
MUNICH RE AMERICA CORPORATION

Quarterly Report For The Period Ended March 31, 2019

(Pursuant to Section 4.04 of the
Indenture between the Company and the
holders of the Company's 7.45% Senior Notes)

555 College Road East
PRINCETON, NEW JERSEY 08543
(609) 243-4200



*IN MARCH 2002 THE COMPANY DEREGISTERED THE NOTES IN ACCORDANCE WITH THE RULES AND REGULATIONS OF THE SECURITIES AND EXCHANGE ACT OF 1934. THIS FINANCIAL REPORT IS NOT FILED WITH THE SECURITIES AND EXCHANGE COMMISSION.

May 13, 2019

MUNICH RE AMERICA CORPORATION

FINANCIAL INFORMATION

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FINANCIAL INFORMATION

MUNICH RE AMERICA CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets

(Dollars in millions, except share amounts)

	<u>March 31,</u> <u>2019</u>	<u>December 31,</u> <u>2018</u>
Assets:		
Investments		
Fixed income securities		
Available for sale, at fair value (amortized cost: March 31, 2019 and December 31, 2018 - \$11,817.0 and \$12,042.9 respectively)	\$ 11,868.2	\$ 11,791.4
Trading, at fair value	17.2	17.6
Equity securities	160.3	167.7
Other invested assets	593.3	583.6
Short term investments	660.8	587.7
Cash and cash equivalents	665.4	405.6
Total investments and cash	<u>13,965.2</u>	<u>13,553.6</u>
Accrued investment income	78.5	81.7
Premiums and other receivables	2,757.2	2,746.9
Deferred policy acquisition costs	650.9	645.3
Reinsurance recoverables on paid and unpaid losses	3,811.3	3,855.5
Funds held by ceding companies	1,365.3	1,322.3
Prepaid reinsurance premiums	115.9	120.3
Goodwill	237.3	237.3
Deferred federal income taxes	480.1	541.8
Other assets	385.5	367.8
Total assets	<u>\$ 23,847.2</u>	<u>\$ 23,472.5</u>
Liabilities:		
Loss and loss adjustment expense reserves	\$ 12,229.1	\$ 12,335.4
Unearned premium reserve	2,231.1	2,178.9
Total insurance reserves	<u>14,460.2</u>	<u>14,514.3</u>
Loss balances payable	101.3	88.1
Funds held under reinsurance treaties	3,153.7	3,111.8
Deferred underwriting revenue	1,531.1	1,553.6
Senior notes	331.7	331.7
Other liabilities	604.1	580.9
Total liabilities	<u>20,182.1</u>	<u>20,180.4</u>
Stockholder's Equity:		
Common stock, par value: \$0.01 per share; authorized: 1,000 shares; issued and outstanding: 149.49712 shares at March 31, 2019 and December 31, 2018	-	-
Additional paid-in capital	5,595.3	5,595.3
Accumulated deficit	(1,826.1)	(1,959.9)
Accumulated other comprehensive loss	(104.1)	(343.3)
Total stockholder's equity	<u>3,665.1</u>	<u>3,292.1</u>
Total liabilities and stockholder's equity	<u>\$ 23,847.2</u>	<u>\$ 23,472.5</u>

See accompanying notes to consolidated interim financial statements.

MUNICH RE AMERICA CORPORATION AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income
(Dollars in millions)
(unaudited)

	Three months ended March 31,	
	2019	2018
Revenue:		
Premiums written	\$ 1,279.5	\$ 1,337.1
Change in unearned premium reserve	(56.6)	(240.2)
Premiums earned	1,222.9	1,096.9
Net investment income	83.7	77.3
Net realized capital losses	(1.4)	(15.0)
Other income	8.5	4.1
Total revenue	<u>1,313.7</u>	<u>1,163.3</u>
Losses and expenses:		
Losses and loss adjustment expenses	718.5	671.3
Commission expense	376.0	318.9
Operating expense	68.4	63.8
Interest expense	6.3	6.3
Interest on ceded funds held balances	3.7	7.3
Other expense	5.3	7.4
Total losses and expenses	<u>1,178.2</u>	<u>1,075.0</u>
Income before income taxes	135.5	88.3
Federal and foreign income taxes	0.7	26.8
Net income	<u>134.8</u>	<u>61.5</u>
Other comprehensive income, net of tax:		
Unrealized appreciation (depreciation) of fixed income securities	236.3	(136.1)
Reclassification adjustment for losses (gains) included in operations	2.2	(2.3)
Defined benefit plan reclassification adjustment for losses included in operations	0.7	0.8
Other comprehensive income (loss)	<u>239.2</u>	<u>(137.6)</u>
Comprehensive income (loss)	<u>\$ 374.0</u>	<u>\$ (76.1)</u>

	Three months ended March 31,	
	2019	2018
Net realized capital gains (losses)		
Total other-than-temporary impairments	\$ -	\$ (0.4)
Other than-temporary impairments recognized in other comprehensive income	-	-
Net impairment losses recognized in earnings	-	(0.4)
Other net realized capital losses	(1.4)	(14.6)
Net realized capital losses	<u>\$ (1.4)</u>	<u>\$ (15.0)</u>

See accompanying notes to consolidated interim financial statements.

