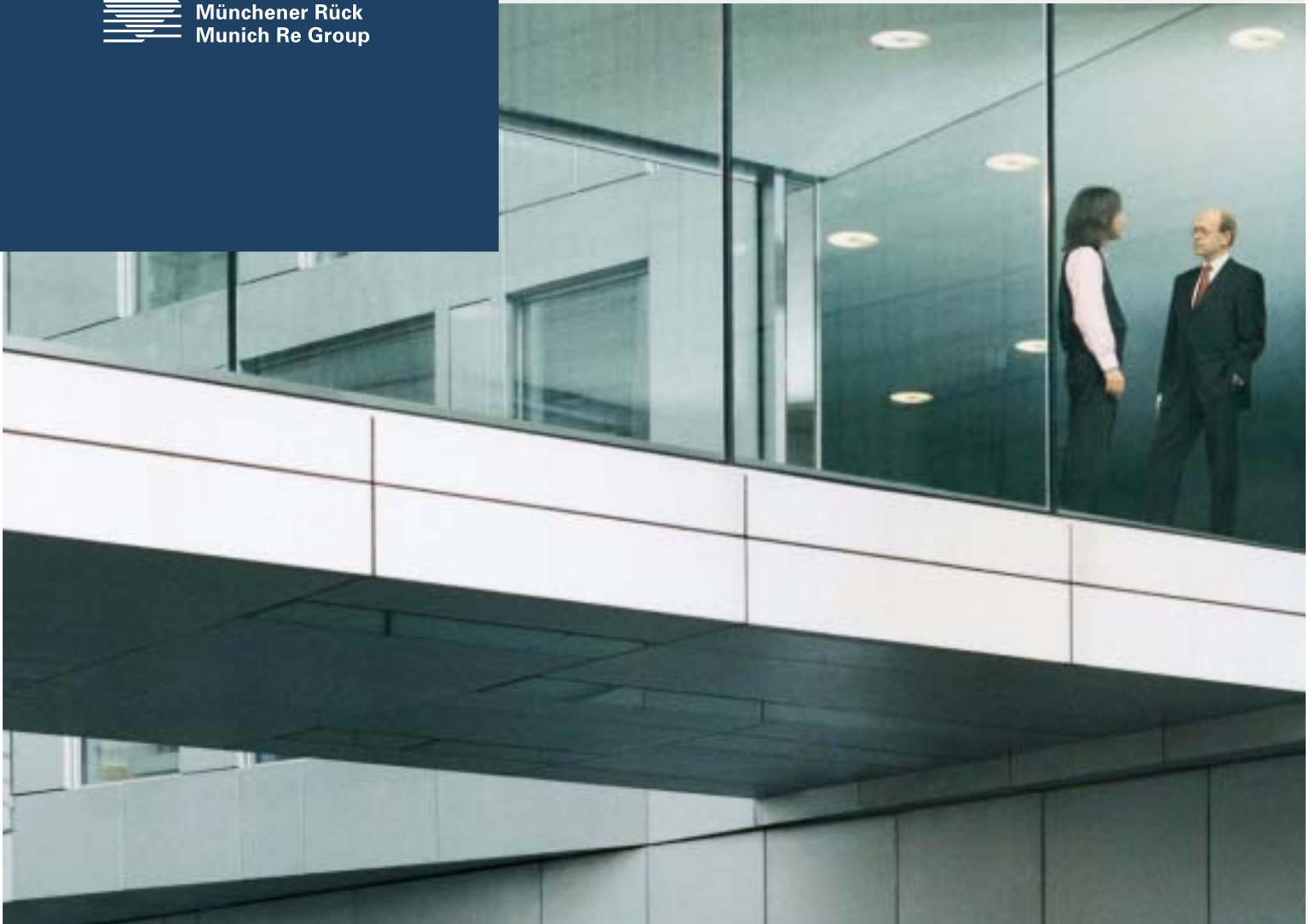


Munich Reinsurance Company Annual Report 2006



Münchener Rück
Munich Re Group



Munich Reinsurance Company

		2006	2005	2004
Gross premiums written	€m	17,847	19,167	19,243
Investments	€m	73,781	78,326	72,794
Net technical provisions	€m	58,747	63,653	55,102
Shareholders' equity	€m	11,155	10,417	11,866
Profit/loss for the year	€m	1,695	-992	777
Dividend	€m	988	707	457
Dividend per share	€	4.50	3.10	2.00
Share price at 31 December	€	130.42	114.38	90.45
Market capitalisation at 31 December	€m	29,942	26,259	20,766

Source: Datastream



Not only hard work and determination, but also flexibility and creative problem-solving – that is how Nikolaus von Bomhard defines perseverance in his discussion with Kent Nagano, General Music Director of the Munich Opera, in this year's Munich Re Group Annual Report. You can read the dialogue, along with four examples illustrating how Munich Re “dares to persevere”, at www.munichre.com.

Munich Reinsurance Company

Report on the 127th year of business

1 January to 31 December 2006

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Note: The abbreviation T€ used in this report stands for thousand euros.

Report of the Supervisory Board



Dr. Hans-Jürgen Schinzler
Chairman of the Supervisory Board

Ladies and gentlemen,

In the year under review, the Supervisory Board again fulfilled all the tasks and duties incumbent upon it by law and under the Articles of Association.

The cooperation between the Supervisory Board and the Board of Management was close and characterised by a spirit of trust. The Board of Management satisfied its reporting obligations towards the Supervisory Board in 2006 by briefing us regularly and in detail on all important business transactions. We discussed these written and oral reports intensively at our meetings. We were consulted directly and without delay by the Board of Management on all decisions of fundamental importance, and we advised it on the management of the Company and constantly monitored its conduct of the business. In addition, I kept in close contact with the Board of Management, in particular the Chairman, throughout the year under review. I regularly discussed strategic issues and, above all, the Company's current business performance and risk management with Dr. von Bomhard. The shareholder representatives and employee representatives met him separately to prepare important topics to be dealt with at the Supervisory Board meetings. We also observed that the Board's new committee structure, introduced on 1 January 2006, was already

working well in the year under review and provided for even greater Group management efficiency. Given the Group's economic situation, no inspection measures in accordance with Section 111 para. 2 sentence 1 of the German Stock Companies Act were required in the financial year.

Focal points of the meetings of the full Supervisory Board

Four meetings of the Supervisory Board took place in the year under review. Apart from one meeting, where one member of the Supervisory Board was unable to attend, there was full attendance at all the meetings. As in the previous year, the German Federal Financial Supervisory Authority (BaFin) exercised its legal powers by sending representatives to take part as guests in two of our meetings.

Focal points of the meetings of the full Supervisory Board were the individual quarterly reports and the outlook for the annual result 2006, on which the Board of Management reported in depth. We gave detailed consideration to the development of the Munich Re Group's results and compared them with those of its competitors. We reviewed and discussed the Company's strategic orientation and talked about its further development with the Board of Management. We dealt intensively with the Group's planning for 2007 and 2008, focusing especially on the result target. The Board of Management informed us on a regular basis about the Company's risk situation and profitability. We satisfied ourselves of the fact that integrated risk management and risk governance have been consistently refined. For example, the Board of Management presented to us a method for modelling natural hazards, the consequences of which we discussed at considerable length. We received routine reports on the business situation of Munich Re America. Likewise, we were briefed by the Board of Management on major losses affecting the Group. We were also provided with an insight into the Munich Re Group's integrated core management system (major IT project Gloria), which was successfully implemented in Munich in the year under review. Prior to the 2006 Annual General Meeting, we looked into the proposal to cancel the existing authorisation for increasing the share capital under "Authorised Capital Increase 2001" and to create an Authorised Capital Increase 2006 for issu-

ing employee shares. Furthermore, we thoroughly discussed on several occasions the Board's decision to launch a share buy-back programme. Our consultations also focused on the Company financial statements and Group financial statements for the financial year 2005.

Other important subjects on the agendas of the Supervisory Board meetings included the investment report, the Board of Management's human resources report and the effects of the German health reform on health insurance, with particular reference to DKV Deutsche Krankenversicherung AG.

Between the meetings, we received up-to-date information from the Board of Management about current business developments – for instance, an overview of the reinsurance renewals in 2006 and the establishment of a life reinsurance subsidiary in Moscow.

Work of the committees

The composition of the four committees of the Supervisory Board (Standing Committee, Personnel Committee, Audit Committee and Conference Committee) is shown in the overview on page 75.

The Standing Committee met three times in the year under review, devoting itself mainly to the preparation of Supervisory Board meetings, topics of corporate governance, and reports on the shareholders' register.

The Personnel Committee held five meetings in 2006, at which it formulated the individual Board members' objectives, assessed their achievements and defined the processes envisaged. The Committee approved a specimen contract for all future appointees to the Board of Management, discussed the Board of Management's succession planning and dealt with the appointments and contracts of Board members. In addition, on behalf of the full Supervisory Board it conducted an advance examination of the structure of the Board of Management's compensation system. Besides this, it approved adjustments to the remuneration paid to the members of the Board of Management and their pension entitlements and authorised the acceptance of new seats on supervisory, advisory and similar boards by members of the Board of Management.

The Audit Committee met four times in the period under review. In the presence of the external auditor, it

concerned itself extensively with the Company financial statements and Group financial statements, the Company management report and Group management report, the auditor's report and the Board of Management's proposal for the appropriation of the net retained profits for the financial year 2005. It also closely discussed the 2006 quarterly reports, made preparations for the external auditor's appointment by the Supervisory Board for the financial year 2007, reviewed and monitored the auditor's independence and commissioned the audit, deciding on its focal points and the auditor's fees. The Audit Committee also requested reports from the auditor on its auditing and non-audit-related services. The Audit Committee concerned itself on several occasions with the Company's risk situation and the new European standards for state insurance supervision (Solvency II). Furthermore, it closely discussed not only the share buy-back programme, but also reinsurance topics such as retrocession cover and the development of embedded values in life reinsurance business and in life and health primary insurance business. The Audit Committee additionally obtained information on the ongoing investigations in the USA regarding broker business and non-traditional reinsurance. Internal Auditing submitted its annual report for 2005 to the Audit Committee.

The Conference Committee as per Section 27 para. 3 of the German Co-Determination Act did not need to be convened.

Dr. Schmidt as Chairman of the Audit Committee, and I as Chairman of the other committees, provided detailed information on the committees' work at the meetings of the full Supervisory Board.

Corporate governance and declaration of conformity

As in previous years, Munich Re's Supervisory Board worked intensively on issues of corporate governance. It reviewed the structure of the Board of Management's remuneration system on the basis of a proposal by the Personnel Committee and analysed the efficiency of the Supervisory Board's work based on the Standing Committee's suggestions. Moreover, the Standing Committee recommended the full Supervisory Board to adhere to the same trading restrictions and exercise windows as the Board of Management with regard to transactions involv-

ing Munich Re's listed securities. Further information on corporate governance is available in the joint corporate governance report of the Board of Management and Supervisory Board on page 32 ff.

In November 2006, the Board of Management and Supervisory Board submitted their annual declaration of conformity with the German Corporate Governance Code as per Section 161 of the German Stock Companies Act, which can be read on page 34 of this report and on the Company's website.

Changes on the Board of Management

On 31 December 2006, Christian Kluge and Karl Wittmann retired as members of the Board of Management. Over many years, both gentlemen created substantial added value for Munich Re in responsible positions. We thank them for their long years of very successful work and exceptional personal dedication.

On 28 February 2007, Dr. Heiner Hasford retired from Munich Re's Board of Management, of which he had been a member since 1993. We thank him as well for his most commendable and successful work for the Company and for his outstanding commitment. Dr. Hasford will continue to be available to Munich Re in an advisory capacity.

Dr. Ludger Arnoldussen was appointed to Munich Re's Board of Management with effect from 1 October 2006. He previously served as Chairman of the Board of Management of Swiss Re Germany AG and is now responsible for Munich Re's Germany, Asia Pacific and Africa Division. To streamline the Board of Management's work, the divisions of which Dr. Hasford, Mr. Kluge and Mr. Wittmann were previously in charge have been restructured. The responsibilities not assumed by Dr. Arnoldussen have been reassigned to the other members of the Board.

Explanations regarding the information contained in the management report in accordance with Sections 289 para. 4 and 315 para. 4 of the German Commercial Code

Munich Re has restrictedly transferable registered shares. Registered shares – unlike bearer shares – are issued in the name of their owner, whose name, address and date of

birth are entered in the Company's register of shareholders together with the number of shares held. This allows Munich Re to communicate directly with the owners. With respect to the Company, the only parties deemed shareholders in accordance with the German Stock Companies Act are those entered in the Company's register of shareholders. This is one of the preconditions for attendance and exercise of voting rights at the Annual General Meeting. For our shareholders, having registered shares means, above all else, that they are informed directly, quickly and comprehensively about our Company and its current activities and that they are also personally invited to take part in our Annual General Meeting.

The issuing of restrictedly transferable registered shares by Munich Re dates back to the Company's foundation in 1880 and is a very common phenomenon in the insurance industry. Restricted transferability means that these shares may be transferred to another holder only with Munich Re's consent. In accordance with Article 3 para. 2 of Munich Re's Articles of Association, it is at the Company's own discretion whether to give its consent. Since the share-trading processes have been made very efficient, consent does not lead to any delays in entry in the register. In recent decades, it has been granted without exception.

The authorisations granted to the Board of Management to issue or buy back shares are listed in the management report. They are within the range of what is customary in the market and allow Munich Re to engage in active capital management. They enable the Company to cover any capital needs, even at short notice, for taking swift and flexible advantage of market opportunities in different fields of business. As illustrated by the recent share buy-back, authorisations also enable Munich Re to buy back shares and thus return to shareholders capital no longer required for an efficient capital structure.

Based on its underwriting guidelines, Munich Re's reinsurance agreements include a clause that grants both parties to the agreement a right of extraordinary cancellation in the event that "the other party merges with another

company or its ownership or control undergoes a significant change". Such or similar clauses are typical in the industry.

The employment contracts for members of the Board of Management or other employees do not contain any clauses obliging the Company to make special payments in the event of a change of control. With regard to the share-price-based compensation component (long-term incentive plan), however, the contractual conditions provide for special exercise options in the event of a change of control following a takeover bid. Details can be found in the notes to the financial statements on page 73.

Munich Re's Articles of Association do not include any special features regarding the appointment and dismissal of members of the Board of Management. Sections 84 and 85 of the German Stock Companies Act and Sections 30–33 of the German Co-Determination Act apply. The Articles of Association do not contain any provisions regarding amendments to the Articles of Association deviating from the legal principles stipulated in Sections 124 paragraph 2 sentence 2, and 179–240 of the German Stock Companies Act.

Company and Group financial statements

KPMG Bayerische Treuhandgesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft audited the following documents and gave them an unqualified auditor's opinion: Munich Reinsurance Company's financial statements and Group financial statements as at 31 December 2006, and the management reports for the Company and the Group. The auditor's reports were sent without delay to all members of the Supervisory Board. At its meeting on 18 March 2007, the Audit Committee prepared the Supervisory Board's resolution on the adoption of the Company financial statements and the approval of the Group financial statements. In this context, it examined in advance the Company financial statements and Group financial statements, the management reports and the Board of Management's proposal for appropriation of the net retained profits. It discussed them in detail with the auditor and also took the auditor's reports into consideration. The Audit Committee briefed the full Supervisory Board

about the outcome of its consultations at the balance sheet meeting on 19 March 2007.

After the Audit Committee, the Supervisory Board also examined the Company financial statements, the Group financial statements, Munich Reinsurance Company's management report, the Group management report (including the report on the Company's profitability) and the proposal of the Board of Management for appropriation of the net retained profits. The Supervisory Board agrees with the outcome of the external audit. After conducting its own concluding examination, the Supervisory Board has no objections to the Company financial statements and Group financial statements. On the basis of the Audit Committee's prior examination and the result of its own examination, the Supervisory Board approved the Company financial statements and Group financial statements at the balance sheet meeting on 19 March 2007. The Supervisory Board also unconditionally supports the Board of Management's proposal for appropriation of the net retained profits.

Words of thanks to the Board of Management and employees

The Supervisory Board wishes to sincerely thank the members of the Board of Management and all staff members, whose work in the year under review significantly contributed to the outstanding result.

Munich, 19 March 2007

For the Supervisory Board



Dr. Hans-Jürgen Schinzler
Chairman

Management report

Munich Reinsurance Company

Structure of Munich Reinsurance Company

As a professional reinsurer, Munich Reinsurance Company operates worldwide in all classes of insurance and offers a full range of products – from traditional reinsurance to innovative solutions for risk assumption. It is the parent company of the Munich Re Group, whose business encompasses reinsurance, primary insurance and asset management.

We conduct our business from our headquarters and also via many branches in such countries as China, Hong Kong, Singapore, Malaysia, Australia, New Zealand, Korea, Canada, the UK, France and Spain.

As a result of a Group directive of 2005 governing the distribution of responsibilities and competencies for key decisions between Group management and our main primary insurance subsidiary, the ERGO Insurance Group, there is “unified control” within the meaning of the German Stock Companies Act.

With a view to maintaining clearly defined strategic management of the equal-ranking business segments of primary insurance and reinsurance – and to providing for a clear assignment of responsibility – the structure of Munich Re’s Board of Management was altered with effect from 1 January 2006. The Parent Board of Management, which for legal purposes continues to represent Munich Reinsurance Company externally, has divided its responsibilities between two Board committees: the Group Committee and the Reinsurance Committee.

This management report summarises the business operations of Munich Reinsurance Company.

Since 1 January 2007, our reinsurance business has been organised into six operative divisions. Until 31 December 2006, there were seven: six servicing our property-casualty business and special lines, and one dealing with life and health reinsurance. Responsibility for the respective client accounts continues to lie in one pair of hands. The operative divisions are also responsible for our business units abroad, including our subsidiaries.

The division **Life and Health** underwrites our life and health reinsurance business worldwide and its structure reflects that of many of our clients, which conduct these two classes of business separately from property-casualty insurance, often through independent entities.

In **Europe 1**, we until recently managed the property-casualty business from our clients in Germany, Switzerland and Austria, eastern Europe, Greece, and Turkey. With effect from 1 January 2007, the division has been divided and incorporated into the new units “Europe and Latin America” and “Germany, Asia Pacific and Africa”.

Consequently, **Europe and Latin America** (formerly Europe 2 and Latin America) is now responsible for our business in central and eastern Europe, as well as for our clients from northern, western and southern Europe, and from Latin America.

Germany, Asia Pacific and Africa (formerly Asia, Australasia, Africa) conducts property-casualty business with clients in Africa, Asia, Australia and the Pacific Islands, and also serves our German clients (as from 1 January 2007).

Special and Financial Risks (SFR) is in charge of the special classes of credit, aviation and space, enterprise risks and contingency risks, and for alternative markets business. Besides this, it develops and implements division-specific innovation projects and coordinates the overarching work of the innovation teams in the non-life divisions. Risk transfer to the capital markets is handled by our new Risk Trading Unit, into which Munich American Capital Markets (MACM) – an entity that structures insurance risks for risk transfer – has been integrated. In addition, SFR also attends to our own reinsurance (retrocession).

The division **North America** is responsible for our subsidiary Munich Re America, for Munich Reinsurance Company of Canada and for Temple Insurance Company. As a logical step in the integration of American Re into the Munich Re Group, American Re-Insurance Company changed its name in September 2006 to Munich Reinsurance America, Inc. and the name of the holding company, American Re Corporation, to Munich Re America Corporation. This change has been greeted warmly by clients and employees alike. It is yet another demonstration of Munich Re’s strong commitment to the US market.

Corporate Underwriting/Global Clients (CUGC) handles our accounts with major international insurance groups (hence “Global Clients”) and writes business worldwide in

special classes such as agriculture and workers' compensation. Its most important markets are Germany, the UK and the USA. In addition to this, it performs important corporate underwriting functions for the reinsurance group in the property-casualty segment: its staff clarify fundamental, cross-divisional issues of underwriting policy, oversee quality assurance, integrate mathematical methods in our business processes, and set standards for claims management. Further information on our guidelines for underwriting and pricing can be found on page 12.

Europe and Latin America

Athens, London, Madrid, Milan, Moscow, Paris

Bogotá, Buenos Aires, Caracas, Mexico City, São Paulo

Subsidiaries/Branches:

Munich Ré France

Münchener Rück Italia

Münchener Rückversicherungs-Gesellschaft Sucursal España y Portugal

Munich Reinsurance Company UK General Branch

Special and Financial Risks

Geneva, London, Munich, New York

Subsidiaries/Branches:

New Reinsurance Company

Great Lakes Reinsurance (UK)

Munich American Capital Markets

Corporate Underwriting / Global Clients

London

Subsidiaries/Branches:

Munich Re Underwriting

Germany, Asia Pacific and Africa

Munich

Beijing, Hong Kong, Kolkata, Kuala Lumpur, Mumbai, Shanghai, Seoul, Singapore, Taipei, Tokyo

Auckland, Brisbane, Melbourne, Perth, Sydney

Accra, Cape Town, Johannesburg, Nairobi, Réduit

Subsidiaries/Branches:

Munich Mauritius Reinsurance Company Ltd.

Munich Reinsurance Company of Africa

Munich Reinsurance Company Australian Branch

Munich Reinsurance Company New Zealand Branch

Munich Reinsurance Company China Branch

Munich Reinsurance Company Singapore Branch

Munich Reinsurance Company Hong Kong Branch

Munich Reinsurance Company Malaysia Branch

Munich Reinsurance Company Korea Branch

North America

Atlanta, Boston, Chicago, Columbus, Dallas, Hamilton, Hartford, Kansas City, Los Angeles, New York, Philadelphia, Princeton, San Francisco, Seattle, Montreal, Toronto, Vancouver

Subsidiaries/Branches:

Munich Reinsurance Company of Canada

Munich Reinsurance America

Temple Insurance Company

Life and Health

Atlanta, Brisbane, Chicago, London, Melbourne, Moscow, Mumbai, Perth, Santiago de Chile, Sydney, Toronto, Waltham, Warsaw

Subsidiaries/Branches:

Munich Reinsurance Company of Australasia

Munich American Reassurance Company

Munich Reinsurance Company Canada Branch (Life)

Munich Reinsurance Company UK Life Branch

Munich Reinsurance Company Life Reinsurance Eastern Europe/

Central Asia

We have transferred Munich Reinsurance Company's investment business to our subsidiary MEAG MUNICH ERGO AssetManagement GmbH, which is one of the major asset managers in the European financial sector. Set up by Munich Re and ERGO in 1999, it combines the two groups' investment activities and the management of their real estate. Virtually the entire asset management of the Munich Re Group is concentrated in MEAG, which had a total of around €172.4bn under management at the end of 2006, €61.5bn from Munich Reinsurance Company. The subsidiary MEAG MUNICH ERGO Kapitalanlagegesellschaft mbH is one of the major investment fund companies in Germany, managing around €38bn in special and retail funds.

With offices in New York and Hong Kong, MEAG is internationally oriented, offering global competence and know-how across a wide range of asset classes to institutional investors and private clients. In July 2006, MEAG acquired a 19% stake in PICC Asset Management Company Ltd. (PAMC) in Shanghai – the asset manager of one of the largest Chinese insurance groups, the People's Insurance Company of China (PICC Group).

Important tools of corporate management

Munich Re's value-based management philosophy

Munich Re's objective is to analyse risk from every conceivable angle and to handle it successfully, thereby creating lasting value for its shareholders, clients and staff. A guiding principle of our corporate activity is to increase Munich Re's share price on a sustained basis. The main features of this "shareholder value" approach in practice are the consistent application of robust, value-based management systems within the Group and a clear focus on future prospects of success.

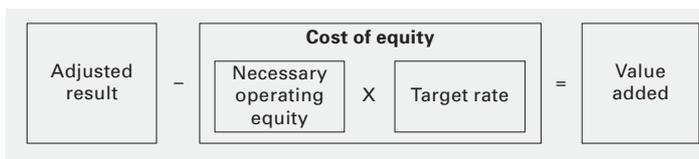
Besides value-based performance measures, we observe a range of important additional conditions in managing our business. These conditions may be reflected in supplementary targets within the Group, or in isolated cases may even determine a unit's short-term orientation in a particular situation. They include the rules of local accounting systems, tax aspects, liquidity requirements, supervisory parameters, and our shareholders' legitimate interest in attractive regular cash distributions and an appropriate return on the overall capital invested.

The key factor in our business decisions is to increase corporate value, which we do in the following ways:

- We assess business activities not only according to their earnings potential but also relative to the extent of the risks assumed, which is material in measuring added value. Only the risk-return relationship reveals how beneficial an activity is from the shareholder's point of view.
- With clearly defined value-based performance indicators, we ensure the necessary comparability of measures and initiatives as the basis for setting priorities.
- We clearly assign responsibilities and make the levers for adding value transparent for both management and staff.
- We closely link strategic and operative planning. All initiatives are ultimately geared to the overriding financial objective of enhancing our corporate value.

Our value-based management system takes into account the individual characteristics of the business segments

In our non-life business, which is mainly of a short-term nature, we employ the following simple formula for measuring the value added annually by our insurance business and for managing and monitoring our business activities:



The adjusted result serves as the basis for determining the value added. It consists of the underwriting result (derived from the income statement), the investment result, and the remaining non-technical result. In each case, value-based adjustments are made, including the smoothing of expenditure for major losses, the "normalisation" of investment income, and the recognition of future claims expenses at present value.

We compare the result adjusted in this way with the requisite cost of equity. A significant factor in the calculation of the cost of equity is the risk-based capital, which we determine using our internal model. In the property-casualty business and health reinsurance business measured on a single-period basis, value is added to the extent that the adjusted result exceeds the cost of equity.

The products of life reinsurance are characterised by their long-term nature and the distribution of results over the duration of the policies. For valuing such long-term portfolios, whose performance cannot be reasonably measured on the basis of a single year, we use the European Embedded Value method. Embedded value is the present value of future net earnings from business in force plus the value of shareholders' equity, less the cost of holding capital. All assets and liabilities are valued consistently with how financial markets price tradeable instruments ("market-consistent embedded value"). Policyholders' options and guarantees are explicitly taken into account using stochastic simulations. By setting a minimum return

requirement, we aim through value-based management to ensure an adequate return on the capital employed and an appropriate value added.

