes	Aggregate impact of changes in the economic environment on the embedded value.
Economic assumptions	Economic assumptions include risk-free interest rates, discount rates, inflation rates and assumptions on the volatility of economic parameters.
Embedded value	The embedded value is the present value of shareholders' interests in the earnings distributable from assets allocated to the covered business after sufficient allowance for the aggregate risks in the covered business.

Embedded value components	<p>The embedded value consists of the following three components:</p> <ul style="list-style-type: none"> ▪ Present value of future shareholder cash flows from in-force covered business (PVIF) ▪ Cost of holding required capital (CoC) ▪ Adjusted net worth (ANW)
Embedded value earnings	<p>Operating embedded value earnings are the total of the following components:</p> <ul style="list-style-type: none"> ▪ Expected return ▪ Experience variances ▪ Operating assumption changes ▪ Value added by new business <p>Total embedded value earnings are the sum of the following components:</p> <ul style="list-style-type: none"> ▪ Operating embedded value earnings ▪ Tax variances and tax assumption changes ▪ Investment variances ▪ Economic assumption changes
European Embedded Value Principles	<p>A set of principles for embedded value reporting developed by the CFO Forum. The CFO Forum is a high-level discussion group attended by the Chief Financial Officers of major European insurance companies. The Munich Re Group is a member of the CFO Forum.</p>
EV	<p>See embedded value.</p>
Expected return	<p>The expected return on embedded value is calculated as the risk-free roll-forward of the embedded value at the beginning of the year plus the unwind of the frictional costs included in the embedded value.</p>
Experience variances	<p>The impact on embedded value of differences between the actual operating experience in the reporting year and the operating result assumed in the previous embedded value calculation.</p>
Financial options and guarantees (FOG)	<p>Options and guarantees whose value is impacted by the behaviour of financial variables.</p>
FOG	<p>See financial options and guarantees.</p>
Free surplus	<p>Free surplus is the amount of capital allocated to the business in excess of the required capital.</p>

Frictional CoC	The frictional cost of capital represents an allowance for non-financial risks.
Frictional cost rate	Annual cost rate applied to calculate the frictional cost of capital.
IFRS	International Financial Reporting Standards.
Investment expense CoC	The investment expense CoC is the present value of the investment expenses related to the assets covering required capital.
Investment variances	The impact on embedded value of differences between the actual investment return in the current year and the investment return assumed in the previous embedded value calculation.
Look-through basis	A basis via which the impact of an item on the whole Munich Re Group is measured, rather than on a particular part.
Operating assumption changes	Aggregate impact of changes in the operating assumptions on the embedded value.
Operating assumptions	Operating assumptions include: <ul style="list-style-type: none"> ▪ Mortality ▪ Morbidity ▪ Persistency ▪ Expenses ▪ Policyholder participation in primary insurance business
Operating embedded value earnings	See embedded value earnings.
Operating experience	Experience from operating assumptions.
Participating business	Primary insurance business in which policyholders have the right to participate in the performance of a specified pool of assets or contracts.
Present value	The value of a future cash flow at the valuation date, discounted at a discount rate applicable to that cash flow.

Present value of in-force business	The present value of in-force business is the present value of future shareholder cash flows projected to emerge from the assets backing liabilities of the in-force covered business (PVIF). This value is reduced by the value of financial options and guarantees.
PVIF	See present value of in-force business.
Reporting currency	The embedded value reporting currency is the euro.
Required capital	The amount of surplus assets whose distribution to shareholders is restricted.
RfB	The Rückstellung für Beitragsrückerstattung (RfB) is the provision for premium refunds in German primary insurance.
Risk-free (interest) rates	Prospective yields on securities considered to be free of default or credit risk.
Statutory basis	The valuation basis used for reporting financial statements to local regulators.
Tax CoC	The tax cost of capital is the cost of investment returns on assets covering required capital being taxed in the insurer's hands.
Tax variances and tax assumption changes	Aggregate impact of changes in the tax legislation on the embedded value.
Time value	The time value of an option represents the possibility that the option may increase in value due to volatility in the capital markets.
Value added by new business	The present value of profits from new business written in the reporting year, reduced by the value of financial options and guarantees and the cost of capital associated with new business.
VANB	See value added by new business.