MUNICH RE AMERICA CORPORATION AND SUBSIDIARIES
Consolidated Statements of Stockholder's Equity
(Dollars in millions)
(unaudited)

	Common stock	Additional paid in capital	Accumulated deficit	Accumulated other comprehensive income (loss)	Total
Balance at January 1, 2019	\$ -	5,595.3	(1,959.9)	(343.3)	3,292.1
Cumulative-effect adjustment for accounting change	-	-	(1.0)	-	(1.0)
Net income	-	-	134.8	-	134.8
Other comprehensive income	-	-	-	239.2	239.2
Balance at March 31, 2019	<u>\$ -</u>	<u>\$ 5,595.3</u>	<u>\$ (1,826.1)</u>	<u>\$ (104.1)</u>	<u>\$ 3,665.1</u>

	Common stock	Additional paid in capital	Accumulated deficit	Accumulated other comprehensive income (loss)	Total
Balance at January 1, 2018	\$ -	5,320.3	(1,735.3)	(152.2)	3,432.8
Cumulative-effect adjustment for accounting change	-	-	14.2	(4.2)	10.0
Net income	-	-	61.5	-	61.5
Other comprehensive income	-	-	-	(137.6)	(137.6)
Dividend to parent company	-	-	0.1	-	0.1
Balance at March 31, 2018	<u>\$ -</u>	<u>\$ 5,320.3</u>	<u>\$ (1,659.5)</u>	<u>\$ (294.0)</u>	<u>\$ 3,366.8</u>

See accompanying notes to consolidated interim financial statements.

MUNICH RE AMERICA CORPORATION AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(Dollars in millions)
(unaudited)

	Three months ended March 31,	
	<u>2019</u>	<u>2018</u>
Cash Flows From Operating Activities:		
Net income	\$ 134.8	\$ 61.5
Adjustments to reconcile net income to net cash provided by operating activities:		
Accrued investment income	3.2	4.1
Trading securities	0.4	1.1
Premiums and other receivables	(10.3)	(314.5)
Deferred policy acquisition costs	(5.6)	(73.5)
Reinsurance recoverables on paid and unpaid losses	44.2	(102.3)
Funds held, net	(1.1)	(82.3)
Insurance reserves	(54.1)	344.6
Deferred revenue	(22.5)	(17.3)
Current and deferred federal and foreign income taxes, net	16.3	28.7
Other assets and liabilities, net	6.9	197.9
Depreciation expense on property and equipment	1.4	1.4
Net realized capital gains	(1.4)	15.0
Equity in income of investees	(5.6)	(1.9)
Other, net	15.8	5.3
Net cash provided by operating activities	<u>122.4</u>	<u>67.8</u>
Cash Flows From Investing Activities:		
Fixed income securities available for sale:		
Purchases	(20.5)	(2,281.1)
Maturities	69.2	73.7
Sales	153.5	2,208.8
Equity securities:		
Sales	11.0	1.4
Other invested assets:		
Purchases	(10.0)	(61.3)
Sales	4.1	2.2
Net derivative instrument settlements	0.3	(11.1)
Net purchases and sales of short term investments	(68.7)	141.7
Cost of additions to property and equipment	(1.5)	(0.4)
Net cash provided by investing activities	<u>137.4</u>	<u>73.9</u>
Net increase in cash and cash equivalents	259.8	141.7
Cash and cash equivalents, beginning of period	405.6	350.5
Cash and cash equivalents, end of period	<u>\$ 665.4</u>	<u>\$ 492.2</u>
Supplemental Schedule of Noncash Financing Activities		
Dividend to parent company	\$ -	\$ 0.1

See accompanying notes to consolidated interim financial statements.

MUNICH RE AMERICA CORPORATION
Notes to Consolidated Interim Financial Statements
March 31, 2019
(Dollars in millions)
(unaudited)

1. Nature of Operations

Munich Re America Corporation (the “Company”) primarily acts as the holding company for three insurance subsidiaries. Munich Reinsurance America, Inc., a Delaware domiciled insurance company, underwrites property and casualty reinsurance. American Alternative Insurance Corporation (“AAIC”), is a Delaware domiciled insurance company which writes primary insurance business primarily for the alternative market. The Princeton Excess and Surplus Lines Insurance Company (“Princeton E&S”), also a Delaware insurance company, was formed to provide insurance coverage on a non-admitted basis in the United States. Princeton E&S is licensed as an admitted insurer in its state of domicile, Delaware, and is authorized as eligible to write insurance in all states on a non-admitted basis. (Munich Reinsurance America, Inc., AAIC, and Princeton E&S together are the “insurance subsidiaries.”)

The Company is a wholly-owned subsidiary of Munich-American Holding Corporation (“MAHC”), a Delaware holding company, which in turn is wholly-owned by Münchener Rückversicherungs-Gesellschaft Aktiengesellschaft in München (“Munich Re”), a company organized under the laws of Germany.