Our steering of Munich Re's investments is strongly geared to the structure of the liabilities on our balance sheet. With the help of asset-liability management, we determine the "neutral position". This involves a synthetic investment portfolio which – taking into consideration significant additional parameters in the investment of capital – best reflects the characteristics of our liabilities towards clients. Further information on asset-liability management is provided on page 24. The target return, i.e. the expected income from the neutral position, is compared with the return from the actual portfolio, bearing in mind the risk capital required for deviating from the neutral position. Finally, a comparison with the returns of relevant stock market indices provides important insights into the performance of our own investments.

In addition to these purely financial performance factors, non-financial performance measures like market share, speed of processes, staff-training level and client satisfaction play a major part. In the long term, a firm can only be successful if it operates sustainably and takes account of such future-oriented qualitative factors as well.

We closely link strategy and operative planning by defining our objectives in structured overviews or "score-cards", from which we derive initiatives, performance measures and responsibilities within a framework of four perspectives: "financial", "market and client", "process" and "employee". We promote an entrepreneurial culture among staff through the clear allocation of responsibility and accountability, recognising how much the individual, unit or field of business contributes to increasing value. The consistent integration of the financial and non-financial objectives into Board, executive and staff incentive systems supports the clear orientation towards value creation.

In order to give more emphasis in external communication to Munich Re's value orientation – as widely implemented through our internal management tools – we have geared our Group return target to risk-adjusted performance indicators, which are explained in more detail below.

What we aim to achieve

Starting point 2006

In the past year, Munich Re's business performed very well. Thanks to the pleasing business experience in reinsurance and the very good investment result, we recorded a profit for the year of €1.7bn. The investment result made a very positive contribution of €3,308m (2,555m), representing a return on investment (including deposits retained on assumed reinsurance) of 4.3% (3.4%). This return on investment is calculated as the ratio between the investment result and the average carrying amount of the investment portfolio in the financial year 2006.

The combined ratio, a much-heeded performance indicator in non-life insurance, is the percentage ratio of total expenses for claims incurred, expenses for premium refunds, change in the provision for future policy benefits, interest on technical provisions (net in each case) and operating expenses (net) to earned premiums (net). It corresponds to the sum of the loss ratio and the expense ratio. Put simply, a combined ratio of 100% means that premium income was exactly sufficient to cover claims and costs. Net expenses for claims and benefits mainly include paid claims and the change in claims reserves. Net operating expenses chiefly comprise commission plus personnel and non-personnel expenses for the acquisition and ongoing administration of insurance contracts.

The combined ratio in reinsurance includes the accident and health segment as well as property-casualty business. In the financial year 2006, it totalled 97.9% (117.0%). This marked improvement is essentially due to the absence of very high natural catastrophe losses, unlike in the previous year, and to our good basic business. For 2007, we are confident of being able to improve the combined ratio further, provided we are spared extreme mega-losses.

When it comes to interpreting the combined ratio, the particular circumstances of the class of business in question have to be taken into account. Of substantial significance, for example, is the composition of the portfolio.

The following factors (among others) are important:

- The more the claims burden fluctuates over time, the greater the risk is, and so the rates needed to cover the risk must be higher. Loss ratios in good years, as well as average loss ratios, have to be all the lower to provide the reinsurer with an adequate return for assuming this risk. This is particularly true in the case of natural catastrophes, which may occur rarely, but are often very severe when they do.
- An important distinguishing feature relates to the time-lag between premium being received and claims being paid. The longer these periods are, the longer the premiums received can be invested in the capital markets. High combined ratios in classes of business in which claims settlement takes a long time (e.g. casualty) therefore also generally entail higher returns from investments with which the loss reserves are covered. These returns are not reflected in the combined ratio.

Therefore, whilst we aim to keep our combined ratio as low as possible, it does not constitute our sole target.

Rather, the key factor we consider is economic value added, which cannot be properly reflected by the combined ratio. We pursue this target internally through the performance metrics of value added and European Embedded Value (see page 12), both of which are more meaningful and better tailored to the characteristics of the relevant business segments. Their common feature is that they measure value creation not only on the basis of current and forecast profits but also taking into account the size of the risks taken. Thus, when considering Group performance, we gear targets (by way of a common, linking element) to a risk-adjusted return. Although this is not a direct performance measure, it is a strong indication of the Group's value creation.

Risk-based return target for the financial year 2007

We have set ourselves ambitious targets again for the whole Munich Re Group in 2007, to follow up the successful performance of the past financial year. For this purpose, we are employing a risk-based performance measure which we used for external communication for the first

time in 2006: return on risk-adjusted capital (RORAC). We derive this target by placing the profit achieved or aimed at, expressed in euros, in relation to the necessary risk capital, the amount of which we determine using our internal risk model and publish once a year. We thus take into account the economic standards currently underlying (at least to some extent) the requirements of supervisory authorities and rating agencies – standards that are set to play a decisive role in future.

On the basis of further assumptions we make and publish regarding key indicators, our shareholders can form their own opinion regarding our target's achievability, against which they can assess Munich Re's business performance and economic value added

RORAC is defined as follows:

$$\text{RORAC} = \frac{\text{Net income} - \text{Interest rate} \times (1 - \text{tax rate}) \times \text{Additional available equity}}{\text{Risk-based capital}}$$

The numerator in the formula comprises the published IFRS net income adjusted for post-tax income (interest rate x [1 – tax rate]) generated on capital not subject to risk within the given risk tolerance. The basis for the adjustment is the capital exceeding the necessary risk-based capital (additional available equity). This is calculated as follows: the starting point is the equity recognised in the IFRS financial statements, from which the "economic equity" is derived by means of various adjustments. These include the addition of the unrecognised valuation reserves and the unrecognised portion of the embedded values in life and health insurance, and the subtraction of goodwill and deferred tax assets. From this economic equity a margin is deducted for the settlement of existing obligations in following years. The difference between the amount then remaining and the required risk-based capital is the additional available equity, which is also necessary for rating and solvency purposes, as well as for profitable growth, but which we strive to keep lean through our active capital management. This is because the additional available

equity in the system presented here only earns a risk-free interest rate, as all the risk components of the investment and underwriting are covered with risk-based capital by the internal risk model, and thus assigned appropriate return requirements. Even though we take a risk-adjusted return as our target, we aspire to meet the high, but fair expectations of our investors also with regard to the return on total capital placed at our disposal.

At what level should the RORAC target be set?

Our RORAC target is a sustained return on risk-adjusted capital of 15% over the whole cycle – a return we aim to surpass again in 2007. We will not finalise and publish the risk-adjusted capital applicable for 2007 until May. We have set our sights on a consolidated profit of between €2.8bn and €3.2bn for 2007.

What assumptions is this target based on?

In both primary insurance and reinsurance, we are proceeding on the basis of statistically expectable claims experience. Provided there are no significant shifts in the composition of our business portfolio, we reckon with a combined ratio of below 97% in property-casualty reinsurance, which includes an amount equivalent to approximately 5.0% of premiums as projected claims expenditure for natural catastrophes costing over €5m per event. In property-casualty primary insurance, we expect a combined ratio of under 95%.

On the investment side, we anticipate a result equivalent to 4.5% of the average market values of Group-wide investments.

Lastly, our target is based on a largely stable currency environment. Changes in tax treatment are only considered to the extent that they are already known today.

Embedded values as additional performance indicators

In life primary insurance and reinsurance and in German health primary insurance, we will use key indicators primarily based on European Embedded Value (EEV).

We aim to achieve EEV earnings of between 8% and 9% in relation to the value of the overall business in force

at the beginning of the year. The life and health primary insurance business, managed and measured on an embedded-value basis, will contribute to the IFRS consolidated profit and thus to reaching the RORAC target, even though IFRS consolidated results follow the narrower individual financial-year perspective.

What do these Group targets mean for Munich Reinsurance Company's result under German Commercial Code accounting?

In underwriting, we are proceeding on the assumption that with the solid quality of our business, we can achieve a combined ratio of 97% or better, on the basis of a major-loss burden from natural catastrophes of 5% of our premiums. As far as the investment result is concerned, we expect a return of 4% in relation to the average carrying amount of the investments.

Overall, it should be possible for Munich Reinsurance Company to achieve another good result in 2007.

Binding standards for underwriting and pricing

In reinsurance, CUGC is not only responsible for business with our global clients but also develops guidelines and best-practice principles for the underwriting of our reinsurance business. Corporate Underwriting defines standards for the underwriting, pricing and claims management of the reinsurance group. Besides this, regular reviews are conducted to make sure that these standards are complied with. In this way, we ensure that the quality of our business is consistently high and that we respond swiftly to changes and new developments. Since Corporate Underwriting is closely linked to our operative business, we can generate needs-oriented products and services for our clients there as well.

Parameters

General parameters

Our business environment is marked to an increasing extent by growing complexity – together with an upward trend in natural catastrophes. There has also been a disproportionate rise in man-made losses in relation to economic activity. The reasons are many and varied, ranging from technological progress and the advancing geopolitical interdependencies to climate change and trends in international liability. In addition, concentrations of values are mushrooming and regions are becoming more dependent on each other, giving rise to new risk potentials and accumulation hazards. These phenomena present demanding challenges for the insurance industry, but also opportunities. It is therefore imperative to carry on refining risk models and to swiftly incorporate new findings.

In addition, the insurance industry's regulatory environment is being affected by profound changes. The introduction of Solvency II in Europe and new accounting standards have implications for insurers' capital requirements and income statements. The new circumstances will have considerable implications for primary insurers' business models. They will also influence the demand for reinsurance cover and trigger changes in its supply. A group like Munich Re, among the leaders in integrated risk management, can utilise the changing industry dynamics to its advantage and exploit the business opportunities they present.

Economic parameters

The general global economic environment for the insurance industry remained largely favourable in 2006. In spite of continued strong rises in oil prices until August, the global economy expanded further, even achieving a slightly higher growth rate than in the previous year. The stock markets in Europe and the USA showed respectable price gains, whereas the upward trend in Japan was somewhat less pronounced. Yields on the bond markets rose appreciably in the first half of the year before receding again until early December, when interest rates reversed again, rising considerably more steeply in Europe than in the USA. Overall, the difference between the transatlantic yields for long-term bonds narrowed over the course of the year.

Global economic growth gathered pace slightly in 2006, sustaining its momentum. China and the USA are still the most important engines driving the world economy, even if the trend in the second half of the year saw economic dynamics shifting from the USA to the eurozone.

In the USA, the world's largest insurance market, momentum remained at about the level of the previous year on average, despite growth slowing considerably between July and December, for which a slackening of the housing market was chiefly responsible. The mainstays of the US economy were private consumption and corporate investments, with real GDP rising by 3.3% compared with the previous year.

Economic growth in Japan was 2.2% in real terms last year – slightly higher than in 2005.

The economy in the eurozone performed significantly better in 2006 than in the previous year. In particular, domestic demand (investments and consumption) gave rise to real growth, which totalled 2.7% for the year as a whole. Nevertheless, there were marked regional differences: economic growth in Ireland and Finland, for example, was well above average, whereas in Italy and Portugal it remained comparatively subdued.

The German economy grew by 2.7% in real terms in 2006 – a considerable improvement on the previous year. The pleasing aspect of this development was that growth derived not only from exports and corporate investments but also from private consumption, which made a more positive contribution again for the year (buoyed by the effects of a resurging labour market). An initial estimate indicates an annual average rise of approximately 176,000 in the number of employees with jobs subject to social insurance, whilst the unemployment rate stood at 9.6% in December, a year-on-year decrease of 1.5 percentage points.

Economic development in the UK was also up appreciably year-on-year, driven mainly by domestic demand.

In 2006, growth in the emerging markets accelerated. China expanded strongly again with 10.7% in real terms. The Indian economy also continued to develop at a high level.

Among the central and eastern European countries, Russia and Poland added to the momentum, whereas in Turkey expansion slowed somewhat, due not least to a strong depreciation of the currency in May and June.

In Latin America, Brazil and Mexico in particular ensured that the region grew more strongly than the previous year.

Due to falling oil prices since August, rates of inflation around the world dropped especially in the final quarter – in some cases considerably. However, the annual average inflation rate remained at around last year's level in the USA and the eurozone. This environment led to further interest-rate increases by a number of central banks. The US Federal Reserve raised its reference interest rate from 4.25% at the start of the year to 5.25% at the end of June, but then left it unchanged up to the end of the year. The European Central Bank increased its reference interest rate from 2.25% to 3.5% during the course of the year, and the Bank of England raised its key interest rate from 4.5% to 5.0%.

By and large, prices on the international stock markets moved upwards in 2006: the EURO STOXX 50, for instance, improved by 15.1% and the DAX by 22.0%.

In the USA, the S&P 500 also recorded presentable growth of 13.6%. The Japanese Nikkei Index, however, recorded an increase of only 6.9%.

Starting from a level of 3.3% at the beginning of the year, yields on ten-year German government bonds initially rose to around 4.1% by July against the background of positive economic expectations and comparatively high inflation. In view of declining rates of inflation and a cooling of the US economy, however, yields subsequently fell to almost 3.6% at the beginning of December, before renewed economic optimism caused them to rise again to nearly 4.0% at the end of the year. Having started the year at just under 4.4%, yields on ten-year US government bonds climbed to a good 5.2% by the end of June, only to recede to about 4.7% at year-end.

The euro gained considerable ground against the US dollar in the course of the year, its price rising from US\$ 1.18 to US\$ 1.32. It also climbed against the Japanese yen, moving up from ¥139.22 at the start of the year to ¥157.12 at the end of 2006.

Writing business at risk-adequate prices was again the central issue in the insurance markets in 2006. In the rein-

surance renewals at the beginning of the year and at 1 April and 1 July, it was again apparent that most market players were giving priority to selective and profit-oriented underwriting.

The capital base of reinsurers has improved globally, and competition is growing more intense, not least because in 2006 respectable underwriting results were not eroded by losses from major natural catastrophes. On the whole, prices remain at a profitable level.

Impulses for growth in life primary insurance and reinsurance continue to come from the long-term trend towards more private provision. With the worldwide ageing of society, pressure on social security systems is mounting, so that private life insurance is generally growing more strongly than the economy as a whole. Health reinsurance is benefiting from the further privatisation and liberalisation of healthcare systems.

Premium growth in the insurance industry, particularly in property-casualty insurance, is strongly influenced by overall economic development. In life and health insurance, market dynamics are also impacted by changes in the legal and tax environment. The still relatively robust global economy was helpful for most insurance markets.

Given the absence of major natural catastrophes in 2006, insurers in the USA were able to achieve exceptionally good results in property-casualty insurance. According to initial estimates, however, premium growth again lagged behind overall economic growth, owing to a cyclically related fall in rates. A notable exception is business exposed to hurricane risks.

Although the macroeconomic parameters in Germany improved, they had no great stimulating effect on the German insurance industry, significant curbing factors being the stagnation of real incomes, the concerns of many citizens regarding the future, and the advanced level of market penetration already reached. According to preliminary estimates, gross premiums written by the German insurance industry rose by around 2.2% in 2006 (2005: 3.7%). With an estimated growth rate of approximately 4.2% in each case, premiums in private health insurance and life insurance were the fastest growing, although in health insurance a significant role was played by premium increases to take account of rising claims expenses. In property-casualty insurance, premium income fell by

around 1.1%, for which sustained price competition was partially responsible.

In most other European markets, the trend continued towards more direct provision for old age through insurance products. In France, premium volume in life insurance grew by a strong 19% in the first three quarters. Over the same period, premiums in health and personal accident rose by 9%, whereas growth in property-casualty only amounted to around 2%. Initial estimates indicate that the Spanish life insurance market grew by 9.8%, with non-life insurance expanding at a rate of 6.5%. In Switzerland, property-casualty business showed growth of around 1.8%. Premiums in individual life insurance fell by an estimated 3.4%, whilst the decrease in group business (occupational retirement provision) amounted to only 1.2%. Premium volume in Poland's life insurance market recorded very strong growth of 41.4% in the first three quarters, whilst growth in non-life insurance was considerably more modest at 4.8%.

Against a backdrop of high overall economic growth, the emerging markets recorded the largest increases in premium income. In China, premium growth totalled around 23% in property-casualty insurance and 12% in life business. Premiums climbed strongly in the Indian market as well, with non-life premium rising by around 24% in the first three quarters of the fiscal year 2006/2007.

Legal parameters

The German insurance industry is affected by several items of proposed legislation that will impact its business in terms of pricing and product design, client relations, and the overall business processes of companies in the sector. Various European and global initiatives in the field of supervisory law have altered the parameters and will continue to provide for a restructuring of the regulatory landscape in future.

In our home market of Germany, the German Federal Government intends to extensively reform German insurance contract law ("Versicherungsvertragsgesetz" – VVG),

and bring it into line with supreme court decisions and the requirements of what is considered modern consumer protection. The proposed reform emphasises, for example, the obligations of insurance companies to provide information and consultancy prior to and on concluding contracts.

In life insurance, the VVG reform is intended to ensure the implementation of requirements with which the German Federal Constitutional Court charged the legislators in its judgements of 26 July 2005. These concerned policyholder bonuses in endowment insurance and portfolio transfers between insurance companies. The Federal Constitutional Court called for hidden reserves to be taken into account in policyholders' bonuses, and demanded greater transparency and competition amongst life insurers.

In its present form, the proposed legislation envisages that, upon contract termination, 50% of the hidden reserves apportionable to the individual policyholders will be allocated to them on a binding basis. Legislators are no longer pursuing the more far-reaching considerations from spring 2006 that would have substantially threatened the life insurance business model. These provided for the binding allocation of hidden reserves every two years based on their respective fair value.

In private health insurance, the VVG reform is intended to create a framework for case and healthcare management and to open up opportunities for insurers to offer other services.

The Act is due to come into force on 1 January 2008 and is to be applicable to all existing insurance contracts effective 1 January 2009. The new regulations for private health insurance can be introduced for existing policies as early as 1 January 2008.

The German private health insurance industry will be impacted directly and intensively by the "Act to promote competition among statutory health insurance institutions" (health reform). In particular, private health insurers are to be required to offer a basic policy providing benefits equivalent in type, scope and amount to the compulsory provision under statutory health insurance. There will be

an obligation to contract, and benefit exclusions and risk loadings will not be possible. The premium for this basic cover is not to exceed the maximum statutory health insurance premium. It is envisaged that insureds moving from one private health insurance company to another will take part of their ageing reserves with them. It is not yet possible to judge the effect the new regulations will have on the amounts of premiums paid by other insureds. This will be determined largely by client behaviour.

Moreover, the introduction on 2 February 2007 of a three-year waiting period for switching to private insurance will have an impact on new business. Employees will only be exempt from compulsory insurance when they have exceeded the earnings ceiling for compulsory public health insurance – currently €47,700 – for three consecutive calendar years.

The part of the Act relevant to private health insurance is expected to come into force on 1 January 2008.

It is anticipated that the **German Insurance Mediation Act** will enter into force on 1 April 2007 (this is the German Federal Government's implementation of the EU directive on insurance mediation of 2002). The new Act will result in major changes for insurance marketing. In future, insurance agents will require authorisation under commercial law which will depend, among other things, upon their being sufficiently qualified. Insurance intermediaries operating exclusively on behalf of one or more insurance companies will require no authorisation if the relevant insurance products are not in competition with each other. In addition, insurance companies must accept unlimited liability for the actions of intermediaries in that capacity.

Further key aspects of the new Act are the expanded consultancy and documentation obligations. Insurance agents are to advise clients according to their specific needs and circumstances, and give grounds for any specific policy recommendations made. Clients are to be provided with clear and comprehensible documentation for this purpose. Furthermore, insurance companies may work only with intermediaries who are entered in a central, publicly accessible register of insurance agents.

The **German General Equal Treatment Act** has been in force since 18 August 2006 and is based partially on four EU discrimination-prevention directives adopted between 2000 and 2004. It aims to prevent or eliminate unfair discrimination on grounds of race, ethnic origin, sex, religion, ideology, disability, age or sexual identity. The Act affects the insurance industry as an employer in particular, but also as an insurer and risk carrier. Employers have new obligations that can result in liability risks and potential claims for indemnity.

The European Commission's **Solvency II project** will have the greatest effect on the insurance industry. This is scheduled to involve a comprehensive reorganisation of insurance supervisory law within the EU, taking a risk-based approach, one of the core ideas of which is to consider individual risk exposure. Preparations for this are increasingly picking up steam. The Commission plans to publish a draft framework directive in July 2007.

Overview and key figures

Munich Reinsurance Company's business performed very well in the past year.

The Company wrote gross premiums totalling €17.8bn (19.2bn) in 2006, a year-on-year decrease mainly attributable to reduced intra-Group cessions. Only in life reinsurance did we record actual organic reductions in premium, due to the scaling-back of a high-volume but not very profitable reinsurance treaty. On balance, currency translation effects had only a small impact on premium volume in the financial year 2006. As a matter of principle, we adhere to a very selective underwriting policy, geared consistently to profitability. With our strategy of "profit before growth", our main focus was not on increasing premium volume, and we continued to refrain from participating in business that did not meet our requirements with regard to prices, terms and conditions. However, we largely succeeded in replacing treaties that we did not renew with attractive new business. Some 78% (78%) of our premium income came from business with non-German clients.

The previous year's result was substantially impacted by €1,097m due to the assumption of undiscounted loss reserves from Munich Re America for the years 2001 and prior. As a result of the company's internal reserve analysis in the financial year 2006, these assumed loss reserves for asbestos-related claims were strengthened by approximately US\$ 600m after reported claims activity accelerated again in 2006. In addition, the loss reserves for workers' compensation business for 2001 and prior were strengthened by US\$ 456m to take account of a higher level of

reported activity than anticipated, owing to longer settlement periods and medical inflation. This amount contains a discounting effect of US\$ 180m, since – as in the previous year – the reserves from workers' compensation business were taken over discounted, whereas German accounting law provides for claims reserves to be recognised at the future settlement value. For more recent accident years, Munich Re America's intra-Group cessions have experienced more favourable loss emergence than expected across virtually all lines of business. Altogether, Munich Re America's intra-Group cessions had a negative impact of €650m on the result.

Our underwriting result before claims equalisation provisions showed a profit of €504m in the financial year 2006, compared with a loss of €1,958m in the previous year. Quite in contrast to 2005, we were largely spared severe natural catastrophe losses, while our basic business remained very profitable. This is reflected particularly in the share of natural catastrophes in our combined ratio. Whereas in the previous year – especially as a result of the devastating Atlantic hurricanes – this share totalled 19.7%, in the past financial year it amounted to only 1.6%. The combined ratio, which reflects the relation of claims and costs to net earned premiums, amounted to 97.9% (117.0%).

The following table shows our expenditure for major losses in the past five years (with the percentage for natural catastrophe losses):

Major losses over €5m (net)

All figures in €m	2006	2005	2004	2003	2002
Major losses total	864	3,092	1,164	921	1,666
Thereof natural catastrophes	196	2,492	675	245	527

Whereas in the previous year, due to very high claims, we had to withdraw €252m from claims equalisation provisions on balance, in the year under review we were able to strengthen them again overall by an amount of €626m, especially in fire business. After the allocations to claims equalisation provisions, our underwriting result showed a loss of €122m (1,706m).

Our investment result totalled €3,308m, a significant improvement of €753m compared with the previous year, of which €969m (1,164m) is incorporated in the underwriting result as interest on technical provisions, in compliance with accounting regulations.

Given our stronger investment in fixed-interest securities, we earned higher interest income in the financial year 2006 than in the previous year. Thanks to the favourable

performance of the stock markets, we were also able to realise significant capital gains and in some cases write up the value of our shareholdings in 2006.

The previous year had been adversely affected by write-downs of €2,190m in connection with the capitalisation of our subsidiary Munich American Holding Corporation. By contrast, much smaller write-downs of investments were necessary in the financial year 2006: €439m (2,443m).

Munich Reinsurance Company's return on investment (including deposits retained on assumed reinsurance) thus increased to a satisfying 4.3% (3.4%) as at 31 December 2006.

Under new legislation on German corporate tax passed in November 2006, corporate tax credits from the

former imputation system may no longer be linked to dividend payments. The system of dividend-linked corporate tax relief has been replaced by an arrangement in which the credit is paid out in instalments. The existing credit was fixed by final special assessment at 31 December 2006 and will be paid out in equal instalments over a ten-year

accounting period, commencing in 2008. However, the total corporate tax credit has to be recognised in the balance sheet in 2006 as an account receivable at its present value, resulting in a corresponding entry in the income statement. For Munich Reinsurance Company this gives rise to tax income of €155m.

Munich Reinsurance Company's results

All figures in €m	2006	2005	2004	2003	2002
Underwriting result	-122	-1,706	-507	-1,747	-2,529
Investment result without interest on technical provisions	2,339	1,391	1,887	2,614	5,754
Other result	-301	-278	-505	-343	-253
Taxes	-221	-399	-98	-13	-366
Profit/loss for the year	1,695	-992	777	511	2,606
Net retained profits	1,033	712	459	287	1,303

In the financial year 2006, we posted a gratifying profit for the year of €1,695m. After the transfer of €667m to our revenue reserves, net retained profits total €1,033m, which is earmarked for the payment of an increased dividend of €4.50 per share.

Events after the balance sheet date

On 18/19 January 2007, Winter Storm Kyrill crossed central Europe with wind speeds of well over 100 km/h on a widespread scale. The countries hardest hit by the storm were Germany and the UK, but it also affected the Benelux countries, Austria, Poland, the Czech Republic, and to a lesser degree Switzerland. All in all, the Munich Re Group expects its claims costs to be significantly lower than the €600m before tax (around €500m for Munich Reinsurance Company) originally anticipated on the basis of initial estimates.

Ownership of land and buildings with a carrying amount of €157m had been transferred to the purchaser by the end of February 2007, realising a capital gain of €325m.

The share buy-back launched in November 2006 was concluded by the end of February 2007. A total of just over eight million shares were acquired at an average price of €124.36, which will be retired prior to the Annual General Meeting.

Classes of business

In 2006, the intra-Group cessions of our US subsidiary Munich Re America were restructured with regard to the classes of business ceded. The restructuring had a sub-

stantial volume and therefore gave rise to marked shifts in both premiums and results between different classes. These changes sometimes mask the organic development of the business. Explicit reference to this special feature will be made in the reports on the individual classes of business where appropriate.

In **life reinsurance**, we were not able to match the previous year's premium level. The decrease was primarily linked to the reduction (beginning in 2005) of a high-volume – but not so profitable – reinsurance treaty. Demand in life primary insurance stagnated, with new business in many important markets remaining at around the level of 2005. The trend away from endowment insurance towards private and company pension products, which had been triggered by the change in German fiscal parameters from 1 January 2005, continued in 2006. This trend also had an impact on premium income in reinsurance, because old-age pension products, to date are not customarily re-insured in Germany. We expect fundamental growth impulses for our new business in future from developments such as the continuing privatisation trend in old-age and disability provision, the dynamic expansion of the insurance markets in Asia and Eastern Europe, and the restructuring of the European solvency regime (Solvency II). The bulk of premium came from the maintenance of large-volume treaties covering mortality and morbidity risks in our core markets, i.e. Germany, the USA, the United Kingdom and Canada. We managed to considerably improve the result in life reinsurance compared with the previous year, thanks to our rigorous profit-oriented

strategy. For the financial year 2007, we expect the continuing remedial measures in our life reinsurance portfolio to cause a further drop in premium income, with a stable result.

Health reinsurance showed a substantial reduction in premium volume in the year under review, but this was mainly due to a decrease in intra-Group cessions. In addition, we also recorded a fall in premium income from a large-volume treaty in the UK. Apart from these special factors, the overall premium level remained stable. There was a significant improvement in the result compared with the previous year, which is also mainly due to the fact that our intra-Group business was restructured in 2006 and in the previous year. Disregarding these effects, the result in health reinsurance business remained at virtually the same positive level as in 2005. The global health insurance market with its segments "financial protection", "health services" and "provision of care" offers considerable growth opportunities. Our key sector "financial protection" is particularly promising. Two main factors are stimulating higher demand here: healthcare is gaining in significance, and healthcare systems worldwide are undergoing further liberalisation and privatisation. As the leading international provider, with a product portfolio that integrates reinsurance and services, Munich Re is well prepared for these developments. We expect strong growth especially in the Gulf region and Asia. For the current year we anticipate a significant rise in premium volume and a result of around the same good level as last year.

Accident reinsurance recorded a marked decrease in premium income, primarily due to the consolidation of our portfolio in workers' compensation business and the discontinuation of some intra-Group and external accident quota shares. The result improved considerably compared with the previous year but was still very negative and did not meet our expectations. The main reason for this poor performance was the need for substantial reserve strengthening in workers' compensation business from the loss portfolio assumed in the previous year from our US subsidiary Munich Re America for the accident years 2001 and prior. This was necessitated by longer settlement periods and higher medical costs, especially in connection with asbestos cases. In the current financial year, we expect premium volume to decline further. The result should show a distinct improvement, owing to the consolidation measures we have taken.

In **liability reinsurance**, we registered a pronounced decline in premium. This was due partly to the continua-

tion of our very selective underwriting policy and partly to the reduction of intra-Group cessions from our US subsidiary Munich Re America. The ongoing concentration of our global clients' reinsurance is resulting in a growing share of highly exposed and more volatile industrial business and of specific segments like professional indemnity and D&O. This reflects our clients' needs, to which we have responded with our specialist know-how and with our analysis and service tools. As there is only a limited amount of capacity available, particularly for large international programmes, the market environment in this segment is stable. There was a definite improvement in the result compared with the previous year. The need for reserve strengthening for our US subsidiary Munich Re America was compensated for by more favourable run-off of loss reserves for accident years 2002 and later. The result reflects in particular the consolidation and stabilisation measures we have worked hard to achieve in recent years in the design of our treaties. We continued to attach great importance to three aspects: transparent loss exposures, clearly defined scopes of cover, and the avoidance of unlimited liability. Premium income for the financial year 2007 should remain constant, and portfolio rehabilitation measures are likely to bring about an improvement in the result.

Our premium income in **motor reinsurance** was slightly up on the previous year, although pressure on rates persisted on a wide scale and some quota share treaties were reduced because of higher cedant retentions. Both the unexpected rise in premium and the considerably worse result were largely attributable to the restructuring of intra-Group cessions. In addition, the long term care costs relevant for claims in French motor liability insurance rose further, continuing to affect treaties from earlier underwriting years. Although we had already taken extensive remedial measures, we once more had to strengthen our reserves for these claims. We will continue to participate very selectively in proportional business here, provided it offers sufficient profitability on a sustained basis. In the current year, we therefore expect a further reduction in premium income. Our aim is to achieve a positive result again in this class of business in 2007.

In **marine reinsurance**, premium growth was significant. This was again mainly because of the positive trend in prices for offshore energy insurance, which were still buoyed by the high hurricane losses of the previous years. The result improved substantially compared with 2005. However, this positive development was masked by the restructuring of intra-Group cessions, especially to the

benefit of fire reinsurance. In the current financial year, we expect premiums to be slightly up on last year and the result to improve further.

Premium development in **aviation reinsurance** differed between its two business segments: whilst rates in aviation fell further due to additional capacity in the market, premium in space business rose, owing to the greater number of insured satellite launches. Overall, however, the premium reductions in aviation outweighed these increases. As in the previous year, the underwriting result we posted was very satisfactory. The trend towards further reductions in rates remains unbroken because of the relatively low market loss expenditure of recent years compared with the long-term average. As we are constantly refining our risk assessment and consistently decline under-rated risks, we expect premium income to fall further in the current year. If claims incidence is average, the result is likely to be positive again in 2007.

In **fire reinsurance**, our premiums were down somewhat on the previous year's level. We continued to systematically withdraw from business that did not meet our profitability requirements. We were able to achieve further appreciable price increases for risks with natural catastrophe exposure in particular, although premiums came under pressure for claims-free treaties. The result improved enormously compared with the previous year, partly because of the exceptionally favourable claims experience during the last hurricane season and partly due to the above-mentioned positive shifts from other lines of business to fire reinsurance. In the renewals of reinsurance treaties, we adhered to our selective, profit-oriented underwriting strategy. We are still prepared to sacrifice premium volume if we cannot achieve risk-adequate conditions. Our premium income should nevertheless rise in the current year. Given average development of claims for natural catastrophes and other major losses, the exceptionally positive result of 2006 in this class of business – aided by chance factors – will be difficult to repeat.

In **engineering reinsurance** (machinery, EAR, CAR, EEI, etc.), premium income was about the same as in the previous year. The result was still satisfactory, even if we were unable to emulate the extraordinarily good profit of 2005. For 2007 we expect the result to reach the same high level, with premium income remaining stable.

Under the heading of **other classes of business**, we subsume the remaining classes of property reinsurance (burglary, glass, hail, water damage, contingency, windstorm, livestock and householders' and homeowners' comprehensive reinsurance) as well as credit and fidelity guarantee reinsurance. Overall premium volume in these classes was somewhat higher. We extended our leading position, especially in agricultural reinsurance. The business we wrote mainly comprised state-supported crop insurance programmes, with a large portion stemming from the USA. The combined result of these classes reached the same positive level as in the previous year on an organic basis, but owing to the restructuring of intra-Group cessations, it slipped into the red. In credit reinsurance, we achieved a clear profit in 2006, with only a few major losses and a more or less unchanged number of small and medium-size losses. Although major European clients increased their retentions due to the good results of the previous years, we managed to slightly increase our premium volume in this segment. Given the growing pressure on prices and our selective underwriting policy, we expect premium volume in the "other classes of business" to fall in the current year, but the result to be very good again in 2007.

All figures in €m	Gross premiums written		Underwriting result	
	2006	2005	2006	2005
Life	5,275	5,747	282	203
Health	667	1,199	51	-22
Accident	539	866	-739	-1,090
Liability	1,502	1,695	-17	-471
Motor	2,352	2,292	-437	-5
Marine	924	838	-211	-149
Aviation	694	773	105	89
Fire	2,974	3,006	1,305	-861
Engineering	1,154	1,176	163	276
Other	1,766	1,575	2	72
Non-life combined	12,572	13,420	222	-2,161
Total	17,847	19,167	504	-1,958

Claims equalisation provision and similar provisions

The **claims equalisation provision and similar provisions**, whose calculation and recognition are largely governed by law, can substantially influence the underwriting result shown.

These provisions are technical reserves that serve to mitigate fluctuations in claims experience of future years; they are established primarily for individual classes of property-casualty business.

The item embraces the claims equalisation provision itself, the provision for natural hazard risks, and reserves for major risks in the form of provisions for nuclear risks, pharmaceutical product liability risks and terrorism risks.

Given the positive results, we were able to strengthen our claims equalisation provisions in the financial year 2006 – especially in fire business, which in the previous year had seen high withdrawals owing to the enormous hurricane losses. Altogether, we allocated a total of €626m (–252m) to the provisions. The bulk of this amount consisted of €364m (747m) to the claims equalisation provision itself and €235 (–1,024m) to the provision for natural hazard risks. In contrast to the previous year, the reserve strengthening was mainly possible because of the absence of severe natural catastrophe losses. Thanks to the good business performance in 2006, we have reached the legally stipulated maximum amount in the equalisation provisions for our most important classes of business. With this strengthening, we have a solid capital basis for dealing with future fluctuations in risk experience. In the case of further good business performance, allocations should be more moderate. Other allocations made by the Company in the financial year 2006 were €19m (17m) to the provision for terrorism risks, €6m (4m) to the provision for pharmaceutical product liability risks, and €2m (3m) to the provision for nuclear risks.

Investments

The vast majority of Munich Re's assets are managed by MEAG MUNICH ERGO AssetManagement GmbH, a wholly owned subsidiary of Munich Reinsurance Company and ERGO. MEAG was set up in 1999 to concentrate our asset management within the Group and enables us to exploit the efficiency gains that can be made with central, overarching asset management.

Investment principles

In addition to our return target, security, liquidity, mix and spread of investments are the main principles of our investment strategy. We reduce currency risks by matching our expected liabilities with assets in correlated currencies. We also take care that the maturities of our fixed-interest securities are aligned with those of our liabilities. Besides this, the Company keeps sufficient liquid funds available to be able to meet its payment obligations at all times. The methods we use to control investment risks are described in the risk report on page 39 ff.

In 2002, we determined that our investments in shares and corporate bonds should meet sustainability requirements. One of our goals is to ensure that 80% of our equities and corporate bonds are included in recognised sustainability indices or satisfy the sustainability criteria of renowned sustainability rating agencies. We have already surpassed this target. In the case of government bonds, we have achieved a gratifying rate of around 99.5% compliance in terms of the criteria in question. Munich Re also considers sustainability factors in its long-term investments. We use an appropriate set of criteria when acquiring participations and take sustainability aspects into account when performing regular analyses of our shareholdings.

Investment mix

All figures in €m	31.12.2006	31.12.2005	31.12.2004	31.12.2003	31.12.2002
Land, land rights and buildings, including buildings on third-party land	981	1,005	1,037	1,049	1,068
Investments in affiliated companies and associates	12,293	12,054	13,015	13,613	14,962
Loans to affiliated companies and participating interests	247	211	1,236	1,325	1,475
Shares, investment certificates and other non-fixed-interest securities	14,590	15,385	12,927	12,920	9,572
Bearer bonds and other fixed-interest securities	21,915	19,266	17,937	16,189	7,699
Other investments	458	522	502	370	465
Total	50,484	48,443	46,654	45,466	35,241

Development and structure of investments

The carrying amount of Munich Reinsurance Company's investments (excluding deposits retained on assumed reinsurance) rose by 4.3% to €50.5bn (48.4bn) in the financial year 2006.

The following items involved significant changes compared with the previous year:

Land, land rights and buildings, including buildings on third-party land

Our objective is to ensure a high and predictable earnings contribution from our investments in real estate. To this end, we continually monitor existing items with regard to their long-term profitability and future exposure to risks. In addition, the international diversification of our portfolio is a key element of our real estate strategy, which is why in the final quarter of last year we commenced the sale of a German real estate package, to be completed in 2007 (see also "Events after the balance sheet date" on page 18).

Investments in affiliated companies and associates

The increase of €239m in the carrying amounts derives mainly from capital increases at our subsidiaries.

Shares, investment certificates and other non-fixed-interest securities

In the year under review, we took advantage of the favourable stock market situation and slightly reduced our equities portfolio. In keeping with our diversification strategy, we sold Allianz shares in the financial year 2006, thus decreasing our stake from 4.7% to 3.5%, realising a capital gain of €406m in the process.

The carrying amount of our special funds is €218m lower compared with the previous year, particularly due to currency translation effects.

Bearer bonds and other fixed-interest securities

At €21.9bn (19.3bn), investments in fixed-interest securities account for 43.4% (39.8%) of total investments (excluding deposits retained on assumed reinsurance business), an increase of 3.6%. This is mainly because we invested the regular cash flow from our underwriting business, as well as gains on disposals realised in the financial year, chiefly in fixed-interest securities. Our portfolio of fixed-interest investments has an excellent rating structure. As at 31 December 2006, approximately 99% of our fixed-interest securities were investment-grade and 95% were rated "A" or better.

In the year under review, we slightly increased the duration, i.e. average capital commitment, of our bond portfolios. As at the balance sheet date, the duration was 5.9 (5.7) years.

Valuation reserves

Our off-balance-sheet valuation reserves, i.e. the difference between the carrying amount and fair value of the investments recognised at amortised cost, rose in comparison with the previous year by €1,011m. The performance of the international stock markets had a favourable effect on our equity portfolios, enabling us to increase our valuation reserves despite a reduction in our proportion of investments in equities. By contrast, the valuation reserves of our fixed-interest securities decreased in the financial year 2006, owing to the higher interest-rate level.

The determination of the fair values is described on page 67.

Valuation reserves

All figures in €m	31.12.2006	31.12.2005	31.12.2004	31.12.2003	31.12.2002
Real estate	1,632	1,509	1,655	1,808	1,559
Equity investments	8,884	7,683	4,565	4,929	7,235
Fixed-interest securities	531	844	583	283	315
Total	11,047	10,036	6,803	7,020	9,109

Result

We succeeded in improving our investment result in the financial year 2006 by €753m compared with the previous year. The return on investment (based on the average investment portfolio at book values, including deposits retained on assumed reinsurance) amounted to 4.3% (3.4%).

The marked year-on-year improvement in the investment result was mainly because in the previous year we had to make write-downs of €2,190m in connection with the additional reserving at Munich American Holding Corporation and the related strengthening of its capital base.

On the other hand, gains on the disposal of investments were considerably higher in 2005, when we realised substantial profits on the sale of Karlsruher Lebensversicherung AG, the exchange of HypoVereinsbank shares for UniCredit stock, and the sale of parcels of shares (including Allianz).

The table below shows the investment result for the past five financial years and broken down by type of investment:

Investment result

All figures in €m	2006	2005	2004	2003	2002
Regular income	3,166	2,873	2,616	6,285	3,063
Write-ups/write-downs	-152	-1,948	-555	-207	-4,761
Net realised capital gains	981	1,846	950	1,114	8,730
Other income/expenses	-687	-216	-125	-3,596	-165
Total	3,308	2,555	2,886	3,596	6,867

Investment result by type of investment

All figures in €m	2006	2005	2004	2003	2002
Real estate	70	48	73	79	86
Investments in affiliated companies and associates	265	-104	-632	307	5,004
Loans to affiliated companies and participating interests	6	-1,234	87	63	68
Shares, investment certificates and other non-fixed-interest securities	1,489	1,570	1,504	1,691	251
Bearer bonds and other fixed-interest securities	576	930	845	542	434
Other investments	902	1,345	1,009	914	1,024
Total	3,308	2,555	2,886	3,596	6,867

Financial situation

Investments on the assets side of the balance sheet serve mainly to cover technical provisions (75% of the balance sheet total). Equity (14.2% of the balance sheet total) and subordinated liabilities classified as strategic debt (3.9% of the balance sheet total) are the most important sources of funds.

In contrast to liabilities under loans and securities issued, we cannot foresee with certainty how high our liabilities from underwriting business will be and when they will arise. The payout pattern of the technical provisions varies from one line of business to another. In property insurance, for instance, a major portion of the provisions is generally paid out after one year, whereas in life insurance substantial amounts are still due decades after the contracts were concluded. The currency distribution of our provisions reflects the global orientation of our business. Besides the euro, our main currencies are the US dollar and pound sterling. We ensure that our business is sufficiently capitalised at all times by monitoring the situation continuously and taking suitable measures, which are dealt with in the section on capital management. To optimise our capital position and reduce capital costs, we have in previous years not only employed internal forms of financing but have also used strategic debt. A detailed analysis of the structure of this funding is provided in the section on strategic debt.

As part of our active capital management, we took the decision to buy back shares up to a value of €1bn by the next Annual General Meeting on 26 April 2007. The share buy-back was successfully concluded in February 2007.

Since we are an international (re)insurance group, some of our financial resources are subject to restraints on disposal. For example, the supervisory authorities in some countries require foreign reinsurers to establish premium and reserve deposits with primary insurers. As at the balance sheet date, investments totalling €6.7bn were subject to restraints on disposal.

Asset-liability management

The structure of our technical provisions and other liabilities is the basis for the Munich Re's investment strategy. The main focus of this strategy is asset-liability management, the aim of which is to ensure that economic factors influence the value of our investments and that of our technical provisions and liabilities in the same way, thus cushioning the effect of capital market fluctuations. For

this purpose, we mirror important features of the liabilities, such as maturity patterns, currency structures and inflation sensitivities, on the assets side of the balance sheet by means of investments with similar characteristics. If, for instance, there is a strong rise in inflation, our nominal outflows as a result of claims payments increase significantly. This applies in particular to lines of business with long payout patterns, e.g. liability, as inflation accumulates over a number of periods. To an increasing extent we are endeavouring in our asset-liability management to structure our investment portfolio in such a way that inflows from investments increase in line with rising inflation rates. To configure our asset-liability management as effectively as possible, we also use derivative financial instruments, which are described on page 66 ff. of the notes to the financial statements.

Capital management

Through active capital management, we ensure that the capital of the Munich Re Group is maintained at an appropriate level. Munich Reinsurance Company's capital is a large and important part of this. The Group's available capital must always be sufficient to cover the capital requirements determined both by our own internal risk model and by the requirements of supervisory authorities and rating agencies. In this way, we ensure that our financial strength is sufficient for us to take advantage of measured opportunities for growth, while remaining at a reasonable level even in the wake of major loss events or substantial falls in the stock markets. At the same time, we also define an appropriate level of Group capital as one which does not significantly exceed that required for our operations. A lean capital level makes a decisive contribution to financial discipline in all our business processes. Our active capital management includes returning surplus capital to equity holders through attractive dividends and share buy-backs. Our proposed dividend is linked directly to the Group result, of which we aim to pay out a minimum of 25%. We also make use of share buy-backs as a flexible way of returning capital, to our shareholders. Naturally, we liaise closely with the regulators, rating agencies and capital market participants in this regard.

Essentially, we see efficient and transparent capital management as an appropriate means of achieving our goal of being recognised as a reliable partner in the capital markets. This should guarantee our ability to raise capital

quickly and easily on the capital markets, especially for large potential growth opportunities.

In addition to the level of capital, its efficient deployment is also a key factor. We use our value-based management (see page 9) to set performance targets designed to ensure that every investment achieves a sustainable return commensurate with the risk involved. To limit fluctuations in results owing to major losses, we have also developed guidelines and limit systems within the framework of integrated risk management and corporate underwriting for our reinsurance companies. We protect the results and capital of our primary insurance companies against unacceptable fluctuations by means of suitable reinsurance covers.

Our internal risk model plays a central role in capital management. We use it to analyse how certain risk scenarios affect segment results and investments. We determine our economic capital on the basis of the internal risk model data so that we are able to absorb two successive annual losses of a size expected only every 100 years. Next, the determined capital is allocated proportionately to divisional units in line with the volatility of their business activities. We continuously review the assumptions on which the internal risk model is based and adjust them as required.

Equity

In the year under review, our equity increased by €738m or 7.1% to €11,155m, mainly owing to the gratifying profit for the year of €1,695m. €707m of the net retained profits for the previous year was distributed as a dividend to shareholders.

Within the framework of the share buy-back approved on 7 November 2006, we bought back shares to the value of approximately €250m by the balance sheet date, which we offset against the revenue reserves.

To strengthen our equity, a total of €667m from the profit for the financial year has been allocated to the revenue reserves. Of the remainder totalling €1,033m, €988m has been earmarked for the dividend payment.

Given the positive performance of the capital markets, the valuation reserves of our equity investments developed favourably, climbing by €1.2bn. In the case of fixed-interest securities, on the other hand, these reserves reduced by €313m as a result of higher interest rates. All in all, our valuation reserves rose from €10bn to €11bn (see pages 22 and 67).

Equity and valuation reserves

All figures in €m	31.12.2006	31.12.2005	31.12.2004	31.12.2003	31.12.2002
Equity	11,155	10,417	11,866	11,375	7,115
Valuation reserves	11,047	10,036	6,803	7,020	9,109

As at 31 December 2006, Munich Reinsurance Company's share capital of €587.7m was divided into 229,580,233 registered, no-par-value, fully paid shares. The shares are endowed with full voting and dividend rights, with the exception of the 3,964,060 shares held by the Munich Re Group itself (Section 71b of the German Stock Companies Act).

The registered shares are subject to transfer restrictions in that pursuant to Article 3 paragraph 2 of the Articles of Association of Munich Reinsurance Company, they may be transferred to another holder only with the consent of the Company. As at the balance sheet date, 12,355 shares issued to staff were subject to a restriction on disposal

until 30 November 2007. The control rights are exercised directly by the employees.

There are no direct or indirect shareholdings in Munich Reinsurance Company that exceed 10% of the voting rights, nor are there any shares with special control rights

Amendments to the Articles of Association are subject to the provisions of the German Stock Companies Act (Sections 179 to 181, 133); the Annual General Meeting has made use of the possibility provided for in Section 179 paragraph 1 sentence 2 of the Act. Pursuant to Article 14 of the Company's Articles of Association, the Supervisory Board is empowered to make amendments to the Articles of Association which affect the wording only.

The authorities of the members of the Board of Management are defined in Sections 71 and 76 to 94 of the German Stock Companies Act.

Furthermore, the Annual General Meeting of 19 April 2006 authorised the Company pursuant to Section 71 paragraph 1 item 8 of the German Stock Companies Act to buy back its own shares up to a total amount of 10% of the current share capital until 18 October 2007; the Board of Management is authorised pursuant to Section 71 paragraph 1 item 8 sentence 5 of the Act to acquire the shares without requiring further approval at an Annual General Meeting.

The Annual General Meeting of 28 April 2005 authorised the Board of Management to issue with the consent of the Supervisory Board convertible bonds or bonds with warrants on one or more occasions up to 27 April 2010 for a maximum nominal amount of €3bn with an unlimited maturity period and to grant the holders of such bonds conversion or option rights in respect of new shares issued by the Company up to a maximum amount of €100m of the share capital, in accordance with the respective bond or warrant conditions; as a precautionary measure, capital of €100m was conditionally authorised under Article 4 of the Articles of Association.

The Annual General Meeting of 11 June 2003 also empowered the Board of Management in the event of a capital increase at any time up to 11 June 2008 from the capital authorised for this purpose, with the consent of the Supervisory Board, to attach one bearer warrant to each of the new shares to which the shareholders have a subscription right when the capital authorised for this purpose is issued. These warrants would entitle the bearer, on the basis of the warrant conditions then stipulated, to acquire registered Munich Re shares. Warrants may be issued for registered shares totalling up to €35m of the share capital; as a precautionary measure, capital of €35m was conditionally authorised under Article 4 paragraph 3 of the Articles of Association. Furthermore, the Board of Management is authorised, with the consent of the Supervisory Board, to increase the share capital pursuant to Article 4 paragraph 1 of the Articles of Association by up to €280m until 25 May 2009 through the issue of new shares subscribed in cash or in kind (Authorised Capital Increase 2004), and pursuant to Article 4 paragraph 2 of the Articles of Association by up to €5m until 18 April 2011 through the issue of new shares subscribed in cash (Authorised Capital Increase 2006).

Strategic debt

We define as strategic debt all financial instruments with the character of outside financing that do not have a direct link with our operative business. It supplements our equity and is essentially designed to reduce the cost of capital and ensure that we have sufficient liquidity at all times. Munich Reinsurance Company qualifies as strategic debt the subordinated loans from Munich Re Finance B.V., Amsterdam, totalling €3,059m (3,051m).

In 2003, the Munich Re Group strengthened its capitalisation with these subordinated loans which are recognised in part as own funds by the German Federal Financial Supervisory Authority (BaFin). They were placed in two tranches with nominal values of €3,000m and £300m each and will mature in 2023 (euro tranche) and 2028 (pound sterling tranche). The first possible redemption dates are 21 June 2013 (euro tranche) and 21 June 2018 (pound sterling tranche). A large portion of these subordinated bonds issued and guaranteed by Munich Re Finance B.V. was transferred to Munich Reinsurance Company as subordinated loans.

Solvency

Solvency in the case of insurance companies is generally understood to be the ability of an insurer to always meet the obligations assumed under its contracts. In concrete terms, this means an insurance company must fulfil specific minimum capital requirements. To calculate solvency, the minimum equity required for the volume of business (required solvency margin) is compared with the eligible equity actually available (actual solvency margin) on the basis of the company's financial statements. In determining the eligible capital elements, the equity is adjusted; specifically, it is increased by portions of the subordinated liabilities and reduced by intangible assets, participations in banks, financial services institutions and financial services companies. As a result of the satisfying profit for the year, Munich Reinsurance Company was able to strengthen its equity capital, which even after the share buy-back still amounts to several times the statutory minimum requirement.

Analysis of the cash flow

The particular features of our underwriting business have a significant influence on the Company's cash flow. We generally first collect the premiums for the risks assumed and do not make payments until later in the event of loss. The cash flow statements of insurance companies are therefore of limited relevance.

The **cash inflows from operating activities** decreased in comparison with the previous year, mainly owing to the scheduled reduction in a large-volume quota share reinsurance treaty. In addition, a large number of claims from prior years for which we had posted reserves were settled, whereas there was a reduced need for new reserves due to the absence of severe natural catastrophes. Altogether, the Company's claims provisions therefore declined. The net gains on the disposal of investments – which in adjusting the consolidated profit have to be deducted from the cash flows from operating activities – are essentially attributable to the sale of shares.

The **cash outflows for investing activities** were determined by the outflows for the acquisition of investments, with funds from the regular cash flow and from portfolio restructurings being invested in fixed-interest securities.

The **cash flows for financing activities** stem mainly from the dividend payment for 2005 and the share buy-back in 2006.

Overall, cash in the year under review – which includes cash and deposits with banks, cheques and cash in hand – fell by €230m to €374m.