A. Basis of Presentation

The Company’s primary business is reinsuring property-casualty risks of domestic and foreign insurance organizations under excess of loss and pro rata reinsurance contracts and providing risk management solutions to alternative market clients. The Company and its subsidiaries operate on a calendar year basis.

The information for the interim periods ended March 31, 2019 and 2018, is not reviewed or audited by the Company’s independent auditors. The interim consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”) and include the accounts of the Company and its subsidiaries. Inter-company accounts and transactions have been eliminated. Investees which represent the Company’s investment in voting interests of 20% to 50% generally are recorded using the equity method. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These financial statements should be read in conjunction with the financial statements and related notes in the Company’s 2018 Annual Report.

B. Subsequent Events

A dividend of \$53.4 was declared and paid to MAHC in April 2019. There were no other subsequent events requiring adjustment to the financial statements or disclosure through May 13, 2019, the date that the Company’s financial statements were available to be issued.

2. New Accounting Standards

A. Application of New Accounting Standards

Leases

In February 2016, the FASB issued ASU 2016-02, “Leases”, which requires lessees to recognize a right-of-use asset and lease liability for all leases other than those that are short term. The new guidance also requires additional qualitative and quantitative disclosures regarding the nature of an entity’s leasing activities. The standard is effective for annual reporting periods beginning after December 15, 2018, and interim periods therein. The guidance was initially to be applied on a modified retrospective basis, which would require application at the earliest period presented in the financial statements.

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In July 2018, the FASB issued ASU 2018-11, “Leases – Targeted Improvements”, which provides entities with an additional transition method for applying the new leases standard. Under the new transition option, an entity may apply the new leases standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption, rather than the earliest period presented in the financial statements.

The Company adopted the new lease accounting guidance effective January 1, 2019, and recorded the following cumulative-effect changes to its opening Consolidated Balance Sheet, representing the recognition of its right-of-use assets and the present value of its leased office space obligations.

Other assets	\$ 17.7
Other liabilities	(19.0)
Accumulated deficit	1.0
Deferred tax asset	0.3

The Company elected the package of practical expedients permitted under the transition guidance to not reassess prior conclusions related to contracts containing leases, lease classification, and initial indirect costs. The Company also elected the practical expedient to not separate the non-lease components of a contract from the lease component to which they relate.

Premium Amortization on Callable Debt Securities

In March 2017, the FASB issued ASU 2017-08, “Premium Amortization on Purchased Callable Debt Securities”, which requires certain premiums on callable debt securities to be amortized to the earliest call date. The standard is effective for interim and annual reporting periods beginning after December 15, 2018. Application is required on a modified retrospective basis with a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. The adoption of this guidance did not have a material impact on the Company’s consolidated financial statements.

B. Future Application of Accounting Standards

Measurement of Credit Losses on Financial Instruments

In June 2016, the FASB issued ASU 2016-13, “Measurement of Credit Losses on Financial Instruments”, which significantly changes the way entities recognize impairment of many financial assets by requiring immediate recognition of estimated credit losses expected to occur over their remaining life based on an expected loss model. Under the new guidance, an entity will measure all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. The standard is effective for interim and annual periods beginning after December 15, 2020, for public business entities that do not file with the Securities and Exchange Commission (“SEC”). Early adoption is permitted for interim and annual periods beginning after December 15, 2018. The Company is currently assessing the impact of the provisions of this new accounting guidance, which will require the establishment of an allowance for credit losses with a resulting negative adjustment to retained earnings.

Goodwill

In January 2017, the FASB issued ASU 2017-04, “Intangibles and Other – Simplifying the Test for Goodwill Impairment”, which eliminates the requirement to determine implied goodwill in measuring an impairment loss. An impairment loss will be measured as the amount by which a reporting unit’s carrying value exceeds its fair value, limited to the amount of the goodwill. The guidance is effective prospectively for goodwill impairment tests in fiscal years beginning after December 15, 2020, for public business entities that do not file with the SEC. Early adoption is permitted. The Company is currently assessing the new guidance, but does not believe its adoption will have a material

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impact on the Company's consolidated financial statements.

Changes to Disclosure Requirements for Fair Value Measurement

In August 2018, the FASB issued ASU 2018-13, "Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement", which eliminates, adds, and modifies certain disclosure requirements for fair value measurements as part of its disclosure framework project. The new guidance is effective for all entities for interim and annual periods beginning after December 15, 2019. Early adoption is permitted. Entities making this election are permitted to early adopt the eliminated or modified disclosure requirements and delay the adoption of the new disclosure requirements until the effective date. The Company does not expect the adoption of this guidance to have a material impact on its footnote disclosures.

All other recently issued but not yet effective accounting and reporting standards are either not applicable to the Company or are not expected to have an impact on the Company.

3. Investments

A. Fixed Income Securities Designated as Available for Sale

Investments available for sale were as follows:

	March 31, 2019			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Fixed income securities:				
U.S. Treasury securities and obligations of U.S. government agencies and corporations	\$ 5,269.5	\$ 61.2	\$ 39.3	\$ 5,291.4
Obligation of states and political subdivisions	25.4	1.6	-	27.0
Foreign government securities	743.2	18.3	7.7	753.8
Corporate securities	4,230.7	54.1	43.3	4,241.5
Asset-backed securities	390.1	0.1	2.6	387.6
Residential mortgage-backed securities	688.7	9.1	11.3	686.5
Commercial mortgage-backed securities	469.4	12.8	1.8	480.4
Total fixed income securities	<u>11,817.0</u>	<u>157.2</u>	<u>106.0</u>	<u>11,868.2</u>
Short term investments	660.6	0.2	-	660.8
Total investments available for sale	<u>\$ 12,477.6</u>	<u>\$ 157.4</u>	<u>\$ 106.0</u>	<u>\$ 12,529.0</u>

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Notes to Consolidated Interim Financial Statements
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	December 31, 2018			
	<u>Amortized cost</u>	<u>Gross unrealized gains</u>	<u>Gross unrealized losses</u>	<u>Fair value</u>
Fixed income securities:				
U.S. Treasury securities and obligations of U.S. government agencies and corporations	\$ 5,333.6	\$ 18.6	\$ 95.6	\$ 5,256.6
Obligation of states and political subdivisions	25.4	0.6	-	26.0
Foreign government securities	686.0	3.6	23.8	665.8
Corporate securities	4,424.5	8.2	150.2	4,282.5
Asset-backed securities	392.2	-	4.6	387.6
Residential mortgage-backed securities	710.4	8.2	17.9	700.7
Commercial mortgage-backed securities	470.8	4.0	2.6	472.2
Total fixed income securities	<u>12,042.9</u>	<u>43.2</u>	<u>294.7</u>	<u>11,791.4</u>
Short term investments	588.3	-	0.6	587.7
Total investments available for sale	<u>\$ 12,631.2</u>	<u>\$ 43.2</u>	<u>\$ 295.3</u>	<u>\$ 12,379.1</u>

The amortized cost and fair value of fixed income securities available for sale at March 31, 2019, are shown below by contractual maturity. Actual maturities may differ from contractual maturities because securities may be called or prepaid with or without call or prepayment penalties.

	<u>Amortized cost</u>	<u>Fair value</u>
Due to mature:		
One year or less	\$ 698.3	\$ 696.1
After one year through five years	5,509.1	5,511.5
After five years through ten years	3,267.2	3,303.9
After ten years	1,184.3	1,189.8
Residential mortgage-backed securities	688.7	686.5
Commercial mortgage-backed securities	469.4	480.4
Total fixed income securities	<u>\$ 11,817.0</u>	<u>\$ 11,868.2</u>

Proceeds from sales of investments available for sale and the related gains and losses realized on those sales were as follows:

	Three-month period ended March 31,	
	<u>2019</u>	<u>2018</u>
Proceeds from sales	\$ 153.5	\$ 2,208.8
Gross gains realized	1.0	9.7
Gross losses realized	(2.4)	(24.3)

The Company holds certain foreign currency denominated securities in portfolios classified as “trading”, and as a result, proceeds from any sales of these securities are not included in cash flows from investing activities.

Investments with unrealized losses at March 31, 2019 and December 31, 2018, and the period of time for which they have been in a continuous loss position, were as follows:

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	March 31, 2019					
	Less than 12 months		12 months or longer		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Fixed income securities:						
U.S Treasury securities and obligations of U.S government agencies and corporations	\$ 30.4	\$ 0.2	\$ 2,642.1	\$ 39.1	\$ 2,672.5	\$ 39.3
Foreign government securities	79.1	0.6	246.7	7.1	325.8	7.7
Corporate securities	182.7	3.6	1,853.3	39.7	2,036.0	43.3
Asset-backed securities	227.7	2.2	72.0	0.4	299.7	2.6
Residential mortgage- backed securities	-	-	383.3	11.3	383.3	11.3
Commercial mortgage- backed securities	-	-	120.9	1.8	120.9	1.8
Total temporarily impaired investments	<u>\$ 519.9</u>	<u>\$ 6.6</u>	<u>\$ 5,318.3</u>	<u>\$ 99.4</u>	<u>\$ 5,838.2</u>	<u>\$ 106.0</u>

	December 31, 2018					
	Less than 12 months		12 months or longer		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Fixed income securities:						
U.S. Treasury securities and obligations of U.S. government agencies and corporations	\$ 420.0	\$ 10.4	\$ 2,763.9	\$ 85.2	\$ 3,183.9	\$ 95.6
Foreign government securities	431.2	17.8	104.5	6.0	535.7	23.8
Corporate securities	2,067.0	78.5	1,642.7	71.7	3,709.7	150.2
Asset-backed securities	276.4	4.3	50.1	0.3	326.5	4.6
Residential mortgage- backed securities	-	-	391.1	17.9	391.1	17.9
Commercial mortgage- backed securities	28.3	0.1	142.2	2.5	170.5	2.6
Short term investments	106.8	0.6	-	-	106.8	0.6
Total temporarily impaired investments	<u>\$ 3,329.7</u>	<u>\$ 111.7</u>	<u>\$ 5,094.5</u>	<u>\$ 183.6</u>	<u>\$ 8,424.2</u>	<u>\$ 295.3</u>