Other success factors

Instrumental in securing Munich Reinsurance Company's sustained economic success are not only the high quality of our business operations but also a number of factors that cannot be measured by financial performance alone. These include:

- Open dialogue with our clients
- Our firm commitment to new, needs-oriented products and services
- Our corporate responsibility towards employees, society and the environment
- Efficient business processes for managing our Group and identifying or avoiding risks

Clients and client relationships

As a professional reinsurer, Munich Reinsurance Company works together with over 4,000 corporate clients – traditional insurers and captives – from around 160 countries.

As reinsurers, we aspire to be the preferred partner in risk for our clients. Our operative business consequently provides companies wishing to cede insurance risks with the full range of underwriting products. In addition, they can benefit from our strengths that go beyond actual reinsurance cover: our financial strength, our knowledge, our solution-oriented approach, and the treatment of our clients as partners.

We continued to be the preferred partner in knowledge for many clients throughout the world in 2006. In Munich and at our many offices and subsidiaries, we offer a large number of seminars and workshops each year on fundamental topics in all lines of insurance. Held in various languages, these place the emphasis on dialogue between our clients and Munich Re experts. We also stage numerous specialist events at our clients' offices every year – forums, symposiums and seminars – dealing with current developments in the individual markets and ensuring a continual transfer of knowledge.

Our two scholarship programmes, which offer high-quality advanced training for our clients' prospective managers, have enabled us over the years to strengthen the partnerships we enjoy with our cedants.

Our solution-oriented approach to collaboration is clearly illustrated by connect.munichre, our internet client

portal, where we provide our cedants with round-the-clock assistance: useful knowledge, services, analysis and quotation tools from the property-casualty and life segments. This both supports primary insurers in their daily business and presents a direct and secure interface to Munich Re. With its swift, efficient and safe interactive features, connect.munichre supplements and optimises Munich Re's range of services and rounds off personal client relationships. The portal is currently used by over 860 insurers globally.

Last but not least, our cedants benefit from our local presence. Branches and subsidiaries around the world ensure that our clients can always find us where and when they need us. We thus combine international know-how with in-depth knowledge of local conditions, to offer our clients individual solutions in every case.

Research and development

As outlined in the general parameters section, the reinsurance market is subject to a wide variety of influences. Munich Re concerns itself with these factors at an early stage so as to help shape them wherever possible and to adapt its products and services to the new circumstances or devise innovative solutions.

Our 23 centres of competence play a special role here: they are active in many different fields, and the significance of their work sometimes goes far beyond the immediate world of insurance. Not only do they create the basis for identifying and highlighting new risks; they also help control them by making them insurable. Geo Risks Research, for example, supports our underwriting of natural hazard risks and is a much sought-after partner for our clients as well as for scientists and politicians. The Centre of Competence for Biosciences focuses on genetic engineering and explores the opportunities and risks of this key technology for the insurance industry. Other centres of competence deal with topics like the assumption of old loss portfolios ("customised portfolio solutions"), IT risks, directors' and officers' liability (D&O) and jewellers' block – a line of insurance covering all the risks of jewellery business and the diamond trade – and also workers' compensation.

Lastly, our Knowledge Management Centre of Competence provides the methodological and institutional foundations for the constant updating and exchange of knowledge within Munich Re, enabling us to secure, expand and efficiently utilise our most important resource – the knowledge of our staff. The centre of competence coordinates these activities centrally, advising the working groups about methods, continually optimising structures and processes, improving the infrastructure and so ensuring a living culture of knowledge.

There are now more than 40 topic networks, in which 650 staff from over 20 countries are engaged. They expand our know-how, package it, and liaise with clients and colleagues alike.

In underwriting, we have set up five cross-divisional innovation teams, i.e. interdisciplinary groups made up of highly qualified experts who work in close contact with the underwriting units to identify and tap new business opportunities. In the year under review, we optimised the integration of our teams in relation to the operative units. They now help promote growth in the respective divisions on three levels: by supporting business transactions, by designing and adapting products, and by developing particular segment strategies. In this process the divisional units, with their direct access to the needs and requirements of our clients, remain the main source of new business ideas – the innovation teams act mainly as internal consultants and the driving force behind the successful realisation of ideas. Our cedants benefit from these solutions in many areas, be it in the individual design of policies, in claims management, or in analysing and optimising a client's portfolio structure.

Thus, for example, in the health markets of Asia and Latin America, we are implementing a new business model called CRI (Consultative Reinsurance). Companies in these regions are faced with the challenge of utilising growth opportunities but at the same time managing the rising health costs and risks. We offer our clients ongoing consultancy as an integrated component in a reinsurance programme. Through our international network of health market specialists, we support them in introducing appropriate actuarial methods, in improving the efficiency of their underwriting, and in combating insurance fraud more

effectively. CRI strengthens our role as an active partner in risk management.

Staff

Our staff provide the basis for our success with their competence, motivation and commitment. They embody the qualities with which Munich Re turns risk into value. That is why we invest in further developing their skills.

Facts and figures

In 2006, an average of 3,476 (3,433) staff were employed with the Company, representing an increase of 1.25%.

Initial and further training

Initial and further training rank among our strategic tasks, not least for reasons of risk management in the human resources sector. Our staff must be highly qualified and motivated to ensure the continued success of our operations. Their knowledge edge is critical to designing solutions for new market developments at an early stage and to meeting the growing requirements of our business. We ensure the necessary qualifications and skills through systematic personnel measures that take into account individual abilities and future requirements. Hence, we consistently offer a large number of internal seminars for personal and specialist training.

We are also firmly committed to giving young people sound professional training and good career perspectives: in 2006, a total of 39 (40) trainees were employed at the Company.

International promotion of talent

Since 1997, Munich Re Munich has been systematically identifying and preparing staff for future management tasks with its scheme for assessing and developing staff potential (POE). We have now extended this system to the international reinsurance group. Highly talented and qualified staff are selected and groomed for management functions in Munich and for leading functions at business units abroad. As a result, we create career prospects for our staff internationally throughout the reinsurance group and can fill vacancies with particularly suitable employees.

Environment

Munich Re's business is inextricably linked with ecological aspects, even if as a service provider we place comparatively little burden on the environment ourselves. We are directly affected by environmental impacts, such as the growing number and intensity of weather-related natural catastrophes. A particular focus of our commitment is therefore climate protection: for many years Munich Re has been contributing its specialist knowledge to numerous organisations and associations concerned with global climate change, especially UNEP FI, the Finance Initiative of the United Nations Environment Programme, which promotes understanding of climate change in the financial sector.

In addition to this, in April 2005, Munich Re became a founder-member of the Munich Climate Insurance Initiative for insurance solutions intended to benefit people in developing countries. In the Climate Group, an international alliance of companies, governments and cities for climate protection, we work for the reduction of greenhouse gases from the 20 economies with the highest emission levels and the 500 largest firms.

Social commitment

As a globally operating corporation, Munich Re accepts its responsibility towards society and supports various social and cultural projects. Knowledge obligates – that is the conviction that led to our setting up the Munich Re Foundation, whose operations were publicly launched in April 2005, with a capital of €50m. Under the motto "From Knowledge to Action", the Munich Re Foundation has set itself the aim of helping people in risk situations and improving their situation – especially in countries where the people are too poor to make use of financial services like insurance. The foundation not only provides direct support but also devotes itself to promoting knowledge, heightening awareness and networking, which facilitates self-help. In its work, it can build on the highly developed risk knowledge of its benefactor. Detailed information on the Munich Re Foundation can be obtained from its report at www.munichre-foundation.org.

IT processes

Information security

Munich Re ensures the security of all its data, computers and networks worldwide. IT security in primary insurance and reinsurance is organised in separate, but individually effective structures.

At the top of our security pyramid in the reinsurance group is the IS Office, which defines uniform standards and guidelines applied by all our companies globally. It is also responsible for information-security crisis management and for quality assurance in the enforcement of the relevant directives. In addition, it instructs our Security Centre of Competence in Toronto, whose functions include testing the IT infrastructure of the reinsurance group and central IT applications for weaknesses and possible security risks. We attach great importance to the security training of all our staff.

Regular external audits have confirmed that Munich Re's information security is at a high level. However, given that we see security as a process rather than a state, we are constantly refining our strategies and standards as part of our information risk management. This process is geared both to the actual risks and to ways of minimising them in order to support Munich Re's business operations. The recommended measures are carefully weighed up and taken into account in the security architecture, which not only describes the technical and organisational aspects but also includes risks related to the "human factor" in the broadest sense.

However, the security organisation does not just concern itself with protective measures. It also acts as a consultant for the divisional units in jointly assessing information security risks at potential clients. To this end, it has delegated a permanent representative to the Information Technology Topic Network and carries out or partners information risk assessments.

Gloria

With our reinsurance platform Global Reinsurance Application (Gloria), we are providing the reinsurance group with a consistent data basis and an integrated system for all business-relevant core processes. Building on various

SAP modules, we are thereby harmonising the business processes in our reinsurance, not only enhancing the quality and efficiency of individual process steps – such as underwriting, claims and accounting – but also improving the analysis, management and administration of our reinsurance business as a whole. The harmonisation of all core business processes will also serve our global risk management, which will have extensive data available even more quickly.

We have successfully completed the roll-out at Munich Re Munich and 15 linked branches. In the next few years, we plan to include the remaining branches and our subsidiaries, starting with Munich Re America.

STAR

Additionally in 2006, the Munich Re Group established a uniform basis for the investment reporting of all its companies. With STAR (STandardised Asset Management Reporting), the Munich Re Group now has a central data basis for Group-wide reporting that covers virtually all the Group's investments. A team of experts from Munich Re, ERGO and MEAG had been working since 2004 to devise and technically implement a Group-wide reporting concept, and in October 2006 the Munich Re Group successfully concluded this process with the go-live of STAR at the remaining companies not yet using the system.

This enables us to steer the Company's investments better and more effectively, because reports are prepared more quickly and conform to uniform standards Group-wide. It also makes it easier for us to satisfy the growing demands of investors, rating agencies, analysts and supervisory authorities, who expect comprehensive reporting on the investments of all our Group companies.

Corporate governance report*

It is our conviction that good corporate governance creates lasting value. We therefore apply the highest standards to our operations and activities, complying with all the recommendations of the German Corporate Governance Code. Beyond this, we have our own Munich Re Code of Conduct specifying ethical and legal requirements that must be met by employees.

How we view corporate governance

Corporate governance stands for a form of responsible company management and control geared to long-term creation of value. Of particular importance to us in this context are the promotion of shareholders' interests, efficient practices on the Board of Management and Supervisory Board, good collaboration between these bodies, and open and transparent corporate communications.

Continually improving our good corporate governance is an important principle underlying our business activities.

What rules apply to Munich Re?

With its international organisation, the Munich Re Group has to consider corporate governance rules in different national legal systems. Clearly, we observe not only the respective national standards but also internationally recognised best practices. In Germany, where Munich Re has its headquarters, corporate governance rules are laid down above all in the German Stock Companies Act, the German Co-Determination Act and the German Corporate Governance Code. The latter, which entered into force in 2002 and has since been amended several times, contains the main legal rules that must be observed by German listed companies. In addition, it includes recommendations and proposals based on nationally and internationally recognised standards of good and responsible management. Every year, Munich Re's Board of Management and Supervisory Board publish a declaration stating how far the Code's recommendations have been complied with. The current declaration of conformity for 2006 can be found on page 34.

Corporate legal structure

Munich Re is a joint-stock company ("Aktiengesellschaft") within the meaning of the German Stock Companies Act. It has three governing bodies: the Board of Management, the Supervisory Board and the Annual General Meeting. Their functions and powers are derived from this Act and the

Articles of Association. This means that our Articles of Association (which can be accessed on our website at any time) are of considerable importance.

Statutory regulations and provisions in the Articles of Association concerning amendments to the Articles

The German Stock Companies Act contains general provisions governing amendments to the Articles of Association (Sections 124 paragraph 2 sentence 2, and 179–181 of the Act). These state that only the Annual General Meeting can make resolutions on changes to the Articles of Association. In order to be carried, a resolution must receive at least three quarters of the votes cast by the share capital represented in the vote. The Articles of Association may stipulate a different capital majority (higher or lower) or other requirements, but Munich Re's Articles of Association do not provide for any such special features.

The German Stock Companies Act contains special regulations on amendments to the Articles of Association where increases and reductions in share capital are concerned (Sections 182–240 of the Act). Under these regulations, all resolutions on capital measures are generally to be made by the Annual General Meeting. Within a self-determined scope, however, the Annual General Meeting can authorise the Board of Management to initiate certain (capital) measures (see page 33 for the authorisations relating to Munich Re). In all such cases, a resolution of the Annual General Meeting is required that has been adopted by at least a three-quarter majority of the share capital represented in the vote. Where these resolutions are concerned, Munich Re's Articles of Association again do not provide for other (i.e. higher) majorities or further requirements.

The Annual General Meeting is entitled to transfer to the Supervisory Board the authority to make amendments to the Articles of Association that affect only the wording (Section 179 paragraph 1 sentence 2 of the German Stock Companies Act). This is the case with Munich Re and has been regulated in Article 14 of the Articles of Association.

Board of Management

Duties and responsibilities of the Board of Management

The Board of Management is responsible for managing the Company. In doing so, it must safeguard Company interests and endeavour to achieve a long-term increase in the value of the Company.

* Joint corporate governance report of the Board of Management and Supervisory Board in accordance with item 3.10 of the German Corporate Governance Code.

Internal regulation of the Board of Management

Munich Re's Board of Management had 11 members at the end of 2006. It was trimmed down to nine members as of 1 January 2007, with a further reduction to only eight members as at 1 March 2007. Pursuant to Article 16 of the Articles of Association, the Board of Management must comprise a minimum of two persons; beyond this, the number of members is determined by the Supervisory Board. Rules of procedure issued by the Supervisory Board regulate the distribution of responsibilities and cooperation on the Board of Management, which has had two committees since 1 January 2006 – one for Group operations and one for reinsurance operations – in order to enhance the efficiency of its work.

Statutory regulations and provisions in the Articles of Association governing the appointment and dismissal of members of the Board of Management

The legal parameters for the appointment and dismissal of members of the Board of Management are specified in Sections 30–33 of the German Co-Determination Act and Sections 84 and 85 of the German Stock Companies Act. Munich Re's Articles of Association do not deviate from this. The Supervisory Board appoints the members of the Board of Management and may dismiss them at any time for good cause. On initial appointment, members of the Board of Management are usually given contracts for a term of between three and five years. Extensions of up to five years are possible and – in exceptional cases – members of the Board of Management may also be appointed by a court of law.

Authorities of the Board of Management with particular regard to the option of issuing or buying back shares

Pursuant to Article 4 of the Articles of Association, Munich Re's Board of Management is authorised to implement certain capital measures (Authorised Capital Increases 2004 and 2006, Contingent Capital Increase 2003 I and 2005).

Furthermore, by resolution of the Annual General Meeting of 19 April 2006, the Board of Management is authorised to buy back and use the Company's own shares. The complete wording of the resolution adopted on agenda item 5 can be accessed on our website (www.munichre.com) at any time. With the share buy-back – resolved and announced on 7 November 2006 for a maximum total purchase price of €1bn – the Board of Management has partially exhausted this authorisation.

Collaboration between Board of Management and Supervisory Board

The Board of Management and Supervisory Board cooperate closely to the benefit of the Company. The Board of Management coordinates the Company's strategic approach with the Supervisory Board and discusses the current state of strategy implementation with it at regular intervals. It reports regularly to the Supervisory Board. Certain types of transaction, such as investments of substantial size, generally require the Supervisory Board's consent.

Supervisory Board

The Supervisory Board monitors the Board of Management and gives counsel where appropriate. Certain transactions, such as major investments or capital measures, require its approval, but it is not authorised to take management action. The Supervisory Board also appoints the external auditor of the financial statements. Remuneration of the members of the Supervisory Board is regulated in the Articles of Association, i.e. is determined by the shareholders.

In compliance with the law and the Company's Articles of Association, Munich Re's Supervisory Board has 20 members. Half are elected representatives of the employees, and half representatives of the shareholders, elected by the Annual General Meeting.

Munich Re's Supervisory Board has four committees: the Standing Committee, the Personnel Committee, the Audit Committee and the Conference Committee.

Annual General Meeting

At Munich Re's AGM, the principle of "one share, one vote" applies. Shareholders may exercise their voting rights personally or authorise a proxy appointed in writing, a bank or a shareholders' association to cast their votes. Munich Re also offers its shareholders the opportunity to have their voting rights exercised in accordance with their personal instructions by one of the proxies nominated by the Company.

Significant agreements which take effect, alter or terminate upon a change of control following a takeover bid

Based on our underwriting policy, our reinsurance agreements include a clause that grants both parties to the agreement a right of extraordinary cancellation in the event that "the other party merges with another company or its ownership or control undergoes a material change". Such or similar clauses are typical of the industry. Munich Re's long-term incentive plans provide for special exercise

conditions in the event of a change of control following a takeover bid. Beyond this, there are no other significant agreements subject to such conditions.

Corporate governance topics in 2006

A code of conduct for all employees of Munich Re and the reinsurance companies of the Munich Re Group has been in force since 2006 and is published on our website. The purpose of the code is to provide clear information and guidance for employees (including members of the Board of Management) on the basic legal and ethical requirements they must comply with in the course of their work for the individual Group companies.

On 1 January 2006, the Board of Management set up two committees from amongst its ranks – one for Group operations and the other for reinsurance operations. This organisational distinction between Group matters and the operative management of our reinsurance business has proven a success. It permits a more focused deployment of resources and enables us to manage the Group as a whole more efficiently in its various fields of business.

As from the financial year 2006, Munich Re is publishing the remuneration of the Board of Management in individualised form for the first time (see remuneration report).

Last year, the Supervisory Board again reviewed the efficiency of the Board of Management's activities. The main focus was on the content and timing of reports from the Board of Management to the Supervisory Board. This was assessed as generally positive and efficient, as was the improvement in the efficiency of the Supervisory Board's work in the financial year 2006.

Recommendations and suggestions of the German Corporate Governance Code

In November 2006, the Board of Management and the Supervisory Board published the following declaration of conformity, in accordance with Section 161 of the German Stock Companies Act:

"Since 24 July 2006, Munich Re has complied with all the recommendations of the Government Commission's German Corporate Governance Code of 12 June 2006 (published on 24 July 2006).

Since the last declaration of conformity in November 2005, Munich Re has fulfilled – with only one exception – the recommendations of the Government Commission's German Corporate Governance Code in the version of 2 June 2005 (published on 20 July 2005). The exception

involved the since-deleted recommendation in item 4.2.4 sentence 2 of the German Corporate Governance Code (individualised disclosure of the Board of Management's remuneration in the notes to the consolidated financial statements)."

Munich Re also complies with all the suggestions of the Code with only one exception. This concerns item 5.4.7 paragraph 2 sentence 2 of the Code, which suggests that the result-related remuneration of members of the Supervisory Board should include components based on the company's long-term performance. We consider that a convincing remuneration model for this is still lacking and that our remuneration model, approved by the Annual General Meeting in 2005, is a good solution in terms of corporate governance.

Remuneration report

Structure of the remuneration system for the Board of Management

In compliance with the German Corporate Governance Code, we here explain the principles of the remuneration system for Munich Re's Board of Management and the structuring of the individual remuneration components.

The structure and amount of the remuneration are determined by the Supervisory Board's Personnel Committee, whose three members comprise the Chairman of the Supervisory Board, another of the shareholder representatives and one of the employee representatives. The full Supervisory Board discusses the remuneration structure and reviews it regularly.

Structure and system of the Board of Management's remuneration effective 1 January 2006

Component	Assessment basis/ parameters	Corridor	Precondition for payment	Payment
Basic remuneration , remuneration in kind/fringe benefits (company car, healthcare, security measures, insurances)	Function, responsibility, length of service on Board	Fixed	Contractual stipulations	Monthly
Short-term compensation component Annual bonus	Consolidated result Company result Divisional result Individual objectives	0–150% 0–150% 0–150% 0–150%	Achievement of objectives	Annually, in the following year
Medium- and long-term compensation component Medium-term bonus	Consolidated result	50–150%	Achievement of objectives at least 50% on average over three years	In the fourth year
Share-price-based compensation component Long-term incentive plan (stock appreciation rights; term: seven years)	Appreciation in share price	0–150%	> End of vesting period (two years) > 20% share price increase > MR shares have outperformed EURO STOXX 50 twice at the end of three-month period during the term of the plan	As from third year of plan until end of plan
Retirement plan Pension entitlement	Basic remuneration Number of years on the Board	Fixed	> Retirement > Insured event > Premature termination or non-extension of employment contract under certain circumstances	–

Fixed components

Basic remuneration

The fixed annual basic remuneration is paid in the form of a monthly salary.

Remuneration in kind/fringe benefits

Remuneration in kind and fringe benefits are granted according to function, and are in line with market trends. Tax on the related benefits is subject to the individual tax rates of the respective Board member; the tax burden is borne by the Company.

Variable components

Short-term compensation component – Annual bonus

This compensation component is based on different categories of objectives. The targets and scaling for Group, corporate and divisional objectives are geared to particular indicators; individual objectives form the basis for the achievement of personal targets. The key indicator used for the Group objective is return on risk-adjusted capital –

RORAC, which is comprised of key figures from external accounting, and from other key portfolio and performance data. Information on the definition of RORAC is provided on page 11 f. We use the performance measures embodied in value-based management for the corporate and divisional objectives.

The processes defined to specify objectives and assess their achievement also involve the external auditor, who examines targets and their fulfilment for correctness, objectivity and reliability. The audit results and any potentially controversial aspects are rendered transparent for the Supervisory Board's Personnel Committee.

Medium- and long-term compensation component – Medium-term bonus

The medium-term bonus is based on performance over a three-year period. It is measured on the basis of the Group result category from the short-term compensation component. Payments are made only if the achievement rate is at least 50% on average for the three-year period.

Share-price-based compensation component – Long-term incentive plan

This remuneration component, with a long-term perspective, is linked to the sustained appreciation of Munich Re's share price. The long-term incentive plan is set up each year, and the participants receive a certain number of stock appreciation rights. These can only be exercised if, after a two-year vesting period, Munich Re's share price has risen by at least 20% since inception of the plan and the shares have outperformed the EURO STOXX 50 at least twice at the end of a three-month period during the term of the plan. The exercise hurdles are exacting and in keeping with the German Corporate Governance Code.

Whether the stock appreciation rights can be exercised and, if so, when, is not certain at the time they are granted. The exercising and proceeds depend on the development of the share price and the exercise price and date. The amount of income is limited. Up to now, it has only been possible to exercise stock appreciation rights under the plans set up in 1999, 2003 and 2004. Further information on the long-term incentive plans can be found on pages 71 to 73 of the notes to the financial statements.

In the case of 100% achievement of objectives (annual bonus, medium-term bonus) and based on the imputed value of the share-price-linked compensation (long-term incentive plan) at the granting date, the weightings of the individual components in terms of total remuneration are as follows: basic remuneration approximately 25%, annual bonus approximately 35%, medium-term bonus approximately 20%, and long-term incentive plan approximately 20%. Annual bonus, medium-term bonus and long-term incentive plan together form a well-balanced incentive system.

In accordance with the recommendations of the German Corporate Governance Code, the monetary remuneration of the Board members thus comprises fixed and variable components, all of which are appropriate in themselves and as a whole. Criteria for this are in particular the respective Board member's duties, the Board member's personal performance, the performance of the Board as a whole and the financial situation, performance and future prospects of Munich Re, taking into account the relevant benchmarks.

A different arrangement applies to the remuneration structure of Mr. Phelan, who is not only a member of the Board of Management but also the President, Chief Executive

Officer and Chairman of the Board of Munich Re America Corporation, and therefore has special remuneration agreements, with the major portion of his income derived from the USA.

Other remuneration

In the case of seats held on other boards, remuneration for board memberships must be paid over to the Company or is deducted in the course of regular compensation computation. Excepted from this is remuneration for personal memberships, which do not exist at present. In the event of a change of control, the members of the Board of Management have no contractual entitlement to payments. As far as the share-price-based remuneration is concerned, the conditions provide for special exercise options in the case of a change of control. Details of this are provided in the notes to the consolidated financial statements on page 73.

Pension entitlement

In addition to the regular remuneration, the members of the Board of Management are members of a defined benefit plan under which they will receive a fixed pension whose amount depends on their basic remuneration and their years of service on the Board. The pension level starts at 30% and can reach a maximum of 60% of annual basic remuneration. Members of the Board of Management are entitled to an occupational pension from age 60 if they leave the active service of the Company, or if their contract of employment is terminated prematurely or not extended due to incapacity for work or under certain other conditions.

Total remuneration of the Board of Management

In the year under review, after allocation to the appropriate periods, the remuneration of Munich Reinsurance Company's Board of Management showed an overall rise of T€3,028 or 15.3% from T€19,743 to T€22,771. The increase was solely attributable to the high provisions for the variable remuneration, mainly due to the very good result for the year under review.

The compensation components that Mr. Phelan received for his work as member of Munich Reinsurance Company's Board of Management is included in the total remuneration.

Remuneration of individual Board members (in accordance with Section 285 sentence 1 item 9a sentences 5–9 of the German Commercial Code and Section 314 paragraph 1 item 6a sentences 5–9 of the German Commercial Code)

Name	Basic remuneration	Remuneration in kind and fringe benefits	Annual bonus ¹	Medium-term bonus ¹	Value of stock appreciation rights granted	Total	Number of stock appreciation rights
All figures in €							
Dr. Nikolaus von Bomhard	864,000.00	57,393.35	1,582,700.00	1,020,000.00	666,000.00	4,190,093.35	30,411
Dr. Ludger Arnoldussen ²	75,000.00	7,566.00	139,650.00	90,000.00	60,000.00	372,216.00	2,740
Dr. Thomas Blunck	300,000.00	26,818.48	558,600.00	360,000.00	240,000.00	1,485,418.48	10,959
Georg Daschner	400,000.00	29,779.88	744,800.00	480,000.00	320,000.00	1,974,579.88	14,612
Dr. Heiner Hasford	696,000.00	40,700.34	1,024,100.00	660,000.00	294,000.00	2,714,800.34	13,425
Dr. Torsten Jeworrek	500,000.00	29,021.04	931,000.00	600,000.00	400,000.00	2,460,021.04	18,265
Christian Kluge	510,000.00	33,701.76	837,900.00	540,000.00	300,000.00	2,221,601.76	13,699
John Phelan ³	–	123,307.88	372,400.00	210,000.00	–	705,707.88	–
Dr. Jörg Schneider	600,000.00	35,014.18	1,117,200.00	720,000.00	480,000.00	2,952,214.18	21,918
Dr. Wolfgang Strassl	300,000.00	14,959.09	558,600.00	360,000.00	240,000.00	1,473,559.09	10,959
Karl Wittmann	510,000.00	33,131.44	837,900.00	540,000.00	300,000.00	2,221,031.44	13,699
Total	4,755,000.00	431,393.44	8,704,850.00	5,580,000.00	3,300,000.00	22,771,243.44	150,687

¹Owing to the very good business performance, provisions have been established for the maximum bonus amounts for the Munich Re Group/Company result.