B. Other-than-Temporary Impairment Evaluation

Investments classified as available for sale are subject to regular reviews to determine if a decline in value is other than temporary. For fixed income securities, the Company individually analyzes all positions with greater emphasis on those that have, in management's opinion, declined significantly below cost. The Company considers market conditions, industry characteristics and the fundamental operating results of the issuer to determine if declines in value are due to changes in interest rates, changes relating to a decline in credit quality, or other issues affecting the investment.

For debt securities that are not deemed to be credit impaired, management performs additional analysis to assess whether it intends to sell or if it is more likely than not that the Company will be required to sell the investment before

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its anticipated recovery in value. This analysis is performed on an individual security basis.

The Company's analysis regarding credit impairment is based on the characteristics of the security:

Corporate securities. In assessing whether a corporate debt security is other than temporarily impaired the Company considers the issuer's financial condition. An analysis of the issuer's financial condition includes whether there has been a decline in the overall value of the issuer or its ability to service the specific security. Factors which may be used include, but are not limited to, credit quality ratings, cash flow sustainability, liquidity, the company's financial strength, industry, and market position.

Structured securities. When evaluating whether a residential mortgage-backed security, commercial mortgage-backed security, collateralized debt obligation and other asset-backed securities are other than temporarily impaired due to credit, the Company examines characteristics of the underlying collateral, such as delinquency and default rates, the quality of the underlying borrower, the type of collateral in the pool, the vintage year of the collateral, subordination levels within the structure of the collateral pool and the quality of any credit guarantors.

For mortgage-backed securities, other than those issued by the Government National Mortgage Association ("GNMA"), which are backed by the full faith and credit of the U.S. Government, or FNMA and FHLMC which are government sponsored enterprises, non-interest related impairment is assessed using a cash flow model that estimates the cash flows on the underlying mortgages. The cash flow model incorporates actual cash flows on the mortgage-backed securities and projects the remaining cash flows using a number of assumptions, including default rates, prepayment rates, and recovery rates.

Management obtains assessments from its investment advisor, an affiliated entity, which develops specific assumptions using as much market data as possible and includes internal estimates as well as estimates published by rating agencies and other third-party sources. Default rates are projected by considering current underlying mortgage loan performance. Other assumptions used contemplate the actual collateral attributes, including geographic concentrations, rating agency loss projections, rating actions and current market prices.

The analysis management utilizes to assess home equity asset-backed securities includes expected cash flow projections provided by the Company's investment advisor which consider expected default expectations and loss severities and prepayment assumptions. The significant inputs in the models include the expected default rates, delinquency rates and foreclosure costs. For non-home equity asset-backed securities, reports and analysis are used to determine expected recovery value for such securities.

At March 31, 2019, fixed income securities that have been in an unrealized loss position for twelve months or longer are comprised of 380 securities with an amortized cost of \$5,417.7 and a gross unrealized loss of \$99.4. These securities mature as follows: 10.5% due in less than one year; 51.8% due in one to five years; 20.8% due in five to ten years; and 16.9% due in greater than ten years (calculated as a percentage of amortized cost). Management believes these unrealized losses are temporary and the result of changes in market conditions, including interest rates and sector spreads. Management does not intend to sell its fixed income securities that are in loss positions, and believes it is not more likely than not that it will be required to sell the securities that are in an unrealized loss position until such time as they recover in value to the Company's amortized cost or they mature.

For other invested assets that are deemed to be impaired, management performs additional analysis to assess whether it intends to sell, or if it is more likely than not that the Company will be required to sell, the investment before its anticipated recovery in value. This analysis is performed on an individual security basis.

For investments in limited partnerships or limited liability companies, the Company regularly monitors the holding for potential impairment indicators. The Company may consider third-party valuations of the partnership or its underlying holdings, sales of underlying holdings, lower than expected cash flows, or any other adverse event that may

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affect the fair value of the investee's stockholders' equity.

C. Fixed Income Securities Designated as Trading

Fixed income securities designated as "trading" include certain foreign currency denominated securities related to an international branch in run-off operations. It is the Company's intent to actively trade these securities. Net gains and losses on trading securities, both realized and unrealized, were included in net investment income as follows:

	Three months ended March 31,	
	2019	2018
Net gains (losses) recognized on trading securities	\$ (0.6)	\$ 0.8
Less: Net gains recognized on securities sold	-	0.3
Unrealized gains (losses) recognized on securities still held at the reporting date	<u>\$ (0.6)</u>	<u>\$ 0.5</u>

D. Equity Securities

Net gains and losses on equity securities, both realized and unrealized, were included in net investment income as follows:

	Three months ended March 31,	
	2019	2018
Net gains recognized on equity securities	\$ 3.2	\$ 1.3
Less: Net gains recognized on securities sold	2.9	3.3
Unrealized gains (losses) recognized on securities still held at the reporting date	<u>\$ 0.3</u>	<u>\$ (2.0)</u>

E. Derivative Financial Instruments

Derivatives are financial instruments whose market values are (i) derived from changes in interest rates, foreign exchange rates, credit exposures, or the value of related securities, and (ii) a function of the type of derivative product, the volume of transactions, the terms of the given agreement and market volatility. The Company's derivative portfolio may at times consist of credit default swaps ("CDS"), credit default swap indices ("CDX"), foreign currency forward contracts, and fixed income futures. Derivatives may be exchange-traded or contracted in the over-the-counter market. The Company does not apply hedge accounting in its reporting of derivative instruments. The Company does not use derivatives for speculative purposes.

Derivative transactions are customarily entered into under industry standard master netting agreements. These are agreements between two counterparties who have multiple derivative contracts with each other that provide for the net settlement of all contracts. Cash collateral and security collateral are used to secure the net open exposure of the other party. The risk that counterparties might be unable to fulfill their contractual obligations is mitigated by (i) entering into derivative transactions with highly-rated and creditworthy counterparties, (ii) monitoring counterparty credit exposure to ensure that exposures are within defined limits, and (iii) monitoring collateral values.

A CDS is an over-the-counter derivative instrument representing an agreement between two parties, a seller and a buyer. The seller of the CDS compensates the buyer in the event of a loan default or other credit event pertaining to a

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“reference entity.” The reference entity may be a specified entity, a group of single name entities, or an index. In return, the buyer makes a series of “premium” payments to the seller. If a credit event does not occur, the seller makes no payments to the buyer and receives only the contractually specified premiums. A CDX is an exchange-traded portfolio of single-entity credit default swaps used to hedge credit risk in the form of an index. Unlike a CDS, a CDX is standardized, making it highly liquid, mitigating counterparty credit risk and a primary market vehicle for gaining diversified credit exposure.

The Company has sold CDS contracts referencing single-name exposures written on corporate credit instruments with the intention of earning spread income on credit exposure through asset replication. Asset replication refers to the development of a synthetic financial instrument with similar risk and return characteristics of an actual security, such as a bond issued by a corporation, that is either unavailable in the cash markets or more economical to acquire in the form of a CDS. The Company replicates the investment characteristics of the reference bond using a combination of a credit default swap and one or more highly-rated fixed income securities held in its investment portfolio. The Company’s CDS derivative agreements contain credit-rating triggers. If the credit rating of either counterparty to the contract were to fall below a given rating level, as specified in each agreement, the transaction is terminated at the then fair value of the derivative.

The notional amounts specified in a CDS or CDX contract are (i) used to calculate the exchange of contractual payments under the agreements, (ii) generally not representative of the potential for gain or loss on these agreements, and (iii) the maximum amount of potential future payments assuming no recoveries in a credit event with respect to a referenced entity. The Company typically enters into CDS or CDX contracts with a maturity of 5 years. At March 31, 2019, the Company had no open CDS or CDX contracts.

Foreign currency forwards are commitments to purchase and sell designated currency amounts at an agreed upon price at a specified future date. The Company invests in foreign exchange forward contracts to economically hedge the foreign currency exchange risk associated with certain non-U.S. dollar denominated exposures. These contracts can be with various counterparties. Cash collateral is required to be maintained within a counterparty’s unsecured account to cover any loss position in excess of \$0.3 on open contracts. A similar requirement exists for the counterparty, should the open contract reflect a gain position. Foreign currency forward contracts are generally settled by the Company every ninety days. At March 31, 2019, the Company’s three open foreign currency forward contracts, having an aggregate notional value of \$162.6, reflected a net unrealized loss of \$0.3, therefore, no cash collateral was required to be provided by the Company.

Futures are standardized contracts between two parties, traded on an exchange, to buy or sell an asset for an agreed upon price as of a given date with delivery and payment occurring at a specified future date. The Company has entered into fixed income futures contracts in order to economically hedge the duration of certain fixed income assets in its portfolio due to anticipated changes in the interest rate environment. The daily fair value of the futures contract is determined by the value of an underlying referenced investment. Futures contracts are settled with cash on a daily basis. At March 31, 2019, the Company had no open futures positions.

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The fair value of derivatives, by contract type, at March 31, 2019 and December 31, 2018 are as follows:

	<u>Balance Sheet location</u>	<u>March 31, 2019</u>	<u>December 31, 2018</u>
Derivatives not designated as hedging instruments under ASC 815			
Derivative assets			
Foreign exchange forward contracts	Other invested assets	\$ -	\$ 2.3
Foreign exchange forward contracts	Other liabilities	0.2	-
Total		<u>\$ 0.2</u>	<u>\$ 2.3</u>
Derivative liabilities			
Foreign exchange forward contracts	Other invested assets	\$ -	\$ 0.2
Foreign exchange forward contracts	Other liabilities	0.5	-
Total		<u>\$ 0.5</u>	<u>\$ 0.2</u>

The following table provides information about the earnings (loss) effects of the Company's derivative investments for the three months ended March 31, 2019 and 2018.