²Member of the Board of Management since 1 October 2006.

³Remuneration in kind and fringe benefits include travel expenses from Princeton to Munich.

The variable compensation includes allocations to provisions for the annual bonus probable on the basis of current estimates and for the medium-term bonus. The share-priced-based compensation component is accounted for at fair value at the granting date. Information on the fair values can be found in the notes to the financial statements on page 72. Whether the variable components will actually be paid out to the Board members, and if so how high the sums will be, is not yet certain and will depend on the degree to which individual objectives are achieved, and on the exercise conditions of the long-term incentive plans.

Munich Re shares have been acquired to cover future obligations arising from the long-term incentive plans so as to neutralise the expenses resulting from a growth in value of the stock appreciation rights with an increase in the value of the share portfolio.

Pension entitlements

Personnel expenses of T€18,015 (1,618) were incurred for the pension entitlements of active members of the Board of Management. The defined benefits for Board members are as follows:

Name	Pension commitments as at 1.1.2007	Commitments for bridging amounts	Personnel expenses for increasing the provision
All figures in €			
Dr. Nikolaus von Bomhard	380,160.00		3,843,434.00
Dr. Ludger Arnoldussen	150,000.00		62,591.00
Dr. Thomas Blunck	105,000.00		670,483.00
Georg Daschner	180,000.00		1,945,021.00
Dr. Heiner Hasford	375,840.00 ¹	548,680.00 ²	3,412,285.00
Dr. Torsten Jeworrek	165,000.00		1,604,037.00
Christian Kluge	244,800.00		1,371,632.00
John Phelan	–		–
Dr. Jörg Schneider	252,000.00		2,431,555.00
Dr. Wolfgang Strassl	105,000.00		1,050,266.00
Karl Wittmann	244,800.00		1,618,196.00
Total	2,202,600.00	548,680.00	18,014,500.00

¹ Pension commitment per annum after the age of 60.

² Bridging amounts for the period between retirement and reaching the age of 60 (March–November 2007).

Members of the Board of Management appointed before 2006 are contractually entitled to an occupational pension comprising their former basic monthly salary for six months after retirement.

Total remuneration of former members of the Board of Management

Payments to retired members of the Board of Management or their surviving dependants totalled T€5,171 (4,271).

Pension commitments

Personnel expenses of T€22,224 (-18) were incurred for retired members of the Board of Management. As at 31 December 2006, the pension provisions and provisions for comparable benefits for former members of the Board of Management amounted to T€80,795 (50,999).

Total remuneration of the Supervisory Board

The remuneration of the Supervisory Board, which was restructured by resolution of the 2005 Annual General Meeting, provides for a fixed remuneration of T€45 and a variable result-related remuneration component. The remuneration of members of the Supervisory Board in the year under review totalled T€1,948 (1,865). This includes variable remuneration of T€774 (677).

Advances and loans

The members of the Supervisory Board and Board of Management did not receive any cash advances or loans in the year under review; no contingent liabilities were entered into for their benefit.

Risk report

The selective acceptance of reinsurance risks is at the core of our business model. Munich Re complies both with the German Law on Corporate Control and Transparency (KonTraG) and with local regulations on risk management in the different countries in which it operates. Our risk early-warning system is regularly examined independently, both by internal auditing units and by the external auditor as part of the annual audits. Whilst we are in a position to adequately assess risk situations, the growing complexity and dynamism of the environment in which we operate means that there are, naturally, limits.

This risk report reflects the German Accounting Standard DRS 5–20.

Objectives of risk management

Risk management plays a core role in the steering of Munich Re's operations. The Company deploys a mixture of decentralised and centralised risk management functions, tools and processes for its diverse global business. The central activities come within the responsibility of the Group Chief Risk Officer (Group CRO). The decentralised risk management activities are integrated in the framework of the Group Chief Risk Officer and the central division Integrated Risk Management (IRM). Important decentralised risk management functions include the Corporate Underwriting Division of the property-casualty reinsurance business, the Life and Health Reinsurance Valuation and Controlling Departments, the Central Reserving Division, the Group Investments Division and the decentralised risk controllers in all divisional units.

With our effective integrated risk management we aim to:

- protect Munich Re's reputation;
- ensure the highest degree of confidence in meeting policyholders' claims; and
- enable Munich Re to protect and sustainably generate shareholder value.

Risk management framework: Principles and governance

The functions and responsibilities of all participants – be they members of the Board of Management, executives, decentralised or central risk controllers or risk managers – are defined. The **Board of Management** is responsible for the cross-divisional planning, steering and controlling of the risk landscape as a whole.

Integrated Risk Management at Munich Re is headed by the Group Chief Risk Officer, is centrally responsible for preparing these Board decisions and for identifying, evaluating, steering, monitoring and communicating risks on the asset and liability sides. In this role the CRO relies on the work of the decentralised risk management units. The Group Chief Risk Officer takes part in all meetings of the risk-related Board of Management Committees, namely the Group Committee and the Global Underwriting and Risk Committee (GURC).

The main responsibility of Integrated Risk Management is to set standards and develop methods and tools as a basis for consistent Group-wide risk management. The decentralised risk controllers in the business units operationalise these in a manner suitable to their business needs and take account of legal requirements when necessary.

In day-to-day business, our executives in the business units are also responsible for systematically handling individual reinsurance risks. They identify, analyse, manage and monitor the risks on an ongoing basis with support from the decentralised risk controllers.

By separating accountability and monitoring within insurance and asset management, we ensure the effective management of our risks.

Board of Management	
Approves business strategy Defines risk appetite and expected risk-adjusted returns	
Business management/Risk owners Business planning Identify and evaluate risks Take steps to manage/mitigate all risks associated with their business Manage and own risks of all approved transactions regardless of ultimate approval level	Integrated Risk Management Clear mandate by the Board to ensure that for all classes of risk appropriate limits, policies, procedures and measures are in place within each business unit Aggregate and monitor Group-wide risks (e.g. risk capital) and report to Board Develop risk mitigation strategies
Internal Auditing	
Audit function independently verifies that effective controls are in place and functioning	

Risk appetite and risk-based capital

The basis for accepting risks is determined by the Board of Management's requirements and decisions on risk appetite. These are defined by the Group's strategic risk management framework (developed in 2006 and implemented as from 2007) and consider the impact on capitalisation, liquidity and earnings volatility. They include "whole portfolio criteria" as well as "supplementary" criteria designed to limit and steer peak exposures, concentrations, accumulations and systematic risks.

We manage business portfolios by assigning return expectations, derived from the size of the risks assumed, to individual business activities. Our internal risk model, the Munich Re Capital Model, plays a central role here. We use it to analyse how certain risk scenarios affect the results of the segments life and health, property-casualty and investments. For the segments life and health, we supplement the risk metrics from our internal risk model with risk metrics derived from our market-consistent embedded value steering framework. This framework allows us to take an objective view of the risks, tailored to the long-term nature of that business.

We determine our required economic capital using a robust market-consistent economic capital model, the Munich Re Capital Model. It is calibrated to absorb two successive annual losses of a size only to be expected every 100 years. The model is built using a series of modules for each of our business segments. For example, for our scenarios of natural hazards worldwide, we utilise the expertise of our geoscience teams, who together with

our Corporate Underwriting unit test and refine external models and internally-built models to represent our global exposures to hurricanes, winter storms, typhoons, earthquakes, flood and other natural perils. The modules are aggregated using a conservative measure of the dependence of the risks in the portfolio, and a series of stress tests are applied to check the resilience of the implied "economic capital buffer" (i.e. excess of available financial resources over required risk capital). In the next step, the required risk capital is allocated to the individual divisional units on a proportional basis in line with the volatility of their business activities.

Value-based management

Risk management tools and processes are embedded in our business steering concepts through the value-based management system applied in the Group. Various risk-adjusted earnings targets are given to our business managers using the results of the Munich Re Capital Model or market-consistent embedded value framework. In this way, there is an explicit linkage of the results from the Munich Re Capital Model to the remuneration of our business executives. The value-based management framework we deploy is geared to ensuring that business which is written by a business unit meets the technically risk-adequate price standard for the aggregate of the business unit's portfolio. The technically risk-adequate price is defined as the price which reflects the sum of expected losses, acquisition and non-acquisition costs plus the cost of allocated risk capital, including an allowance for frictional costs.

Risk measurement

As a global risk carrier, we can diversify our portfolio through the broadest possible mix and spread of individual risks, thus significantly reducing the volatility of total claims payments and substantially increasing the value added by all divisional units.

We are constantly refining the tools with which we monitor and manage risks. Our suite of tools for measuring risks is tailored to the business or operational segment we are monitoring. In each case, the lead risk measure is an economic risk measure designed to best reflect the risk in our portfolio. We also regularly compare these economic risk measures with both regulatory and rating-agency measures as part of our active capital management process. These comparisons are performed at many levels, including segment, legal entity, risk type, geographical and line of business. We also regularly perform outside-in benchmarking of our capital model results and participate in industry surveys to constantly challenge and continuously refine our risk measurement tools so that they continue to reflect the most faithful representation of the economic risks in our portfolio.

To improve supervision of risks, we distinguish between market, credit, liquidity, insurance and operational risks.

Qualitative risk assessment

Whilst we are in a position to adequately assess the known risks in our portfolio, the growing complexity and dynamism of the environment in which we operate means that we must also remain vigilant with respect to the detection and representation of new or emerging risks. We follow a multidisciplinary approach in this regard using the know-how and experience of geoscientists, biologists, specialist underwriters, lawyers, economists, sociologists and actuaries. For example, the Geo Risks Research Unit for natural catastrophes consists of 28 staff, who have published numerous papers on the likely impact of climate change on the future frequency and severity of losses for the insurance industry. We utilise their research to ensure that the capitalisation for risks in our portfolio includes an allowance for the risk of change.

For the holistic assessment of the risk situation, risk surveys coordinated by IRM (Integrated Risk Management) are conducted.

Such surveys consist partly of standardised reports based on risk questionnaires, meetings and workshops held with the individual departments and subsidiaries. These are supplemented by various top-down assessments from senior management on concrete topics. The findings thus obtained are additionally reconciled with our operative corporate planning process. Besides this, there is an internal ad-hoc reporting process to ensure we can take immediate action if risks or hazards emerge suddenly. The Board of Management or its respective committees may also be called within 24 hours' notice in addition to the regular meetings. Thanks to information from the risk assessments, the Board of Management is notified at an early stage about risk-relevant developments, and risk-reduction measures can be recommended and coordinated. Where a risk assessment is performed by one of the decentralised risk functions, the role of the Group CRO's central IRM unit is to independently challenge and verify the findings of that risk assessment using its own knowledge of the risks, together with structured interviews and independent analysis.

As part of the early-warning system under the German Law on Corporate Control and Transparency, "emerging risks" have to be considered. These are risks that may have unidentified effects on our risk portfolio due to changes in risk factors (e.g. legal, socio-political, scientific and technological), where the degree of uncertainty as regards the extent of damage and occurrence probability is very high. Trends and faint signals are identified internally in many different ways: this includes systematic trend research in Group Development, utilising Munich Re's knowledge management, and risk assessment. Different forms of cooperation with external partners supplement our internal early warning system. One example is our collaboration with the US RAND Institute for Civil Justice on the issue of class actions; another is Munich Re's chairing of the CRO Forum's Emerging Risks Initiative in 2007 (the CRO Forum being an association of Chief Risk Officers from major insurance companies). The primary objectives of the initiative are to identify key emerging risks for the insurance industry, to create corresponding scenarios for these, and to proceed with developing the requisite range of tools to deal with them. The initiative includes representatives of the European, US and Australasian insurance and reinsurance industries.

Our investments are continually monitored on the basis of various key risk and earnings figures as part of an early-warning system. This is designed to ensure the achievement of result targets, the fulfilment of solvency requirements and sufficient equity capital protection. We have established asset-liability teams (ALTs) that advise on and monitor strategic decisions relating to investments. This has enabled us to standardise Munich Re's investment-related risk management activities and to follow a liability-driven investment strategy. The recommendations of the ALTs are formally presented to the member of the Board of Management responsible for investments together with independent verification and challenge provided by the Integrated Risk Management Division.

Quantitative risk measurement: Modelling and aggregation

For a quantitative assessment of the overall risk situation, an internal model has been developed and maintained. The design of our internal model follows a bottom-up approach. We have selected the financial year as the period for evaluating risk capital requirements. Risks within this period are covered by risk-based capital derived from our specified risk tolerance. All risks beyond the annual timeline are accounted for by the costs of holding risk-based capital over time. In so doing, we follow the "cost of capital" approach.

When determining risk-based capital, we distinguish between market, credit, insurance and operational risks. Within insurance risks, we distinguish between property-casualty and life and health risks. Further subcategories are applied to these risk types – for example, for property-casualty we distinguish between natural catastrophe risks, other accumulation losses (such as terrorism or "liability catastrophes"), large losses and basic losses. Basic losses can also be broken down into premium insufficiency risks and the risks of adverse loss development. Those risks are first modelled separately. In a further step, the risks are aggregated using a combination of empirical and judgemental techniques that allow for the risks of so-called "tail dependencies" (e.g. the risk that extreme events happen at the same time in different lines of business, geographies, and risk types) and the overall risk is thereby quantified.

Risk management processes and exposures

We adopt a holistic risk management approach, the main objective of which is to analyse and control the interdependencies between risks on the asset and liability sides, and between strategic and operational risks. This entails considering economic parameters as well as the requirements and expectations of clients, shareholders, supervisory authorities and rating agencies.

Market risks

Risk management processes

At Munich Re we are guided by the following ALM principles. In a first step, we structure our investments so that they match the characteristics of our liabilities as closely as possible. We allow in this step for the economic structure of the liabilities as well as any regulatory restrictions on the determination of those liabilities. We call this the "neutral position" for the liabilities. In a second step, the Company exploits its expertise in international financial markets to deliver a commensurate return for the risk taken by deviating from the neutral position. Such market risk is taken in a way that is commensurate with the risk-bearing capacities of Munich Re, the skills and expertise of our asset managers and the strategic level of asset-liability mismatch that is set by the Board or its Risk Committees.

In line with our **asset-liability management** (see page 24), we follow a liability-driven investment approach, i.e. we match the outflows implied by the insurance operations with appropriate investments, e.g. by matching currencies, durations and, where relevant, convexity. Basically our asset-liability mismatch risks are mainly steered on an economic basis, meaning that the pure accounting effects must be treated with caution, as the financial statements prepared in accordance with the applicable accounting rules do not always fully reflect the economic situation. Besides these aspects, our investment strategy also considers requirements relating to supervisory regulations, accounting and tax purposes.

Furthermore, for individual reinsurance products involving explicit market risks, such as interest rate or currency risks, asset-liability management principles are applied at micro (e.g. treaty) level when the products are

being designed and priced. This is especially important for life business and long-tail property-casualty business, where long time horizons are involved. The companies entrusted with our asset management, in particular MEAG, are given mandates based on uniform investment criteria (General Investment Guidelines) that are established by the Board of Management.

Market risks are measured and limited using a value-at-risk (VaR) approach for the asset-liability mismatch risk, which is also employed in our strategic investment planning to model the optimal investment portfolio according to our risk preference. This asset-liability mismatch risk approach measures the possible adverse changes in economic surplus resulting from changes in assets and the valuation of liabilities. Within this VaR, all important sources of the market risks of assets are considered, i.e. equity, interest rate, credit spread, and currency and real estate risks. As far as equity investments are concerned, we model diversified equities using appropriate indices, whereas concentrated equity investments are modelled by name. Besides this, the change in valuation of liabilities with respect to changes in interest rates, FX rates and inflation is included.

When modelling these risks, state-of-the-art models are used which allow, for example, for "fat tails" in equity market risk distributions or all different shapes of interest rate curves within the interest-rate modelling. Our stochastic modelling is supplemented by applying stress tests, sensitivity and duration analyses.

In our real estate investments, we are constantly optimising the return and risk profile. We are achieving this by rejuvenating our portfolio on an ongoing basis, diversifying internationally and investing in top-class commercial real estate primarily located in major European cities. In addition, we are pursuing the aim of reducing the concentration of our real estate investments in Germany, of which we sold a significant package in 2006. To mitigate the risk of loss of rental income, we structure our portfolio by selecting tenants of high credit-standing.

We only run currency risks to a small extent, since we practise a policy of **currency matching**. This means that we match the currencies of our liabilities accordingly. Mismatches are strictly limited from an accounting as well as

an economic aspect. We use derivative financial instruments to achieve a better match to our liabilities, to hedge parts of the asset portfolio against market price fluctuations, and to prepare planned purchases and sales. We also hold these instruments for trading purposes in order to enhance earnings, albeit only to a limited degree. Credit derivatives are only employed in our investment portfolio to a limited extent. Changes in value of derivative financial instruments are accounted for at market price and are fully recognised in the income statement on the respective balance sheet dates. Therefore large fluctuations in their prices may impact our income materially, even though they stabilise our economic value. We show the volumes of all derivatives on page 66.

Risk exposures

Applying stress tests, sensitivity and duration analyses, we simulate market fluctuations and devise strategies for counteracting them where necessary.

The following sensitivity analyses for **market risks** serve to estimate potential changes in the value of investments under hypothetically possible market scenarios. The review is based on Munich Re's investments at 31 December 2006.

The changes in share price assumed in these scenarios, $\pm 10\%$ and $\pm 20\%$ respectively, a corresponding shift in the interest rate curve of ± 100 and ± 200 basis points (bp) respectively, and a fluctuation in exchange rates of $\pm 10\%$, would produce the following changes in the market value of the investments:

Market risk: Share prices

Change in share prices	Change in market value of investments sensitive to share prices
Increase of 20%	+€5.405bn
Increase of 10%	+€2.693bn
Decrease of 10%	-€2.675bn
Decrease of 20%	-€5.331bn
Market values at 31 December 2006	€27.338bn

Market risk: Interest rates

Change in interest rates	Change in market value of investments sensitive to interest rates
Increase of 200 BP	-€3.165bn
Increase of 100 BP	-€1.674bn
Decrease of 100 BP	+€1.856bn
Decrease of 200 BP	+€3.894bn
Market values at 31 December 2006	€31.606bn

Market risk: Exchange rates

Change in exchange rates	Change in market value of investments sensitive to share prices
Increase of 10%	+€2.591bn
Decrease of 10%	-€2.591bn
Market values at 31 December 2006	€25.910bn

The changes in market value shown in the table can only be taken as rough indicators of actual market value losses that might occur in the future, as they do not consider any counteractive measures. Moreover, the effects on the annual result and equity would be reduced as a consequence of policyholders' shares and the tax implications.

More importantly, we consider the economic effects of such changes on the difference between asset and liability values to be the most reliable indicator of our asset-liability mismatch.

Credit risks

Risk management processes

Our internal risk model also takes account of a wide range of specific drivers that impact on our credit exposure.

Credit risks emanating from the insurance and investment sides of the balance sheet are considered. On the insurance side we model trade credit, surety and bonding, credit enhancement, and political risks. We also take into consideration credit risks associated with claims on our retrocessionaires after allowing for any collateralisation. On the investment side, credit risks are measured and limited using the credit-value-at-risk (CVaR) approach with a standard "asset value" model. The main input parameters are our investment volume, the migration matrix between different rating classes, discounting curves and recovery rates. The correlated rating class migrations and defaults of the respective bond issuers are modelled using a Monte Carlo simulation. Revaluation of our investments under these rating scenarios ultimately leads to a future profit and loss distribution. Hence, we can then adequately capitalise for this risk and manage our portfolio with respect to its expected and unexpected loss.

In order to aggregate the credit risks emanating from the insurance and investment sides, we utilise an in-house counterparty exposure monitoring system. We restrict default risks by limiting our total exposure in respect of individual debtors. The Board Group Committee sets and monitors these limits. Moreover, we consider a whole range of individual attributes, including the issuer's individual rating, its capitalisation as a basis for covering the liability, the quality of the collateralisation and of the respective issue, as well as the industry sector concerned.

This allows us to control the exposure on a single issuer and to steer towards a well-balanced credit risk portfolio. Furthermore, we are able to shift available capacities between the insurance and investment sides of the balance sheet.

We also regularly perform stress tests on our cross-balance-sheet exposures utilising the expertise of our economists, who together with our experts in Integrated Risk Management have developed a range of both short-term/shock-event-type scenarios and more long-term trends to ensure the resilience of our assigned credit risk capital in aggregate. The results of this analysis are shared with the Board Risk Committees.

Munich Re's investments were not affected by any significant defaults in 2006.

Risk exposures

Credit assessment is of central importance for the management of credit risks relating to **fixed-interest securities**. The main factor here is the quality of the issuer or the respective issue, which is primarily reflected – according to Munich Reinsurance Company’s investment principles – in the ratings of international rating agencies: 95% of our investments in fixed-interest securities at 31 December 2006 had a rating of “A” or better (according to Standard & Poor’s classification). The majority of fixed-interest securities in our portfolio have been issued by governments or banks with excellent ratings or top security, e.g. German government bonds, US Treasuries, or mortgage-backed securities.

Retrocessions

The **reinsurers and retrocessionaires** participating in our external placements are approved by our Security Committee, which screens their creditworthiness regularly according to several criteria. One of the minimum criteria is a rating of A– or better from one of the major rating agencies or equivalent, e.g. collateralisation. Furthermore, concentrations of credit risks are avoided by a broad spread of our cessions.

The exposure of the capital market placements, namely the cat bonds Aiolos (covering windstorm in Europe) and Carillon (covering windstorm in the USA), was collateralised with financial instruments of best quality, so that the credit risk involved is negligible.

Insurance and investments combined

The asset-related and credit-insurance-related credit risks contain accumulation potential in their counterparty default risks. These are therefore monitored in detail.

Receivables

As at 31 December 2006, our **accounts receivable on ceded business** were split between the following ratings (based on those of Standard & Poor’s):

Ratings of receivables

All figures in €m

AAA	4.4
AA	38.6
A	9.3
BBB or lower	0.5
No external rating	15.3

Of all our receivables on underwriting business at the balance sheet date, €52.7m were outstanding for more than 90 days. The average defaults of the last three years amount to €5.1m.

Liquidity risks

Detailed **liquidity planning** ensures that we are able to make the necessary payments at all times. Liquidity risks may also arise because the actual payout structure of our liabilities differs from that assumed in our asset-liability management (e.g. due to a lengthening or acceleration of claim payments in a line of business or region). We thus have processes in place that regularly track these differences and report their implications to the Group Committee of the Board. This planning concept, which has been in place for many years, has proved its value after major loss events.

Insurance risks

We define technical insurance risk as the risk of insurance losses exceeding our expectations. Such a development may result from different sources (cf. section on quantitative risk management on page 42). We supplement our quantitative risk management of these risks with qualitative considerations. For example, our Corporate Underwriting units develop standards for how to assess the “risk of change” in the business environment and our Claims Management Departments complement this by monitoring trends in types of claims, such as bodily injury claims under various liability regimes.

The interaction of risks of change and **risk concentrations** may lead to considerable loss potential. This not only involves regional concentrations but can also occur within a class of business or across several classes owing to events like natural catastrophes, pandemics or terrorist attacks. Our Integrated Risk Management Division is responsible for identifying, analysing, monitoring and coordinating cross-segment and cross-balance-sheet accumulations or concentrations. It works closely with the experts in each segment to advise the Board of Management’s relevant Risk Committees on the likely impacts of such accumulations on our exposures.

Accumulation risks arising from **natural catastrophes** (nat cat) are modelled and monitored centrally by Corporate Underwriting relying on geoscientific as well as on

underwriting and risk-modelling expertise. In general, natural catastrophe scenarios are set up and monitored individually, once the Group-wide exposure – measured in terms of the 1-in-1,000-year probable maximum loss (PML) estimate – exceeds €500m. The exposure measurement processes can never be all-embracing, as we learned from Hurricane Katrina, where losses were significantly higher than we would have expected for a hurricane of comparable wind force.

In general, several external models and the respective internal model are run in parallel and differences in results are reviewed by geoscientists, senior underwriters and nat cat modelling experts from Corporate Underwriting in order to come up with the final model, which thus takes expertise from all relevant sources into account. Our models are always built to calculate the combined total of all expected losses in any one event, including secondary loss components like storm surge and/or altered economic parameters, such as demand-induced inflation.

In addition, exposures arising from other lines of business for which no stochastic models on nat cat have been developed so far (e.g. casualty and aviation) are assessed in close cooperation with the respective business units, using their expertise.

Accumulation risks pursuant to individual natural perils are strictly limited at Group level as part of the Board of Management's strategic risk management framework. We have procedures in place to reallocate unused capacities between business units.

Within the Munich Re Capital Model, risks from natural catastrophes are represented in their entire stochasticity, i.e. by aggregating the full distributions. With this method, it is assured that the tails of the nat cat loss distributions – and the associated possible losses, are captured when determining the capital requirements needed to back nat cat business.

The **terrorism attack** in New York in 2001 showed that, in view of the growing concentration of wealth in economic centres around the world, terrorists can cause damage of staggering dimensions. The attacks in Istanbul and Madrid in 2004 and London in 2005, as well as prevented attacks for example in Dortmund/Cologne 2006, also made it all

too clear that the threat of international terrorism remains on the agenda for reinsurers, insurers and risk managers.

For Munich Reinsurance Company, terrorism does not constitute an insurable peril like earthquake, storm or flood. Unlike natural hazards, terrorism does not occur randomly, and its probabilities and consequences cannot be modelled and quantified with scientific data and methods. The assessment of terrorism risk is therefore based on a mixture of qualitative and quantitative data (e.g. for estimating property damage consequent to an attack of a predefined magnitude), with information on terrorism being inconsistent and not available to all parties in the same detail. This means that accumulation scenarios are extremely difficult to gauge. Significant attacks, particularly those conducted with chemical, biological, radioactive or nuclear devices, might far exceed the capability of the insurance industry as a whole. Given the additional uncertainty about the frequency of terrorism attacks, it is evident that only governments can act as viable reinsurers of last resort. Munich Re therefore actively supports long-term market solutions, requiring a risk partnership between risk managers, insurers, reinsurers, capital markets and governments. The challenge is to find the most efficient way to achieve such public-private partnerships.