	<u>Location in Statement of Comprehensive Income</u>	<u>Three months ended March 31, 2019</u>	<u>2018</u>
Derivatives not designated as hedging instruments under ASC 815			
Credit default swaps	Net investment income	\$ -	\$ (1.2)
Foreign exchange forward contracts	Net investment income	(1.8)	(7.7)
Fixed income futures	Net investment income	-	(2.1)
Total		<u>\$ (1.8)</u>	<u>\$ (11.0)</u>

The following table provides the foreign exchange forward contract derivative asset and liability balances that are offset together in the Consolidated Balance Sheet as of March 31, 2019 and December 31, 2018.

	<u>March 31, 2019</u>		
	<u>Gross amounts of recognized assets (liabilities)</u>	<u>Gross amounts offset in Balance Sheet</u>	<u>Net amounts of assets presented in Balance Sheet</u>
Derivative assets			
Foreign exchange forward contracts	\$ 0.2	\$ (0.2)	\$ -
Total	<u>\$ 0.2</u>	<u>\$ (0.2)</u>	<u>\$ -</u>
Derivative liabilities			
Foreign exchange forward contracts	\$ (0.5)	\$ 0.2	\$ (0.3)
Total	<u>\$ (0.5)</u>	<u>\$ 0.2</u>	<u>\$ (0.3)</u>

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	December 31, 2018		
	Gross amounts of recognized assets (liabilities)	Gross amounts offset in Balance Sheet	Net amounts of assets presented in Balance Sheet
Derivative assets			
Foreign exchange forward contracts	\$ 2.3	\$ (0.5)	\$ 1.8
Total	\$ 2.3	\$ (0.5)	\$ 1.8
Derivative liabilities			
Foreign exchange forward contracts	\$ (0.2)	\$ 0.2	\$ -
Total	\$ (0.2)	\$ 0.2	\$ -

F. Loans

The Company holds investments in two senior secured fixed term loans with U.S. infrastructure entities. The first loan matures July 2030 and the Company receives a semi-annual variable rate coupon on the outstanding principal and a commitment fee on the undrawn but committed loan balance to the borrower. At March 31, 2019, the Company's open loan commitment was \$14.0. The second loan matures November 2025 and the Company receives periodic interest and principal payments based on the applicable London Interbank Offered Rate ("LIBOR") rate for the period. Both loans permit prepayment by the borrower. Loans receivable of \$84.9 and \$75.1 at March 31, 2019 and December 31, 2018, respectively, are included in other invested assets in the Consolidated Balance Sheet.

4. Fair Value Measurement

The fair value hierarchy established by Accounting Standards Codification ("ASC") 820, prioritizes valuation technique inputs to measure fair value into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement. The Company categorizes the fair value of its financial instruments as follows:

Level 1 – Unadjusted quoted prices accessible in active markets for identical assets or liabilities at the measurement date. A market is considered active if: (i) pricing information is obtained from the exchange-traded securities, (ii) the securities are actively traded, and (iii) current pricing is available. The types of assets and liabilities utilizing Level 1 valuations include equity securities listed in active markets and investments in publicly traded mutual funds with quoted market prices. The Company receives the quoted market prices from nationally recognized, independent pricing services.

Level 2 – Unadjusted quoted prices for similar assets or liabilities in active markets or inputs, other than quoted prices, that are observable or that are derived principally from, or corroborated by, observable market data through correlation or other means. The Company uses quoted values and other data provided by nationally recognized, independent pricing sources for determining fair values of its fixed income investments. When quoted market prices are unavailable, the pricing services provide an estimated fair value. The pricing services will only produce an estimate of fair value if there is objectively verifiable information to produce a valuation. The services use pricing applications that vary by asset class and incorporate available market information through processes such as matrix pricing. Fixed income securities are generally categorized as Level 2 since a particular security may not have traded, but the pricing services are able to use valuation models with observable market inputs, such as interest yield curves and prices for similar fixed maturity securities in terms of issuer, maturity and seniority. The types of assets and liabilities utilizing Level 2 valuations generally include U.S. Government securities, municipal bonds, structured notes, mortgage-backed and asset-backed securities, and corporate debt. Foreign exchange

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forward contracts and credit default swaps are also categorized as Level 2 holdings. Credit default swaps are valued using various models that utilize actively quoted or observable market input values from external market data providers and third party pricing vendors.

Level 3 – Prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. The types of assets and liabilities utilizing Level 3 valuations generally include collateralized or senior secured loans; fixed income securities, and certain equity securities which do not have a readily determinable fair value. These instruments are measured via broker-dealer pricing, cash flow modeling, or net asset value per share, as applicable.

Broker-dealer pricing is used either (i) when fair values are unavailable from independent pricing sources and, instead, non-binding quotes are obtained directly from broker-dealers who are active, and often considered the “market makers”, in the corresponding markets, or (ii) when the pricing hierarchy indicates that the broker-dealer is the best available source, even though pricing services’ values may be available. The inputs of broker-dealer pricing are both significant and unobservable as the Company does not have access to the valuation models used, nor information regarding specific inputs such as credit spreads, prepayment assumptions, or market liquidity factors.