In those markets where such partnerships cannot be achieved, Munich Re offers terrorism coverage on a limited and selective basis. Munich Reinsurance Company is committed to controlling its risk accumulation and has therefore adopted various measures to control, limit and manage its aggregate terrorism exposure. Accumulation risks arising from terrorism are monitored centrally, based on a selection of markets, terrorism accumulation zones and scenarios. The methods for exposure analysis are developed by a group of experts from business units and Corporate Underwriting. Line/market-specific exposure is assessed in close cooperation with the respective business units and, where appropriate, with the support of terrorism models. Within the Munich Re Capital Model, risks from terrorism are represented so that a determination and allocation of risk capital is ensured. Stress testing is also used, given the difficulties associated with quantifying the risk exposure.

A **pandemic** is defined as a geographically widespread outbreak of an infectious disease with many people being affected at the same time. Infection figures may slowly increase over time – such as with AIDS – or suddenly explode, e.g. in case of an influenza pandemic. The latter is considered a shock event and may affect our portfolio in manifold ways. The major difference to nat cat risks is that sound statistical data are lacking, as only few pandemics have occurred in the past.

Munich Re has been addressing this issue for several years. In 2006, scenarios for a flu pandemic were refined to comprehensively assess the exposure for all relevant segments. It is important to mention that mortality – basically due to better hygienic conditions and medical progress – improved significantly during the first half of the last century. Therefore, historical death tolls, e.g. from the Spanish Flu, cannot be simply extrapolated to today's world. Additional risk-limiting measures are a global surveillance system and local emergency plans. However, global air travel as well as increasing areas with high population density (so-called megacities) might accelerate the spread of infectious diseases and thus aggravate the risk.

An interdisciplinary team has thoroughly analysed Munich Re's exposure. The overall impact could be significant – depending on the scenario chosen.

Insurance risk: Property-casualty

Risk management processes

Binding **underwriting guidelines and limits** and clear underwriting authorities precisely regulate who is authorised and accountable for concluding reinsurance contracts at Munich Reinsurance Company and at what prices, terms and conditions. We regularly check compliance with these guidelines in our underwriting reviews. We closely observe developments in our portfolio, reacting where necessary with guidance for our underwriting in the form of "mandatory guidelines", "divisional guidelines" or "best-practice standards". Deviations from the mandatory guidelines are only permitted with the approval of the Board of Management or one of its Risk Committees and require a comprehensive assessment of the risks associated with such deviations. In the case of divisional guidelines, the responsible Board Member decides who in the divisions is authorised to allow deviations.

Risk exposures

In addition to other key indicators, combined ratios are important for us in monitoring the premium/claims risk in property-casualty (re)insurance (cf. page 71).

Combined ratio for the last ten years

All figures in %	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997
Including natural catastrophes	97.9	117.0***	96.4	93.8	108.3**	127.4*	115.7	120.6	101.9	98.8
Excluding natural catastrophes	96.3	97.3***	91.2	92.1	104.8**	126.1*	111.7	107.2	98.9	97.9

*Thereof World Trade Center and reserve strengthening at American Re: 15.9%.

**Thereof World Trade Center and reserve strengthening at American Re: 3.5%.

***Thereof effect of assuming discounted claims provisions from American Re-Insurance Company: 8.7%.

Insurance risk: Life and Health

Risk management processes

In life reinsurance the biometric risk, the lapse risk and the interest guarantee risk are especially relevant. The calculation of underwriting provisions is based on "biometric" actuarial assumptions, i.e. on assumptions with regard to mortality and disablement, which also take future trends into account.

We calculate the **biometric risk** mainly on the basis of tables relating to mortality and claims development, pub-

lished by national actuarial associations. These tables are modified in accordance with the experience observed in the reinsured portfolios and with the assistance of our Centre of Competence for Biosciences to reflect future trends. **Lapse risks** can be reduced in insurance and reinsurance by means of suitable product and contract design. We estimate the residual lapse risk by means of product-specific portfolio analyses and take this into account in our pricing.

In reinsurance, we exclude the interest-guarantee risk in many cases through suitable treaty design or by a back-to-back micro hedge of the risk.

Furthermore, as a matter of principle, we use market-consistent assumptions for determining the technically risk-adequate price for each contract.

Risk exposures

For our life reinsurance business, our embedded value disclosure provides details of the sensitivity of the embedded value and the value added by new business to factors such as changes in mortality/morbidity, lapse rates, expenses, interest rates, and equity and property market value changes. The disclosure follows the Additional Guidance on European Embedded Value Disclosures as published by the CFO Forum, an organisation of the Chief Risk Officers of large insurance companies, in September 2005.

As soon as the European Embedded Values for 2006 have been calculated, they will be published on our website on 4 May 2007. Last year's disclosure of the European Embedded Value from 9 May 2006, available on our website, shows that the most significant risk is the risk of future mortality being less favourable than that assumed in our valuation bases.

Operational risks

Operational risks comprise the risks of losses as a result of inadequate processes, technical failure, human error or external events. These include criminal acts committed by employees or third parties, insider trading, infringements of antitrust law, business interruptions, inaccurate processing of transactions, non-compliance with reporting obligations or disagreements with business partners.

We minimise such risks through systematic application of **specific risk management measures**. It is our declared corporate aim, which we consistently pursue, to sensitise employees to possible risks and to establish an appropriate risk culture. This includes the willingness to learn from mistakes and to recognise and grasp these as opportunities for change and improvement.

To prevent infringements of insider law, Munich Re has appointed a Compliance Officer, who ensures that

inside information is handled in conformity with the law. In addition, a Disclosure Committee has been established to ensure that disclosure requirements regarding price-sensitive information are complied with.

Compliance with antitrust regulations is a basic principle of Munich Re's business policy. To prevent violations, staff are informed about antitrust regulations and are expected to comply with them.

We attach particular importance to precautionary measures that ensure continuity of our operations in an emergency or crisis situation. Business processes critical to value creation can be maintained or resumed as quickly as possible in such cases. Responsibility for establishing and monitoring this business continuity process at Munich Re has been entrusted to a separate unit, which is guided by internationally recognised business continuity management standards (e.g. PAS 56).

Risks in the area of information technology and project risks

Munich Re's global business and Group-wide risk management require an organisational and technical networking of our business units and systems. We are dependent on electronic communications technology, the complexity of which is continually increasing. The significance of the stored and transmitted information is growing as well. As a result, we are also increasingly exposed not only to IT security risks (such as breakdowns and outages, disruptions due to viruses, attacks by hackers and theft of data) but also to the risk of theft of information through the deception of staff ("social engineering").

These risks are identified and limited by decentralised security organisations that liaise closely. Their procedures are constantly being improved and adjusted to take into account the latest knowledge and state-of-the-art techniques. Our security regulations embrace not only the technical design of hardware and software systems but also functional security structures and organisational measures, including training staff in the proper handling of systems and data.

Various major projects are currently being realised that will, among other things, integrate information architecture more extensively in the back-office area. Considerable project risks are related to size and complexity of such projects. Proceeding from project management, Munich Re's project landscape will be made more transparent and the interfaces of individual projects enhanced by means of multi-project management designed to assess and control interdependencies better. In addition, the dependencies and priorities within the systems architecture are analysed and addressed by specially appointed committees.

The conclusion of our internal IT project Gloria in 2006 marked an important milestone in the unification – on the basis of an SAP standard product – of the IT and process landscape for our branches. This system, which has now gone live at Munich Re Munich, will be successively extended to other branches, whilst additional systems that build on it are being designed and implemented.

Risks involving human resources

Munich Re has binding rules setting out minimum standards of corporate integrity for conduct within the companies themselves, their business transactions and other relationships with external parties. These standards, which are included in a detailed code of conduct, are tailored to the special features of each company and serve to prevent conflicts of interest for staff, thus ensuring that we use only fair and legal means of competition. The clear separation of management and control functions limits the risk of internal and external regulations being breached. We ensure that the German General Equal Treatment Act and similar anti-discrimination requirements of other countries are enforced by means of intensive and widespread training measures for our staff.

Given its business model, Munich Re is particularly dependent on the knowledge and proficiency of its staff. We control the resultant human resources risks by means of appropriate indicators and metrics. Our human resources tools as a whole serve to strengthen our staff's ties with the Group and consequently to safeguard our business intelligence. With our specially tailored programme of qualification and further training measures, we make sure that our staff are able to adapt to current market demands.

Targeted personnel marketing measures, staff potential assessment and development schemes and systematic succession planning are designed to reduce the risk of

shortages in qualified staff. Modern management tools and adequate monetary and non-monetary incentives ensure a high level of motivation.

Legal and supervisory risks

Legal risks may arise on the one hand from court decisions and legislation (changes in legal parameters) and on the other from legal disputes and arbitration proceedings in which we as an international insurance group are involved, especially in the area of claims settlement.

We counter risks from changes in legislation and court decisions by constantly monitoring current developments and by actively participating in relevant bodies and associations in order to contribute our views.

The following are examples of currently relevant legal risks:

- In April of 2004, New York State Attorney General Eliot Spitzer started an investigation into the use of Placement or Market Service Agreements (PSAs) in the insurance industry. Several other US state regulators subsequently commenced similar probes into this matter, as have other regulators. We have received requests to provide information in connection with these investigations and are cooperating fully with the authorities. Entities of the Munich Re organisation, together with several other insurers and brokers, have been named defendants in several PSA-related class actions by US policyholders. Munich Re denies any wrongdoing and will defend itself vigorously.
- Given the unbroken trend of rising claims against insurance companies, we increased our provisions for asbestos claims as at 31 December 2006. In February 2006, the federal legislative procedure for the Fairness in Asbestos Injury Resolution Act in the USA foundered. With the Democrats gaining the majority of seats in the House of Representatives in the Congressional elections in November 2006, the chances of the Bill being revived have fallen substantially. Revelations about questionable asbestos-related disease diagnoses and resultant lawsuits have led to the convening of various investigation committees in the USA to look into these practices. This could be a sign of a positive trend with regard to the asbestos situation in the USA. However, it is too early to say whether and to what extent this will have favourable implications for the insurance industry's loss development.

- In connection with the attack on the World Trade Center of 11 September 2001, a New York federal court has upheld two district court rulings which had earlier found that the attacks on the two WTC towers should be treated either as one or as two separate events, depending on the wording of the insurance policies. The remit of the Court of Appeals was solely to establish whether procedural errors alleged by the parties to the dispute warranted fresh proceedings in a court of the first instance. As the objections were dismissed, the legal uncertainty regarding the loss event issue is now finally resolved. Since the rulings of the courts of first instance are already reflected in our ultimate loss estimates, the decision will not affect our projected US\$ 2.6bn total WTC claims bill. Confirmation of the Wilprop decision will, however, enable Munich Re to defend itself against additional financial burdens.
- As a consequence of the severe hurricanes of 2005, particularly Katrina, hundreds of lawsuits against diverse insurers are still pending in the affected US states. Plaintiffs with private buildings insurance are attempting to circumvent the exclusion of all flood damage routinely contained in such policies. The fact is that the damage along the coast was caused mainly by the storm surge accompanying Katrina rather than as a direct result of the wind. Despite the good arguments of the insurers (the exclusion of flood damage in private buildings insurance policies has been established practice for years and has been approved by the regulatory authorities) the outcome of the lawsuits is at present difficult to assess, not least owing to public pressure on the insurance industry and the uncertainties inherent in jury decisions.
- As a result of our global activities, we are subject to a large number of supervisory regulations in different countries. These may give rise to legal and regulatory risks. In late 2004, the US Securities and Exchange Commission (SEC) and the Office of the New York State Attorney General initiated inquiries of Munich Re with respect to “certain loss mitigation insurance products”. Subsequently, a number of other authorities in the USA and elsewhere made both formal and informal requests for

similar information from Munich Reinsurance Company and some of its subsidiaries. We are fully cooperating with these inquiries.

Main other risks

As reinsurers, we are dependent on economic and political parameters in the different markets in which we operate, as well as on macroeconomic and geopolitical risks. The development of the economy not only affects our insurance business but also influences the capital markets and hence our investment portfolio. An economic downturn can lead to payment defaults and downgradings of credit ratings among our debtors, which may require write-downs in our books.

When developing new markets, such as those in Asia and Eastern Europe, Munich Re is largely dependent on the prevailing economic, political and regulatory conditions, the accessibility of market segments, and the local sales channels. But even in developed markets, social or political changes may result in a deterioration of legal, fiscal or economic conditions, and this may ultimately affect the assets, liabilities, financial position and results of Munich Reinsurance Company.

As a matter of general principle, our economists constantly study and monitor the economic and political situation of our main markets and inform the Board of Management without delay about relevant trends so that, if necessary, suitable risk mitigation or management measures can be taken. Conceivable scenarios are also discussed and coordinated with our asset management company MEAG to enable us to react promptly and appropriately in respect of our held investments.

Strategic risks arise if the strategy at overall Group level or business-segment level is not compatible with existing and future client requirements, market conditions or other parameters (e.g. economic or regulatory). If these disparities were not recognised, our objectives and initiatives would not take sufficient account of developments. In our strategic planning, we therefore carefully analyse the strategic risks, which are evaluated in individual projects (e.g. investment or market-entry projects) using scenarios and at an aggregate level on the basis of “wild cards”. These

wild cards describe events with a very low occurrence probability but a potentially strong impact on our business operations. In addition, we systematically perform "SWOT analyses" (strengths, weaknesses, opportunities, threats) and, building on these, specify what action is to be taken. Our Group Development Division works closely with our Integrated Risk Management Division to ensure these risks can be adequately reflected in the "stress tests" applied under the Munich Re Capital Model and in our management of cross-line, cross-segment and cross-balance-sheet accumulations of risks.

One of the main risks for any company is failing to recognise new business opportunities that maximise the franchise value of the company. We counter this danger by, among other things, integrating innovation teams into our operative reinsurance units in order to tap into new product and client segments at an early stage. This approach is also designed to ensure that we identify and work on topical market and client issues, as well as fields of knowledge that are of critical importance for the future. Furthermore, our steering tools are increasingly oriented towards the key drivers of new business value – for example, in life reinsurance, management compensation is explicitly linked to the meeting of value added by new business targets. These targets are not top-line growth-oriented, but rather bottom-line-oriented – meaning that management is incentivised to grow the franchise in a sustainable and profitable way.

Financial strength

Financial strength on an economic basis

We started the reporting year 2006 with available financial resources comfortably exceeding the risk-based capital requirements. This was also illustrated by a series of "stress tests" applied to our economic measure of financial strength. The favourable result for the financial year 2006 further consolidated this position, giving us headroom to launch our first €1bn share buy-back programme. Shares repurchased during the period November 2006 to April 2007 will subsequently be cancelled.

At the present time, the way we determine our financial strength differs somewhat from the regulatory and

rating-agency approaches. This means that we must constantly compare and contrast these calculation methods and resultant evaluations of our financial strength as part of our active capital management. It is not yet possible for insurance groups to adopt one measure of financial strength, although the Solvency II project to reform insurance supervision in Europe and various initiatives of all major rating agencies may assist in converging these indicators of financial strength over time.

Regulatory and rating-agency capital requirements

Munich Re meets the regulatory solvency requirements stipulating a specified minimum capitalisation supplemented by the criteria of specific ratings from the major rating agencies. More detail is provided in the "Financial situation" section.

Assessment of risk situation

Status quo

We see ourselves in a position to sustain the level of profitability we have achieved in recent years, adjusted to eliminate the effects of exceptionally low claims expenditure for natural catastrophes and particularly favourable capital market conditions. We therefore assess Munich Reinsurance Company's risk situation as manageable and under control.

With our risk management instruments, we will systematically control the risks in our reinsurance business and ensure that we firmly adhere to our policy of risk-adequate prices, terms and conditions (e.g. exclusions), even if this means having to refrain from participating in some business.

Outlook

The external requirements for risk management are likely to increase further since national and international initiatives such as IFRS are setting new standards for accounting, and Solvency II is fundamentally restructuring insurance supervision in the European Member States. Rating agencies increasingly and explicitly take the quality and effectiveness of risk management into account in their ratings and their requirements are very much in line with

what we have adopted internally as best practices. Insurance associations and research institutions such as the Geneva Association actively promote an exchange of views on risk management best practices and their establishment. At the end of 2006, Munich Re hosted the second CRO Assembly of the Geneva Association, which is the largest global gathering of insurance and reinsurance CROs. The programme organised by Munich Re provided a unique opportunity for our clients and peers to exchange views on developments in risk management and to interact with regulators, rating agencies, policymakers and analysts. Munich Re's experts from the fields of geosciences, biosciences, liability regimes and macroeconomics also conducted workshops during the Assembly to assist our clients in a deeper understanding of the risks of change in their portfolio. It is our hope that our efforts in these areas will help reduce the cyclicity of results in our industry and further improve the underwriting standards adopted by insurers and reinsurers globally.

Munich Re also participates actively in the CRO Forum and in 2007 will chair the Emerging Risks Initiative of the CRO Forum, which it co-founded (see section on qualitative risk management on page 41 for a description of the activities of this initiative).

Prospects

There is a growing tendency among some capital market players to pursue legal action against companies in connection with statements they have published on future development, a trend that involves considerable loss potential for the companies concerned and for their other shareholders. This practice inevitably affects transparency, as many companies tend to be reluctant about the information they give on future business performance and disclose only what is required by law.

For this reason, we wish to emphasise the following: predictions about the forthcoming development of our Group are based primarily on planning figures, forecasts and expectations. Consequently, the following assessment of Munich Reinsurance Company's development merely reflects our incomplete assumptions and subjective views. It follows that we cannot accept any responsibility or liability in the event that they are not realised in part or in full.

For information on the risks emanating from our business, please consult page 39 ff.

In the coming years, we will adhere to our principle of "profit before growth". In other words, we will strive for growth in profits, not in premium income. This means that we will continue to make every effort to optimise our business portfolio and improve the efficiency of our processes. Furthermore, we intend to and will expand our business, but not at the expense of sustained profitability.

We will continue to systematically pursue our policy of risk-adequate prices, terms and conditions, aiming for profitable growth in both renewal business and new business. There is no alternative to profitable underwriting and active risk diversification: it is the only way to create long-term added value for our shareholders and clients alike.

Reinsurance offers considerable promise for the future, and we project that it will grow worldwide in the next decade. The development of property-casualty business is likely to be surpassed by the dynamic growth of life and health reinsurance. We predict the highest percentage growth rates will come from the emerging markets of Asia and Latin America. Given their higher starting level, Europe and North America should attain significantly greater absolute growth, albeit with lower percentage increases.

Thanks to our global presence and special initiatives to expand our business in rapidly growing regions, we are excellently positioned to take advantage of market opportunities in all areas of the world and in all fields of business.

In **life reinsurance**, we expect the continuing remedial measures in our portfolio, which partly affect large-volume treaties, to cause a further drop in premium income, with a stable result in 2007.

At present, a host of opportunities for growth in various business models are opening up worldwide in the **health** segment. As the world's leading provider in this field, with a product portfolio that integrates reinsurance and services, Munich Re is well prepared for these developments. We expect strong growth especially in the Gulf region and Asia. For the current year, we therefore anticipate a significant rise in premium volume and a result of around the same very good level as last year.

In past years, we have laid the foundations in **property-casualty reinsurance** for the sustained profitability of our business by consistently adhering to risk-adequate prices, terms and conditions – even in phases with a fortuitously low incidence of major losses. Only in this way can we cope with potential peak burdens which can occur at any time. That is why the renewals at 1 January 2007 (which involved large portions of our property-casualty business) were by and large satisfactory, despite the low natural catastrophes burden in 2006. The development of prices, terms and conditions varied considerably, depending on the class of business and region concerned. We did not observe a globally uniform cycle. The trend away from proportional business towards non-proportional forms of cover continued.

Following the substantial price increases for natural catastrophe risks in the US market in the previous year, we were able to maintain and in some cases even significantly increase their prices. The renewals of large multinational property and liability treaties proved very satisfactory, with prices, terms and conditions remaining stable, and we again recorded growth in attractive agricultural business. By contrast, there were further price reductions in European industrial business, parts of aviation business, and

German and French motor liability business. We systematically refrained from writing business that did not meet our stringent requirements, and we also terminated unprofitable proportional treaties in the highly competitive Chinese market. Rates for the renewed portfolio were slightly lower overall, but remain at a good profitability level.

For the forthcoming renewals on 1 April 2007 (Japan and Korea) and 1 July 2007 (parts of the US market, Australia and Latin America), we expect a similarly stable environment to that prevailing for the renewals at 1 January 2007.

Provided there are no strong movements in exchange rates, our gross premium volume should reach roughly the same level as in the previous year. We estimate that positive developments in the growth markets will make up for the premium reductions associated with the shift from proportional to non-proportional forms of cover. In property-casualty reinsurance, we anticipate a combined ratio of less than 97% based on the major-loss burden from natural catastrophes of 5% of our earned premiums. Altogether, we expect our annual result for 2007 to show another clear improvement.

The investment environment in 2006 was characterised by low interest rates and rising share prices.

Since last year's mid-year peak in interest rates, yields on long-term fixed-interest securities have declined again. Interest-rate developments in the USA, which resulted in an inverse interest-rate structure, have caused the yield curve in the eurozone to level out.

For 2007, we anticipate that increasing inflation rates will result in greater volatility in bond markets. From an economic point of view, we address this risk with our asset-liability management, which gears the maturities of our fixed-interest securities to those of our liabilities. We assume that the yields on long-term bonds relevant for our bond portfolio will increase moderately by the end of 2007.

The US dollar has lost considerable ground in foreign exchange markets since November 2006. For 2007, we expect the euro to remain strong and the US dollar to trend somewhat higher again in the course of the year.

Rebounding from a course correction in May 2006, the equities market resumed its upward climb for the fourth year in succession. However, the environment for equities might become more difficult, given the geopolitical risks and expected cooling of the US economy.

Share prices should experience a moderate increase by the end of 2007. In view of the risks described, we will reduce the proportion of our investments in equities if necessary.

By achieving a 4.3% return on investment in the past financial year, we were again well over our target of 4%. For the current financial year, we should again be able to earn a return on investment of 4%.

We remain committed to active capital management and a shareholder-friendly dividend policy. That is why we resolved on 7 November 2006 to buy back and retire Munich Re shares with a volume of up to €1bn. The share buy-back was successfully concluded in February 2007.

Barring any extraordinary developments on the claims side or in the capital markets, there is every prospect of another very good result for Munich Reinsurance Company in 2007.

Financial statements

Balance sheet as at 31 December 2006

Assets	Notes	T€	T€	T€	T€	Prev. year T€
A. Intangible assets	(1)				80,414	98,916
B. Investments	(2, 3)					
I. Land, land rights and buildings, including buildings on third-party land				980,540		1,004,552
II. Investments in affiliated companies and participating interests						
1. Shares in affiliated companies			12,170,882			11,934,454
2. Loans to affiliated companies			221,589			184,483
3. Participating interests			122,286			120,079
4. Loans to participating interests			25,134			26,158
				12,539,891		12,265,174
III. Other investments						
1. Shares, investment fund certificates and other non-fixed-interest securities			14,590,343			15,384,914
2. Bearer bonds and other fixed-interest securities			21,914,620			19,266,054
3. Loans secured on property			5,427			7,090
4. Other loans						
a) Registered bonds		3,792				5,420
b) Loans and promissory notes		8,023				142
c) Miscellaneous		170				190
				11,985		5,752
5. Deposits with banks			142,791			310,411
6. Miscellaneous investments			298,152			198,963
				36,963,318		35,173,184
IV. Deposits retained on assumed reinsurance				23,297,334		29,883,303
					73,781,083	78,326,213
C. Receivables						
I. Accounts receivable on reinsurance business				3,214,119		2,793,610
Thereof from						
– affiliated companies: T€885,610 (659,958)						
– participating interests: T€5,293 (5,088)						
II. Other receivables				437,438		812,207
Thereof from						
– affiliated companies: T€97,200 (451,498)						
– participating interests: T€– (77)						
					3,651,557	3,605,817

Assets	Notes	T€	T€	T€	T€	Prev. year T€
D. Other assets						
I. Tangible assets and inventories				46,108		54,944
II. Cash at bank, cheques and cash in hand				231,229		294,052
III. Own shares				-		11
					277,337	349,007
E. Deferred taxes					156,037	156,037
F. Other deferred items						
I. Accrued interest and rent				377,292		314,837
II. Miscellaneous deferred items				33,658		18,351
					410,950	333,188
Total assets					78,357,378	82,869,178

Equity and liabilities	Notes	T€	T€	T€	Prev. year T€
A. Equity	(4)				
I. Issued capital			587,725		587,725
II. Capital reserve			6,832,037		6,832,037
III. Revenue reserves			2,702,274		2,285,548
IV. Net retained profits			1,033,111		711,699
				11,155,147	10,417,009
B. Subordinated liabilities	(5)			3,059,224	3,050,652
C. Technical provisions	(6)				
I. Unearned premiums					
1. Gross amount		3,304,931			4,631,778
2. Less for retroceded business		236,949			263,978
			3,067,982		4,367,800
II. Provision for future policy benefits					
1. Gross amount		16,207,498			19,635,549
2. Less for retroceded business		568,242			1,412,532
			15,639,256		18,223,017
III. Provision for outstanding claims					
1. Gross amount		32,639,375			34,340,573
2. Less for retroceded business		1,971,304			1,914,721
			30,668,071		32,425,852
IV. Provision for premium refunds					
1. Gross amount		10,121			8,685
2. Less for retroceded business		-			-
			10,121		8,685
V. Claims equalisation provision and similar provisions			8,408,595		7,782,804
VI. Other technical provisions					
1. Gross amount		1,002,376			864,275
2. Less for retroceded business		49,028			18,976
			953,348		845,299
				58,747,373	63,653,457

Equity and liabilities	Notes	T€	T€	T€	Prev. year T€
D. Other accrued liabilities	(7)				
I. Provisions for employees' pensions and similar commitments			567,838		344,533
II. Provisions for tax			895,331		804,386
III. Other provisions			786,945		787,581
				2,250,114	1,936,500
E. Deposits retained on retroceded business				750,465	1,611,409
F. Other liabilities					
I. Accounts payable on reinsurance business			1,873,034		1,778,834
Thereof to					
– affiliated companies: T€403,466 (144,134)					
– participating interests: T€– (651)					
II. Amounts owed to banks			133,836		149,046
III. Miscellaneous liabilities			387,388		271,144
Thereof towards					
– affiliated companies: T€135,563 (133,956)					
Thereof from taxes: T€138,405 (9,489)					
Thereof for social security: T€– (4,310)					
				2,394,258	2,199,024
G. Deferred items				797	1,127
Total equity and liabilities				78,357,378	82,869,178

Income statement for the financial year 2006

Items	Notes	T€	T€	T€	Prev. year T€
I. Technical account					
1. Earned premiums for own account					
a) Gross premiums written		17,847,207			19,167,183
b) Retroceded premiums		1,159,757			1,307,872
			16,687,450		17,859,311
c) Change in gross unearned premiums		1,171,088			-112,462
d) Change in retroceded share of unearned premiums		-20,974			48,362
			1,150,114		-64,100
				17,837,564	17,795,211
2. Interest on technical provisions for own account	(9)			944,677	1,091,081
3. Other underwriting income for own account				1,793	-6,469
4. Claims incurred for own account					
a) Claims paid					
aa) Gross amount		12,367,602			7,682,716
ab) Retroceded amount		428,144			477,495
			11,939,458		7,205,221
b) Change in provision for outstanding claims					
ba) Gross amount		277,092			8,644,965
bb) Retroceded amount		156,173			606,758
			120,919		8,038,207
				12,060,377	15,243,428
5. Change in other technical provisions for own account					
a) Net provision for future policy benefits				-978,815	-180,998
b) Other net technical provisions				-5,918	9,582
				-984,733	-171,416
6. Expenses for premium refunds for own account				5,788	7,818
7. Operating expenses for own account	(10, 13)				
a) Gross operating expenses				5,510,390	5,693,665
b) Less commission received on retroceded business				308,125	296,109
				5,202,265	5,397,556
8. Other underwriting expenses for own account				27,054	17,947
9. Subtotal				503,817	-1,958,342
10. Change in claims equalisation provision and similar provisions				-625,791	251,875
11. Underwriting result for own account	(8)			-121,974	-1,706,467

Items	Notes	T€	T€	T€	T€	Prev. year T€
II. Non-technical account						
1. Investment income	(11)					
a) Dividends from participating interests						
Thereof from affiliated companies: T€210,005 (154,873)			222,268			160,107
b) Income from other investments						
Thereof from affiliated companies: T€397,947 (703,062)						
ba) Rents from land and building, including buildings on third-party land		128,705				131,136
bb) Income from other investments		2,815,449				2,582,116
			2,944,154			2,713,252
c) Income from write-ups			286,731			494,769
d) Realised gains on the disposal of investments			1,289,207			1,912,117
e) Income from profit-transfer agreements			324			181
				4,742,684		5,280,426
2. Investment expenses	(10, 12, 13)					
a) Expenses for the management of investments, interest paid and other expenses for investments			687,832			216,189
b) Write-downs of investments			439,313			2,443,216
c) Realised losses on the disposal of investments			307,623			66,020
d) Expenses from loss transfers			-			2
				1,434,768		2,725,427
				3,307,916		2,554,999
3. Interest income on technical provisions				968,854		1,163,949
					2,339,062	1,391,050
4. Other income					383,192	447,321
5. Other expenses					684,809	725,186
6. Operating result before tax					1,915,471	-593,282
7. Taxes on income				225,937		393,041
8. Other taxes				-5,428		5,806
					220,509	398,847
9. Profit/loss for the year					1,694,962	-992,129
10. Profit brought forward from previous year					4,875	2,122
11. Withdrawals from revenue reserves					250,000	1,701,706
12. Transfers to revenue reserves					666,726	-
13. Offset against shares bought back for cancellation					-250,000	-
14. Net retained profits					1,033,111	711,699

Notes to the financial statements

Recognition and measurement

Accounting basis

The financial statements and management report have been prepared in accordance with the German Commercial Code (HGB) and the German Stock Companies Act (AktG), the German Accounting Regulations for Insurance Companies (RechVersV) and the German Insurance Control Act (VAG), observing conservative accounting principles.

Intangible assets

Intangible assets are measured at the acquisition cost less admissible straight-line amortisation or, where applicable, write-downs for impairment.

Investments

Our real estate is valued at the acquisition or construction cost less depreciations admissible under German tax law. The whole portfolio was revalued at the balance sheet date. The useful economic life of the items concerned ranges from 25 to 50 years.

The carrying amount of shareholdings in affiliated companies and other participating interests is generally the acquisition cost, written down for impairments in value where applicable.

Loans to affiliated companies and to participating interests, mortgage loans, registered bonds, and loans and promissory notes are generally recognised in the balance sheet at their nominal values. An exception are zero bonds, which are accounted for at amortised cost. The relevant premiums and discounts are shown as deferred items and placed to account pro rata temporis.

Shares, investment fund certificates, bearer bonds, fixed-interest and non-fixed-interest securities, and other investments are valued at acquisition cost or at the market price at the balance sheet date, whichever is the lower. Investments with participating interests have been valued according to the strict lower of cost or market principle, despite the alternative valuation option provided for under Section 341b of the German Commercial Code.

Lower valuations from previous years are maintained for our investments if the impairment in value is probably permanent. Where the market value at the balance sheet date was higher than the previous year's valuation, we have written back the value to the acquisition cost or the amortised cost.

Receivables

Deposits retained on assumed reinsurance business, accounts receivable on reinsurance business and other receivables are recognised at the nominal values less any necessary adjustments of value.

Other assets

Inventories are recognised at acquisition cost. Office furniture and equipment is valued at acquisition cost less admissible depreciations. The purchase price of assets classifying as low-value goods is fully written off in the year of acquisition.

Deferred taxes

Deferred taxes result from temporary differences between financial statement valuations and valuations prescribed for determining taxable income.

Technical provisions

The technical provisions are calculated in accordance with the requirements of German commercial law. In all cases we have taken into account the necessity of ensuring that our obligations from reinsurance business can always be met.

Unearned premiums are accrued premiums already written for future risk periods. They have been calculated in accordance with the principles of German commercial law, partly on the basis of information received from our ceding companies and partly using nominal percentages. Where unearned premiums are calculated using such percentages, these are based on many years of experience and the latest knowledge available.

The provision for future policy benefits is generally set up in accordance with the amounts reported to us by our ceding companies. Sufficient provisions, calculated using actuarial methods, have been posted for claims that have been incurred but not yet reported or not reported enough. The actuarial assumptions used for their calculation include, in particular, assumptions relating to mortality, disablement, morbidity, interest rate development, lapses and costs. These are estimated on a realistic basis at the time the insurance contracts are concluded and they include adequate provision for adverse deviation to take into account the risks of change, error and random fluctua-

tions. The actuarial assumptions are adjusted if the original provisions for adverse deviation are no longer considered sufficient.

Provisions for outstanding claims are generally established in accordance with the amounts reported to us by our cedants. They are posted for payment obligations arising from reinsurance contracts where the size of the claim or the timing of the payment is still uncertain. Part of the provisions is for known claims for which individually calculated provisions are posted. Another part is for expenses for claims which are not yet known (e.g. because they have not been reported yet or have not yet manifested themselves). A third class of provisions covers claims which are basically known but whose extent has turned out to be greater than originally foreseen. All these provisions include expenses for internal and external loss adjustment expenses. The provision for outstanding claims is based on estimates: the actual payments may be higher or lower. The amounts posted are the realistically estimated future amounts to be paid; they are calculated on the basis of past experience and assumptions about future developments (e.g. social, economic or technological parameters) and using appropriate actuarial methods. Future payment obligations are not discounted but recognised at the future settlement value.

The item "claims equalisation provision and similar provisions" contains the amounts required in accordance with commercial law to mitigate fluctuations in claims experience in future years, plus the provisions for major risks and natural hazards.

The "other technical provisions" mainly comprise provisions for profit commission and the provision for anticipated losses. Provisions for anticipated losses are posted if, in a reinsurance portfolio, the future premiums plus the proportionate investment result will probably not be sufficient to cover the expected claims and costs.

Technical provisions apportionable to the business retroceded by us have been calculated in accordance with the terms of the retrocession agreements.

Other accrued liabilities

Until 31 December 2005, the amount recognised for the provision for employees' pensions was derived by means of the IFRS approach using the corridor method. With this method, the provision was determined from the

amount of the liability less unrecognised actuarial losses. As from 2006, the provision for pensions is shown as the present value of the pension obligations. This changeover has resulted in an increase of €108m in the pension provision.

In 2003, Munich Reinsurance Company established a contractual trust agreement in the form of a two-way trust for its unfunded company pension obligations. To finance these obligations, it is necessary for the trust assets to correspond to the present value of pension obligations. In the process, however, account has to be taken of the difference between the actuarial interest rate relevant for measuring the obligations and the return attainable on the investments. Therefore, the present value of the pension obligations is calculated using an actuarial interest rate equivalent to the expected investment return. Moreover, based on studies of the Company's portfolio of pensioners, the mortalities of the currently used Heubeck 2005 G tables were also modified. These two adjustments result in a total increase of €119m in the present value of the defined benefit obligation in the financial year 2006.

The reserve amount is €283m (86m) higher than the reserve amount pursuant to Section 6a of the German Income Tax Act, applying an actuarial interest rate of 6%.

Except for the semi-retirement provision, which is measured using an actuarial interest rate of 4.0% (2.8%), the other provisions are posted in accordance with the probable requirements.

Liabilities

Subordinated liabilities, deposits retained on retroceded business, accounts payable on reinsurance business, amounts owed to banks and other liabilities are stated at the amount repayable.

Foreign currency translation

All business transactions are generally booked in the respective original currencies and recorded using the respective day's exchange rate in euros. The foreign currency amounts are retranslated for the balance sheet at the year-end exchange rate, but not for the income statement.

Realised exchange gains and realised and unrealised exchange losses are recognised in "other income" and "other expenses" respectively; unrealised exchange gains

are neutralised through the formation of an appropriate provision.

The following table shows the exchange rates of the most important currencies for our business (exchange rate for €1 in each case):

Balance sheet	31.12.2006	Prev. year
Australian dollar	1.67300	1.60800
Canadian dollar	1.53450	1.37790
Pound sterling	0.67375	0.68710
Rand	9.29750	7.48125
Swiss franc	1.60965	1.55460
US dollar	1.31865	1.17955
Yen	157.12400	139.22200

Notes to the balance sheet – Assets

(1), (2) Intangible assets and investments

	Carrying amount 31.12.2005 T€	Currency translation effects T€	Additions T€	Reclassifications T€	Disposals T€	Write-ups T€	Write-downs T€	Carrying amounts 31.12.2006 T€
(1) Intangible assets	98,916	–	14,940	–	–47	–	–33,395	80,414
(2) Investments								
Land, land rights and buildings, including buildings on third-party land	1,004,552	–	20,467	–	–27,743	7,891	–24,627	980,540
Investments in affiliated companies and participating interests								
– Shares in affiliated companies	11,934,454	–3	374,166	470	–165,965	29,800	–2,040	12,170,882
– Loans to affiliated companies	184,483	–13,555	165,403	569	–115,311	–	–	221,589
– Participating interests	120,079	–317	5,949	–470	–2,865	4,296	–4,386	122,286
– Loans to participating interests	26,158	295	–	–569	–750	–	–	25,134
	12,265,174	–13,580	545,518	0	–284,891	34,096	–6,426	12,539,891
Other investments								
– Shares, investment fund certificates and other non-fixed-interest securities	15,384,914	–585,409	29,166,939	–	–29,586,008	242,833	–32,926	14,590,343
– Bearer bonds and other fixed-interest securities	19,266,054	–526,513	26,097,214	5,053	–22,601,664	1,911	–327,435	21,914,620
– Loans secured on property	7,090	–	200	–	–1,863	–	–	5,427
– Other loans								
– Registered bonds	5,420	–553	3,978	–5,053	–	–	–	3,792
– Loans and promissory notes	142	–	1,739,291	–	–1,731,410	–	–	8,023
– Miscellaneous	190	–10	–	–	–10	–	–	170
– Deposits with banks	310,411	–8,952	–	–	–158,668	–	–	142,791
– Miscellaneous investments	198,963	–	5,161,967	–	–5,014,919	–	–47,859	298,152
	35,173,184	–1,121,437	62,169,589	0	–59,094,542	244,744	–408,220	36,963,318
Total investments (2)	48,442,910	–1,135,017	62,735,574	0	–59,407,176	286,731	–439,273	50,483,749
Total (1) + (2)	48,541,826	–1,135,017	62,750,514	0	–59,407,223	286,731	–472,668	50,564,163

In the above table, the write-ups and write-downs in investments in the financial year 2006 have been shown at year-end exchange rates, whereas in the income statement they are recognised using daily exchange rates.

The intangible assets consist mainly of purchased insurance portfolios, renewal rights in respect of insurance portfolios, and software.

The carrying amount of owner-occupied property totals €217m (220m).

The increase in miscellaneous investments is due to the fact that our deposits with MEAG Cash Management GmbH have been reclassified from “other receivables” to

“investments”. This recognises their character as short-term investments earning interest on our surplus liquidity.

Of our total investments (excluding deposits retained on assumed reinsurance) with a carrying amount of €50,484m (48,443m), an amount of €6,176m (6,110m) is deposited with ceding companies or foreign governments or in the custody of trustees nominated by us. In addition, investments of €499m (377m) are subject to a restraint on disposal and have been transferred to the custody of a trustee solely to safeguard pension commitments and provisions for comparable benefits.

Derivatives	Balance sheet item	Carrying amount	Fair value	Notional principal amount T€
		T€	T€	
Equity and index risks				
Long stock options	Shares, investment fund certificates and other non-fixed-interest securities	36,599	36,599	848,684
Long index futures	Other provisions	-1,177	6,280	547,502
Short equity forwards	Other provisions	-	-21,679	289,983
Total return swaps (hedge fund certificates)	Other deferred items	26,246	43,037	190,000
Interest-rate risks				
Long interest-rate swaptions	Other investments	141,050	141,050	1,471,700
Short interest-rate guarantee	Other provisions	-141,050	-141,050	-1,471,700
Interest-rate swaps	Other provisions	-463	193	103,006
Currency risks				
Long currency options	Shares, investment fund certificates and other non-fixed-interest securities	11	11	4,591
Short currency options	Other liabilities and provisions	-13	-11	4,591
Currency forwards	Other provisions	-	5,134	917,455
Other transactions				
Insurance derivatives I (swaps)	Other deferred items	925	84	25,405
	Other provisions	-	1,588	148,676
Insurance derivatives II (cat bonds)	Other provisions	-26	-26	51,625
Credit default swaps	Other investments	719	719	28,134

Derivative financial instruments (derivatives) are financial instruments whose fair value is derived from one or more underlying assets.

We generally use derivative financial instruments only to hedge parts of the portfolio, optimise earnings or implement planned purchases and sales. For this, strict rules apply as regards the limitation of risks and the choice of top-quality business partners. Adherence to these rules is continually monitored.

Beyond this, derivatives are used in isolated cases to hedge against risks assumed in underwriting business. These derivatives include, in particular, interest-rate swaps (interest-rate swaptions) to hedge against an interest-rate risk (interest-rate guarantee) in insurance contracts. Securitisation of insurance risks and their placement on the capital markets is gaining in importance as an instrument of risk transfer to supplement traditional reinsurance. Here, an underwriting risk is ceded by way of a retrocession contract (swap contract) to a special-purpose vehicle (Insurance derivatives I). The special-purpose vehicle covers potential liabilities arising from the contract by issuing insurance bonds (cat bonds). In addition, Munich Reinsurance Company itself has cat bonds in its portfolio. These in turn contain derivative components to be accounted for separately (Insurance derivatives II). A comparable underwriting-investment motive underlies the credit-default swaps.

With the exception of index futures and some stock options, all the derivatives are over-the-counter products.

Derivatives are generally valued at acquisition cost or fair value at the balance sheet date, whichever is the lower. A pending liability is taken into account through the posting of a provision for anticipated losses. Upfront payments are capitalised and amortised over the term. In the case of the interest-rate swaptions, we deviate from this rule: these investments are always accounted for at fair value.

Total return swaps are part of the hedge fund certificates. They are calculated as the difference between the total market value of the funds and the respective capital component (zero bonds), in line with the accounting requirement to divide items into a capital component and a derivative component. The carrying amounts of the insurance derivatives (swap contracts and derivatives embedded in cat bonds) are derived in the same way from the market values of the related insurance risk bonds. The equity forwards form a single valuation unit with the hedged portfolio – the derivative is not recognised in the balance sheet; any loss on the underlying business is thus shown only to the extent that it is not compensated for by the hedging transaction.

Recognised valuation methods are used to determine the fair values of derivatives not traded on the stock exchange. Details may be obtained from the following table:

Derivatives	Pricing method	Parameters	Pricing model
Stock options traded on the stock exchange	Listed price	–	–
OTC stock options	Theoretical price	Listing of underlying shares Effective volatilities Money-market interest rate Dividend yield	Black-Scholes (European) Cox, Ross and Rubinstein (American)
Index futures	Listed price	–	–
Equity forwards	Theoretical price	Money-market interest rate Share price Dividend yield	Present-value method
Total return swaps (hedge-fund certificates)	Theoretical price	Market values of the funds Interest-rate curve	Present-value method
Swaptions	Theoretical price	At-the-money volatility matrix and skew Swap curve Money-market interest-rate curve	Black 76
Interest-rate swaps	Theoretical price	Swap curve Money-market interest-rate curve	Present-value method
Currency options	Theoretical price	Volatility Currency spot rates Money-market interest-rate curve	Garman-Kohlhagen
Currency forwards	Theoretical price	Currency spot rates Money-market interest-rate curve	Present-value method
Insurance derivatives	Theoretical price	Market values of the cat bonds Interest-rate curve	Present-value method
Credit default swaps	Theoretical price	Credit spreads Recovery rates Interest-rate curve	Present-value method

The fair value of investments carried at acquisition cost (excluding deposits retained on assumed reinsurance), in accordance with Section 54 of the German Accounting Regulations for Insurance Companies, amounts to €60.8bn (57.7bn). The relevant carrying amount totals €49.8bn (47.7bn). This results in valuation reserves of €11.0bn (10.0bn) for the financial year 2006.

The valuation reserves include hidden losses of €0.4m for a participation company whose sole corporate purpose is the holding of shares in a listed company. Owing to the small trading volume of shares held, we regard a fair value based on the shares' stock market price as inappropriate. A more meaningful valuation is obtained using the net asset value approach. The fair value thus determined exceeds the carrying amount of the shareholding, which is why no write-down has been made.

For the fair values of real estate, the capitalised earnings value is generally used; new buildings are valued at

cost at the balance sheet date. In the case of shares in affiliated companies, participating interests, equities, investment fund certificates and other non-fixed-interest securities, the market prices on the balance sheet date are used if the investments concerned are listed on the stock market. If no market prices are available, we calculate the value using the discounted earnings method. In the case of unlisted new acquisitions, we use the acquisition cost.

The fair values of fixed-interest securities listed on the stock market are determined on the basis of the market prices at the balance sheet date. In the case of fixed-interest securities not listed on the stock market, interest-rate curves are used.

(3) List of shareholdings

The list of all our shareholdings is filed with the Company Registry, Munich, under registration number HRB 42039.

Notes to the balance sheet – Equity and liabilities

(4) Equity

The total share capital of €587,725,396.48 as at 31 December 2006 is divided into 229,580,233 registered no-par-value shares, each fully paid up and entitled to one vote.

The Annual General Meeting on 19 April 2006 voted to cancel the Authorised Capital Increase 2001 (due to expire on 18 July 2006) and to create a new Authorised Capital Increase 2006 for the issue of employee shares.

Capital authorised for capital increases comprises the following items:

All figures in €m	31.12.2006
Authorised Capital Increase 2004 (until 25 May 2009)	280
Authorised Capital Increase 2006 (until 18 April 2011)	5
Total	285

The contingent capital is as follows:

All figures in €m	31.12.2006
To safeguard conversion rights or subscription rights from convertible bonds or bonds with warrants (Contingent Capital Increase 2005)	100
To safeguard subscription rights from exercise of warrants (Contingent Capital Increase 2003 I)	35
Total	135

The withdrawal from the revenue reserves owing to the share buy-back programme amounts to €250m, whilst the allocation to the revenue reserves totals €667m.

Net retained profits include a profit of T€4,875 carried forward from the previous year.

By resolution of the Annual General Meeting on 28 April 2005, Munich Re was authorised to buy back shares amounting to a maximum of 10% of the share capital up to 27 October 2006. This authorisation was cancelled by the Annual General Meeting on 19 April 2006 and replaced by a new one, authorising the Board of Management to buy back shares amounting to a maximum of 10% of the share capital up to 18 October 2007.

On 31 December 2006, a total of 3,964,060 Munich Re shares with a calculated nominal value of €10,147,993.60 were held by Group companies. This represents 1.73% of the share capital.

For the employee share programme set up by Munich Reinsurance Company in 2006, the 130 shares left over from the 2005 employee share programme were supplemented by 12,225 shares purchased at an average price of €124.00 and sold to staff at a price of €91.90 each.

At its meeting on 7 November 2006, Munich Re's Board of Management decided on a share buy-back programme, thus availing itself of the authorisation granted by the Annual General Meeting on 19 April 2006, in accordance with Section 71 para. 1 item 8 of the German Stock Companies Act. In the period from 8 November 2006 to the Annual General Meeting on 26 April 2007, up to 11,000,000 Munich Re shares will be acquired via the stock exchange. The share buy-back will be restricted to a total purchase price (excluding incidental expenses) of €1bn. The purpose of the share buy-back is to cancel the repurchased shares in order to optimise the Company's capital structure. At 31 December 2006, a total of 2,036,061 shares had been purchased at an average price of €122.79. The purchase price of €250m for acquiring the shares for cancellation was offset against the revenue reserves.

For the employee share programme set up by MEAG MUNICH ERGO AssetManagement GmbH in 2006, 2,293 shares were purchased at an average price of €112.16, which staff acquired at a price of €82.84 each. At 31 December 2006, there were no shares remaining in the portfolio.

In addition, one subsidiary holds 1,463,578 shares to safeguard stock appreciation rights granted to the Board of Management and top Munich Re executives since 1999. In 2006, a total of 400,000 shares were acquired for these programmes at an average price of €106.69 and 139,691 shares were sold at an average price of €121.51.

In the financial year 2006, companies of the ERGO Insurance Group acquired 121,196 shares at an average price of €110.16 each to cover future commitments from the long-term incentive plans launched since 2002 and sold 43,921 shares at a price of €125.16 each. Together with the remaining Munich Re shares acquired to safeguard the stock appreciation rights granted in 2002–2005, the ERGO Insurance Group had a total portfolio of 377,510 shares at 31 December 2006.

Europäische Reiseversicherung AG did not acquire further Munich Re shares to safeguard its long-term incentive plans in 2006 and sold 16,872 shares at a price of €112.36 each. There are no more shares in the portfolio as at 31 December 2006.

In the financial year 2006, MEAG MUNICH ERGO AssetManagement GmbH acquired 37,440 shares at €106.11 each to safeguard obligations from its long-term incentive plan and sold 2,593 shares at an average price of €98.15. It thus has a total portfolio of 86,911 Munich Re shares.

The acquisition costs of all Munich Re shares in the possession of Group companies at the end of the financial year totalled €460,022,921.03.

The Company has received the following notifications pursuant to Section 21 para. 1 of the German Securities Trading Act regarding voting-right percentages:

- Allianz Aktiengesellschaft, Munich, notified us in March 2004 – in accordance with Section 21 para. 1 and Section 22 para. 1 sentence 1 item 1 of the German Securities Trading Act – that Allianz AG's share of the voting rights in our Company had fallen below the threshold of 10% on 2 March 2004 and totalled 9.40% on that date. Of this, 9.40 % was attributable to Allianz AG in accordance with Section 22 para. 1 sentence 1 item 1 of the German Securities Trading Act.
- AXA Investments Managers Deutschland GmbH, Frankfurt, notified us of the following in September 2006 on behalf and as authorised agent of AXA S. A., Paris, 25, Avenue Matignon, 75008 Paris, France, in accordance with Section 21 ff. of the German Securities Trading Act: The share of the voting rights of AllianceBernstein L. P., 1345 Avenue of the Americas, New York, NY 10105, USA, exceeded the threshold of 5% of the voting rights in Munich Reinsurance Company on 13 September 2006 and totalled 5.15%. These voting rights were attributable in accordance with Section 21 para. 1 and Section 22 para. 1 sentence 1 item 6 of the German Securities Trading Act.

The share of the voting rights of AllianceBernstein Corporation, 1345 Avenue of the Americas, New York, NY 10105, USA, exceeded the threshold of 5% of the voting rights in Munich Reinsurance Company on 13 September 2006 and totalled 5.15%. These voting rights were attributable in accordance with Section 21 para. 1 and Section 22 para. 1 sentence 1 item 6 in conjunction with Section 22 para. 1 sentence 2 of the German Securities Trading Act.

The share of the voting rights of Equitable Holdings LLC, 1290 Avenue of the Americas, New York, NY 10019, USA, exceeded the threshold of 5% of the voting rights in Munich Reinsurance Company on 13 September 2006 and totalled 5.15 %. These voting rights were attributable in accordance with Section 21 para. 1 and Section 22 para. 1 sentence 1 item 6 in conjunction with Section 22 para. 1 sentence 2 of the German Securities Trading Act.

The share of the voting rights of AXA Equitable Life Insurance Company, 1290 Avenue of the Americas, New York, NY 10019, USA, exceeded the threshold of 5% of the voting rights in Munich Reinsurance Company on 13 September 2006 and totalled 5.15%. These voting rights were attributable in accordance with Section 21 para. 1 and Section 22 para. 1 sentence 1 item 6 in conjunction with Section 22 para. 1 sentence 2 of the German Securities Trading Act. The share of the voting rights of AXA Financial Services LLC, 1290 Avenue of the Americas, New York, NY 10019, USA, exceeded the threshold of 5% of the voting rights in Munich Reinsurance Company on 13 September 2006 and totalled 5.15%. These voting rights were attributable in accordance with Section 21 para. 1 and Section 22 para. 1 sentence 1 item 6 in conjunction with Section 22 para. 1 sentence 2 of the German Securities Trading Act. The share of the voting rights of AXA Financial Inc., 1290 Avenue of the Americas, New York, NY 10019, USA, exceeded the threshold of 5% of the voting rights in Munich Reinsurance Company on 13 September 2006 and totalled 5.15%. These voting rights were attributable in accordance with Section 21 para. 1 and Section 22 para. 1 sentence 1 item 6 in conjunction with Section 22 para. 1 sentence 2 of the German Securities Trading Act. The share of the voting rights of AXA S. A., 25, Avenue Matignon, 75008 Paris, France, exceeded the threshold of 5% of the voting rights in Munich Reinsurance Company on 13 September 2006 and totalled 5.59%. Of this, 5.59 % was attributable to AXA S. A. in accordance with Section 21 para. 1 and Section 22 para. 1 sentence 1 item 6 in conjunction with Section 22 para. 1 sentence 2 of the German Securities Trading Act, and a further 4,800 votes in accordance with Section 22 para. 1 sentence 1 item 1 of the German Securities Trading Act.

(5) Subordinated liabilities

The proceeds from the subordinated bonds of €3,000m and £300m issued and guaranteed by Munich Re Finance B. V. was transferred to Munich Re as subordinated loans of €2,970m and £297m in the financial year 2003. The period to redemption of each bond is more than five years.

In the financial year 2004, our subsidiary ERGO assumed a partial amount of €352m from the euro loan by way of full discharge of the original debtor.

(6) Technical provisions broken down by class of business in €m

	Unearned premiums	Provision for future policy benefits	Claims provision	Claims equalisation provision and similar provisions	Other provisions	Total	Reserves as % of net premiums
Life	458	13,950	1,079	6	743	16,236	330
Health	48	951	159	3	35	1,196	187
Accident	71	738	3,921	1	2	4,733	921
Liability	298	–	10,542	1,185	–	12,025	818
Motor	381	–	6,020	502	78	6,981	309
Marine	209	–	1,375	57	6	1,647	189
Aviation	230	–	1,026	1,114	–	2,370	428
Fire	518	–	3,457	3,186	68	7,229	269
Engineering	553	–	1,648	1,027	–8	3,220	296
Other classes	302	–	1,441	1,328	39	3,110	185
Non-life combined	2,610	1,689	29,589	8,403	220	42,511	361
Total	3,068	15,639	30,668	8,409	963	58,747	352

The claims provisions shown comprise payments made in the year under review and expenses for increasing the provision.

Claims expenses for the year under review less the payments already made in the same year increase the provisions. The provisions for previous years are reduced by the payments made in the year under review for these years. As the provisions are determined using best estimates based on claims information and past claims experience, as well as estimates of future claims development, it is inevitable that the relevant estimate will regularly change as knowledge of claims cases grows in the year under review.

The claims equalisation provision and similar provisions break down as follows:

	31.12.2006 T€	31.12.2005 T€
Claims equalisation provision	7,470,771	7,106,411
Provision for major risks	312,472	286,301
– For nuclear facilities	69,885	68,223
– For pharmaceutical products liability	66,722	60,936
– For terrorism risks	175,865	157,142
Provisions for natural hazard risks	625,352	390,092
Total	8,408,595	7,782,804

(7) Other accrued liabilities

We have agreed to pay pensions to nearly all our staff and their surviving dependants. These commitments are to be met partly by the company itself and partly by the Munich Re staff pension fund.

There are pension provisions of T€80,795 (50,999) for former members of the Board of Management or their surviving dependants.

The other provisions include, in particular, a provision of T€420,387 for unrealised currency gains.

They also include a provision of T€142,709 for an interest-rate guarantee granted under an individual contract. The risk from the interest-rate guarantee is fully covered by interest-rate swaptions on the assets side (derivatives).

In addition, provisions of T€179,311 have been posted for personnel expenses not yet due at the balance sheet date.

Notes to the income statement

(8) Reinsurance underwriting result by class of business in €m

	Gross premiums written		Underwriting result		Change in claims equalisation provisions		Combined ratio in %	
	2006	2005*	2006	2005*	2006	2005*	2006	2005*
Life	5,275	5,747	282	203	-2	-2	-	-
Health	667	1,199	51	-22	-1	-1	92.6	101.9
Accident	539	866	-739	-1,090	-	-	238.0	226.3
Liability	1,502	1,695	-17	-471	342	67	101.1	127.3
Motor	2,352	2,292	-437	-5	155	64	119.4	100.3
Marine	924	838	-211	-149	102	51	124.1	119.1
Aviation	694	773	105	89	-161	-164	82.0	85.3
Fire	2,974	3,006	1,305	-861	-898	666	52.6	130.8
Engineering	1,154	1,176	163	276	-104	-192	84.4	73.8
Other classes	1,766	1,575	2	72	-59	-237	99.2	95.0
Non-life combined	12,572	13,420	222	-2,161	-624	254	97.9	117.0
Total	17,847	19,167	504	-1,958	-626	252	-	-

*The previous year's figures have been adjusted owing to a new BaFin regulation relating to the breakdown by class of business.

(9) Interest on technical provisions

We have calculated the interest on technical provisions in accordance with Section 38 of the German Accounting Regulations for Insurance Companies and – where prescribed there – have transferred it from the non-technical to the technical account.

(10) Personnel expenses

The management expenses include the following personnel expenses:

	2006 T€	Prev. year T€
Wages and salaries	317,044	309,353
Social insurance contributions and voluntary assistance	61,438	66,789
Expenses for employees' pensions	232,536	32,392
Total	611,018	408,534

The increase in expenses for employees' pensions is due on the one hand to the retrospective recognition of actuarial losses from the previous years, since as from 2006 the full present value of the pension obligations is shown as the provision for pensions (the corridor method was used until 2005). On the other hand, the actuarial interest rate was adjusted to take account of the market situation and mortality. Further details may be obtained on page 63 of this annual report.

(11) Investment income

The write-ups result from the reversal of write-downs, in accordance with Section 280 para. 1 of the German Commercial Code, because the reasons for these write-downs no longer apply.

(12) Investment expenses

The write-downs of investments include T€302,463 (2,340,929) in write-downs for impairment as per Section 253 para. 2 sentence 3 of the German Commercial Code.

(13) Long-term incentive plans

Every year since 1 July 1999, Munich Reinsurance Company has set up long-term incentive plans, each with a term of seven years. Entitled to participate in these share-price-related remuneration plans are members of the Board of Management, senior management in Munich, and top executives in Munich Re's international organisation. Participants receive a certain number of stock appreciation rights. The relevant initial share price is calculated from the average of closing prices for Munich Re shares in Frankfurt Xetra trading over the last three months prior to plan commencement. The initial price for the 2006 long-term incentive plan is €108.87 (88.10).

As a result of Munich Reinsurance Company's capital increase in the business year 2003, the initial share prices for the stock appreciation rights issued up to then and the

number of stock appreciation rights already granted were adjusted in accordance with the conditions.

In the year under review, a total of 443,609 (487,544) stock appreciation rights were granted, 150,687 (138,833) of these to Board of Management members. The future obligations arising from the long-term incentive plans are covered by means of Munich Re shares.

The personnel expenses and income incurred for the stock appreciation rights are determined on the basis of the change in the fair value of the underlying options. The fair value recognises not only the intrinsic value (difference between current share price and initial share price of the stock appreciation rights) but also the possibility of growth in value up to the date of forfeiture or expiry of the rights and is determined on the basis of recognised valuation

models, taking into account the exercise conditions.

At each balance sheet date, the fair value is calculated and reserved; this amount is recognised in full. Munich Reinsurance Company's personnel expenses recognised in the income statement therefore correspond to the change in the provision in the year under review, taking into consideration any rights exercised.

In the year under review, related provisions of €63.2m (46.8m) had to be posted; the personnel expenses totalled €20.6m (44.9m). The weighted average share price for the stock appreciation rights exercised in 2006 was €118.17 for plan year 2003 and €117.52 for plan year 2004. The intrinsic value of the exercisable stock appreciation rights amounted to €22.6m at the balance sheet date.

Munich Re's incentive plans 1999–2006

	Incentive Plan 1999	Incentive Plan 2000	Incentive Plan 2001	Incentive Plan 2002	Incentive Plan 2003	Incentive Plan 2004	Incentive Plan 2005	Incentive Plan 2006
Plan commencement	1.7.1999	1.7.2000	1.7.2001	1.7.2002	1.7.2003	1.7.2004	1.7.2005	1.7.2006
Plan end	30.6.2006	30.6.2007	30.6.2008	30.6.2009	30.6.2010	30.6.2011	30.6.2012	30.6.2013
Old initial share price	182.60 €	319.34 €	320.47 €	260.37 €	86.24 €	-	-	-
New initial share price after 2003 capital increase	173.67 €	303.72 €	304.80 €	247.64 €	82.02 €	88.65 €	88.10 €	108.87 €
Intrinsic value 2006 for one right	-	-	-	-	46.60 €	39.97 €	40.52 €	19.75 €
Fair value 2006 for one right	-	-	0.02 €	1.09 €	47.40 €	44.36 €	46.03 €	37.35 €
Number of rights on 31 December 1999	110,840	-	-	-	-	-	-	-
Additions	9,045	80,582	-	-	-	-	-	-
Number of rights on 31 December 2000	119,885	80,582	-	-	-	-	-	-
Additions	-	-	109,474	-	-	-	-	-
Exercised	34,240	-	-	-	-	-	-	-
Number of rights on 31 December 2001	85,645	80,582	109,474	-	-	-	-	-
Additions	-	-	270	132,466	-	-	-	-
Exercised	6,977	-	-	-	-	-	-	-
Forfeited	-	321	443	-	-	-	-	-
Number of rights on 31 December 2002	78,668	80,261	109,301	132,466	-	-	-	-
Additions	4,009	3,793	5,319	6,696	439,581	-	-	-
Exercised	-	-	-	-	-	-	-	-
Forfeited	3,696	6,199	7,192	3,962	-	-	-	-
Number of rights on 31 December 2003	78,981	77,855	107,428	135,200	439,581	-	-	-
Additions	-	-	-	-	-	456,336	-	-
Exercised	-	-	-	-	-	-	-	-
Forfeited	-	438	600	748	2,354	-	-	-
Number of rights on 31 December 2004	78,981	77,417	106,828	134,452	437,227	456,336	-	-
Additions	-	-	-	-	320	1,697	485,527	-
Exercised	-	-	-	-	177,748	-	-	-
Forfeited	-	23	542	680	121	2,005	-	-
Number of rights on 31 December 2005	78,981	77,394	106,286	133,772	259,678	456,028	485,527	-
Additions	-	-	-	-	-	-	-	443,609
Exercised	-	-	-	-	63,942	119,363	-	-
Forfeited	78,981	-	-	-	-	-	-	1,019
Number of rights on 31 December 2006	-	77,394	106,286	133,772	195,736	336,665	485,527	442,590
Exercisable at year-end	-	77,394	106,286	133,772	195,736	336,665	-	-

Each stock appreciation right entitles the holder to draw in cash the difference between the Munich Re share price at the time when the right is exercised and the initial share price. The stock appreciation rights may only be exercised after a two-year vesting period and then only if the share price is at least 20% higher than the initial price. In addition, Munich Re shares must have outperformed the DAX 30 (Plan 1999) or the EURO STOXX 50 (from Plan 2000 onwards) twice at the end of a three-month period during the term of the plan. The gross amount that may be obtained from the exercising of the stock appreciation rights is limited to an increase of 150% of the initial share price.

Stock appreciation rights not exercised on the last trading day of the plan term are exercised on the participant's behalf insofar as the prerequisites for this are met. If the prerequisites are not met, the stock appreciation rights are forfeited.

If another company acquires control of Munich Re or the company's group of shareholders changes significantly due to a merger or comparable transaction or intended business combination ("change of control"), all plan participants may exercise their stock appreciation rights within 60 days after the change of control becomes effective, even if the prerequisites for exercising the rights are not yet met at that juncture.

(14) Remuneration report

The total remuneration of Munich Reinsurance Company's Board of Management amounted to €22.8m (19.7m) and that of the Supervisory Board to €1.9m (1.9m). All other disclosures on the remuneration of and loans to Board members, share trading and shares held by the members of the Board of Management and the Supervisory Board, and the structure of the Board of Management's remuneration system can be found in the remuneration report on page 34 ff.

(15) Governing bodies of the Company**Board of Management****Dr. jur. Nikolaus von Bomhard**

(Chairman of the Board of Management)
 (Chairman of the Group Committee)
 Group Investments (from 1 March 2007)
 Group Development
 Press
 Internal Auditing
 Executive Offices, Group Top Executives

Dr. rer. pol. Ludger Arnoldussen (from 1 October 2006)

Asia, Australasia, Africa (until 31 December 2006 together with Mr. Wittmann)
 Germany, Asia Pacific and Africa (from 1 January 2007)
 General Services (from 1 March 2007)

Dr. rer. pol. Thomas Blunck

Special and Financial Risks
 Organisational Design & Development (from 1 March 2007)
 Information Technology

Georg Daschner

Europe 2 and Latin America (until 31 December 2006)
 Europe and Latin America (from 1 January 2007)
 Corporate Communications (from 1 January 2007)

Dr. jur. Heiner Hasford (until 28 February 2007)

Group Investments, Corporate Finance, M&A
 Legal and Regulatory Affairs, Compliance
 General Services
 Organisational Design and Development

Dr. rer. nat. Torsten Jeworrek

(Chairman of the Reinsurance Committee)
 Corporate Underwriting/Global Clients
 Reinsurance Investments
 Accounting, Controlling and Central Reserving for Reinsurance

Christian Kluge (until 31 December 2006)

Europe 1
 Corporate Communications

John Phelan

North America

Dr. jur. Jörg Schneider

Group Accounting
 Group Controlling
 Corporate Finance, M&A (from 1 March 2007)
 Integrated Risk Management
 Legal and Regulatory Affairs, Compliance (from 1 March 2007)
 Taxes
 Investor and Rating Agency Relations

Dr. oec. publ. Wolfgang Strassl

(Board member responsible for personnel and welfare matters, within the meaning of Section 33 of the German Co-Determination Act)
 Life and Health
 Human Resources

Karl Wittmann (until 31 December 2006)

Asia, Australasia, Africa
 (as from 1 October 2006 together with Dr. Arnoldussen)

Supervisory Board

Chairman

Dr. jur. Hans-Jürgen Schinzler
Former Chairman of the Board of Management
of Munich Reinsurance Company

Deputy Chairman

Herbert Bach
Employee of Munich Reinsurance Company

Hans-Georg Appel

Employee of Munich Reinsurance Company

Holger Emmert

Employee of Munich Reinsurance Company

Ulrich Hartmann

Chairman of the Supervisory Board of E.ON AG

Dr. rer. nat. Rainer Janßen

Employee of Munich Reinsurance Company

Prof. Dr. rer. nat. Henning Kagermann

Chairman of the Executive Board and Chief Executive Officer of SAP AG

Prof. Dr. rer. nat. Drs. h. c. mult. Hubert Markl

Former President of the Max Planck Society
Emeritus Professor of Biology

Wolfgang Mayrhuber

Chairman of the Board of Management of Deutsche Lufthansa AG

Kerstin Michl

Employee of Munich Reinsurance Company

Prof. Karel Van Miert

Professor at the University of Nyenrode

Ingrid Müller

Employee of Munich Reinsurance Company

Prof. Dr. jur. Dr.-Ing. E. h. Heinrich v. Pierer

Chairman of the Supervisory Board of Siemens AG

Dr.-Ing. e. h. Bernd Pischetsrieder

Chairman of the Board of Management of Volkswagen AG
(until 31 December 2006)

Dr. rer. nat. Jürgen Schimetschek

Employee of Munich Reinsurance Company

Dr. jur. Dr. h. c. Albrecht Schmidt

Former Chairman of the Supervisory Board of Bayerische Hypo- und
Vereinsbank AG

Dr. phil. Ron Sommer

Former Chairman of the Board of Management of Deutsche Telekom AG

Wolfgang Stögbauer

Employee of Munich Reinsurance Company

Josef Süßl

Employee of Munich Reinsurance Company

Judy Vó

Employee of Munich Reinsurance Company

Membership of the Supervisory Board Committees

Standing Committee

Dr. Hans-Jürgen Schinzler (Chairman)
Herbert Bach
Dr. Bernd Pischetsrieder
Dr. Albrecht Schmidt
Josef Süßl

Personnel Committee

Dr. Hans-Jürgen Schinzler (Chairman)
Herbert Bach
Dr. Bernd Pischetsrieder

Audit Committee

Dr. Albrecht Schmidt (Chairman)
Hans-Georg Appel
Prof. Dr. Henning Kagermann
Dr. Hans-Jürgen Schinzler
Wolfgang Stögbauer

Conference Committee

Dr. Hans-Jürgen Schinzler (Chairman)
Herbert Bach
Dr. Bernd Pischetsrieder
Judy Vó

Other seats held by Board members

Board of Management ¹	Seats held on supervisory boards of other German companies	Membership of comparable bodies of German and foreign business enterprises
Dr. jur. Nikolaus von Bomhard Chairman	ERGO Versicherungsgruppe AG* (Chairman)	UniCredit S. p. A., Genoa
Dr. rer. pol. Ludger Arnoldussen (from 1 October 2006)	–	–
Dr. rer. pol. Thomas Blunck	–	Global Aerospace Underwriting Managers Ltd. (GAUM), London New Reinsurance Company, Geneva* (Chairman)
Georg Daschner	–	Münchener Rück Italia S. p. A., Milan* (Chairman)
Dr. jur. Heiner Hasford (until 28 February 2007)	Commerzbank AG D. A. S. Deutscher Automobil Schutz Allgemeine Rechtsschutz-Versicherungs-AG* ERGO Versicherungsgruppe AG* Europäische Reiseversicherung AG (Chairman) Nürnberger Beteiligungs-AG VICTORIA Lebensversicherung AG* VICTORIA Versicherung AG*	Munich Re America Corporation, Wilmington, Delaware*
Dr. rer. nat. Torsten Jeworrek	–	–
Christian Kluge (until 31 December 2006)	–	–
John Phelan	–	Munich Re America Corporation, Wilmington, Delaware* (Chairman) Munich Reinsurance America Inc., Princeton* (Chairman) Munich Reinsurance Company of Canada, Toronto*
Dr. jur. Jörg Schneider	MEAG MUNICH ERGO Kapitalanlagegesellschaft mbH*	Munich Re America Corporation, Wilmington, Delaware*
Dr. oec. publ. Wolfgang Strassl	DKV Deutsche Krankenversicherung AG* Hamburg-Mannheimer Sachversicherungs-AG* Hamburg-Mannheimer Versicherungs-AG* Mecklenburgische Leben Versicherungs-AG	Munich American Reassurance Company, Atlanta* (Chairman)
Karl Wittmann (until 31 December 2006)	–	Jordan Ins. Co. p. l. c., Amman Saudi National Insurance Company E. C., Jeddah

¹ Status: 31 December 2006/1 January 2007 (in the case of members who have left the Board of Management, the information shows the status at the date of their departure).

* Own group company within the meaning of Section 18 of the German Stock Companies Act.

Supervisory Board ²	Seats held on supervisory boards of other German companies	Membership of comparable bodies of German and foreign business enterprises
Dr. jur. Hans-Jürgen Schinzler Chairman	METRO AG	UniCredit S. p. A., Genoa
Ulrich Hartmann	Deutsche Bank AG Deutsche Lufthansa AG E.ON AG (Chairman) Hochtief AG IKB Deutsche Industriebank AG (Chairman)	Henkel KGaA
Prof. Dr. rer. nat. Henning Kagermann	Deutsche Bank AG	–
Prof. Dr. rer. nat. Drs. h. c. mult. Hubert Markl	Bayerische Motoren Werke AG	Sanofi-Aventis S. A., Paris Georg von Holtzbrinck GmbH
Wolfgang Mayrhuber	Bayerische Motoren Werke AG Eurowings Luftverkehrs AG Fraport AG Thomas Cook AG LSG Lufthansa Service Holding AG* Lufthansa Cargo AG* (Chairman) Lufthansa Technik AG*	Heico Corporation, Miami Swiss International AG, Basle
Prof. Karel Van Miert	RWE AG	Agfa-Gevaert NV, Mortsel Anglo American plc, London De Persgroep, Asse Royal Philips Electronics NV, Amsterdam Sibelco NV, Antwerp Solvay S. A., Brussels Vivendi Universal S. A., Paris
Prof. Dr. jur. Dr.-Ing. E. h. Heinrich v. Pierer	Deutsche Bank AG Hochtief AG Siemens AG (Chairman) ThyssenKrupp AG Volkswagen AG	–
Dr.-Ing. e. h. Bernd Pischetsrieder	Dresdner Bank AG METRO AG Audi AG* (Chairman)	Tetra-Laval Group, Pully Scania AB, Södertälje* (Chairman) SEAT S. A., Barcelona*
Dr. jur. Dr. h. c. Albrecht Schmidt	Siemens AG	Thyssen'sche Handelsgesellschaft m. b. H.
Dr. phil. Ron Sommer	Celanese AG	Motorola Inc., Schaumburg Sistema, Moscow Tata Consultancy Services Ltd., Mumbai Weather Investments S. p. A., Rome

²Status: 31 December 2006.

*Own group company within the meaning of Section 18 of the German Stock Companies Act.

(16) Number of staff

The number of staff employed by the Company in Munich and at its offices abroad in the financial year 2006 averaged 3,476 (3,433).

(17) Auditor's fees

The following fees have been recognised as an expense in the financial year for the auditor of the financial statements pursuant to Section 319 para. 1 sentences and 1 and 2 of the German Commercial Code:

	2006 T€
Audits of financial statements	970
Other assurance and appraisal services	297
Tax consultancy services	508
Other services	1,974
Total	3,749

KPMG has supported Munich Re in connection with the Gloria project, primarily with assurance and appraisal services, e.g. in relation to data migration and the examination of control concepts. In addition, KPMG's services have included professional consultancy in the design of the requisite processes prior to Munich Re's own development of systems and their subsequent implementation.

The expenses for this work are shown under "other services".

(18) Contingent liabilities, other financial commitments

Munich Reinsurance Company has assumed a guarantee for certain reinsurance liabilities of Munich American Reassurance Company (MARC Life). In addition, an agreement has been signed under which Munich Reinsurance Company guarantees to maintain the company's solvency capital above the level required by supervisory law.

For a loan obligation of Munich Re America Corporation towards third parties, a guarantee of US\$ 250m has been given.

There is an agreement between Munich Reinsurance Company and Munich American Capital Markets in which a target minimum capitalisation and the liquidity of the subsidiary is guaranteed.

Munich Reinsurance Company has given guarantees on a subordinated basis on behalf of the creditors of two

bonds with a nominal amount of €3bn and £300m issued by Munich Re Finance B.V. This issue has provided Munich Reinsurance Company with €3,059m in funds recognised in the balance sheet as subordinated loans. The difference of €386m compared with the total nominal amount derives mainly from the passing-on of part of the loan to ERGO and represents a contingent liability for Munich Reinsurance Company.

For three foreign subsidiaries, a guarantee for office rents in the full amount, equivalent to €2.7m per annum, has been assumed.

Moreover, Munich Reinsurance Company has assumed a guarantee of €500,000 for a small German subsidiary's pension obligation towards a former member of its Board of Management.

In connection with an investment project of DKV International Health Holding AG, Munich Reinsurance Company has assumed the obligation of making agreed capital injections should the subsidiary be unable to do so.

In isolated cases, we have given guarantees concerning the correctness of individual items warranted in the sales contract when selling investments.

As a member of the German Reinsurance Pharmapool and the German Nuclear Insurance Pool, we are committed – to the extent of our proportional share – to assuming the payment obligations of another pool member if the latter is not able to meet these obligations.

There are other financial commitments amounting to €160m. These result mainly from agency and leasing agreements, initiated investment projects and a commitment to inject capital into an investment fund.

Information on open forward transactions, which were included in other financial commitments last year, can be found on page 66 of this annual report.

(19) Declaration of conformity with the German Corporate Governance Code as per Section 161 of the German Stock Companies Act

In November 2006, the Board of Management and Supervisory Board of Munich Reinsurance Company published an updated declaration of conformity with the German Corporate Governance Code as per Section 161 of the German Stock Companies Act and made this declaration permanently available to shareholders on the internet.

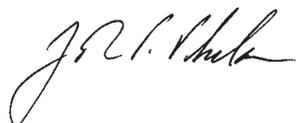
(20) Proposal for appropriation of profit

The net retained profits at the disposal of the Annual General Meeting amount to €1,033,111,048.50.

We propose that this amount be appropriated as follows: distribution of a dividend of €4.50 on each share entitled to dividend, with the amount apportionable to own shares held directly or indirectly and to own shares earmarked for cancellation being carried forward to new account. Up to the Annual General Meeting the number of shares entitled to dividend may decrease or increase through the further acquisition, cancellation or sale of own shares. In this case, a suitably modified proposal for the appropriation of the profit, with a dividend of €4.50 per share entitled to dividend, will be made to the Annual General Meeting.

Munich, 6 March 2007

The Board of Management



Auditor's report

The following is a translation of the auditor's opinion in respect of the original German financial statements and management report:

We have audited the financial statements prepared by the Münchener Rückversicherungs-Gesellschaft Aktiengesellschaft in München, Munich, comprising the balance sheet, the income statement, and the notes to the financial statements, together with the bookkeeping system and management report for the financial year from 1 January to 31 December 2006. The maintenance of the books and records and the preparation of the annual financial statements and management report in accordance with German commercial law and supplementary provisions in the Articles of Association are the responsibility of the Company's Board of Management. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and the management report based on our audit.

We conducted our audit of the annual financial statements in accordance with Section 317 of the German Commercial Code and German generally accepted standards for the audit of financial statements promulgated by the German Institute of Certified Accountants (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the annual financial statements in accordance with the principles of proper accounting and in the management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Company and expectations as to possible

misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the books and records, the annual financial statements and the management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by the Board of Management, as well as evaluating the overall presentation of the annual financial statements and management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations. In our opinion, the annual financial statements give a true and fair view of the net assets, financial position and results of operations of Münchener Rückversicherungs-Gesellschaft Aktiengesellschaft in München in accordance with principles of proper accounting. The management report is consistent with the annual financial statements and as a whole provides a suitable view of the Company's position and suitably presents the opportunities and risks of future development.

Munich, 12 March 2007

KPMG Bayerische Treuhandgesellschaft Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Klaus Becker
Wirtschaftsprüfer
(Certified public accountant)

Herbert Loy
Wirtschaftsprüfer
(Certified public accountant)

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Münchener Rückversicherungs-Gesellschaft
Königinstrasse 107
80802 München
Germany
<http://www.munichre.com>

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80802 München
Germany

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