Discounted cash flow modeling is performed for privately placed fixed income securities and loans which are not actively traded and do not have readily observable prices.

Net asset values are applied to investments in privately placed real estate limited partnerships which apply industry practice and measure investment assets at fair value. Such values are provided by the fund sponsors.

The Company utilizes a price source hierarchy to select which price source it will use to determine the fair value. The hierarchy prioritizes pricing sources based on the source’s expertise, reliability and availability. Priority is given to established pricing services ahead of broker-dealer price sources. The highest level price source available in the hierarchy is used to measure fair value. The majority of the Company’s selected price sources are index providers.

The Company relies on its third-party investment accounting service provider to analyze prices received from the pricing services and broker-dealers to ensure they represent a reasonable estimate of fair value. The Company performs additional analyses to gain assurance on the overall reasonableness of inputs and valuation methodologies used by those sources. These analyses include an annual review of respective price services methodologies and processes, quarterly comparison of market prices to prices obtained from different independent pricing sources, and back-testing of selected sales to determine if there were significant differences between the market price used to value the security prior to sale and the actual sales price.

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The fair value of financial instruments at March 31, 2019 and December 31, 2018, were as follows:

	March 31, 2019		December 31, 2018	
	Carrying value	Fair value	Carrying value	Fair value
Assets:				
Fixed income securities				
Available for sale	\$ 11,868.2	11,868.2	\$ 11,791.4	\$ 11,791.4
Trading	17.2	17.2	17.6	17.6
Equity securities	160.3	160.3	167.7	167.7
Other invested assets				
Derivative assets	-	-	1.8	1.8
Other	84.9	86.3	75.1	75.1
Short term investments	660.8	660.8	587.7	587.7
Total	<u>\$ 12,791.4</u>	<u>\$ 12,792.8</u>	<u>\$ 12,641.3</u>	<u>\$ 12,641.3</u>
Liabilities:				
Senior notes	\$ 331.7	\$ 417.2	\$ 331.7	\$ 404.1
Derivative liabilities	0.3	0.3	-	-
Total	<u>\$ 332.0</u>	<u>\$ 417.5</u>	<u>\$ 331.7</u>	<u>\$ 404.1</u>

Other invested assets includes a senior secured loan, which is carried at amortized cost and categorized as Level 3 within the fair value hierarchy. Other invested assets carried under the equity method of accounting are not included in the presentation above.

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Investments measured at fair value on the Consolidated Balance Sheet are categorized as follows:

	March 31, 2019			Total
	Level 1	Level 2	Level 3	
Assets:				
Fixed income securities				
Available for sale investments				
U.S Treasury securities and obligations of U.S government agencies and corporations	\$ -	\$ 5,291.4	\$ -	\$ 5,291.4
Obligations of states and political subdivisions	-	27.0	-	27.0
Foreign government securities	-	753.8	-	753.8
Corporate securities	-	4,112.2	129.3	4,241.5
Asset-backed securities	-	93.1	294.5	387.6
Residential mortgage-backed securities	-	686.5	-	686.5
Commercial mortgage-backed securities	-	480.4	-	480.4
Total available for sale investment	<u>-</u>	<u>11,444.4</u>	<u>423.8</u>	<u>11,868.2</u>
Trading investments				
Foreign government securities	-	14.5	-	14.5
Corporate securities and foreign bonds	-	2.7	-	2.7
Equity securities	89.3	-	71.0	160.3
Short term investments	-	660.8	-	660.8
Total investments carried at fair value	<u>\$ 89.3</u>	<u>\$ 12,122.4</u>	<u>\$ 494.8</u>	<u>\$ 12,706.5</u>
Investments carried at cost				84.9
Investments carried at equity				508.4
Cash and cash equivalents				665.4
Total investments not carried at fair value				<u>1,258.7</u>
Total investments and cash				<u>\$ 13,965.2</u>

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	December 31, 2018			Total
	Level 1	Level 2	Level 3	
Assets:				
Fixed income securities				
Available for sale investments				
U.S Treasury securities and obligations of U.S government agencies and corporations	\$ -	\$ 5,256.6	\$ -	\$ 5,256.6
Obligations of states and political subdivisions	-	26.0	-	26.0
Foreign government securities	-	665.8	-	665.8
Corporate securities	-	4,157.0	125.5	4,282.5
Asset-backed securities	-	94.9	292.7	387.6
Residential mortgage-backed securities	-	700.7	-	700.7
Commercial mortgage-backed securities	-	472.2	-	472.2
Total available for sale investment	<u>-</u>	<u>11,373.2</u>	<u>418.2</u>	<u>11,791.4</u>
Trading investments				
Foreign government securities	-	15.0	-	15.0
Corporate securities and foreign bonds	-	2.6	-	2.6
Equity securities	95.4	-	72.3	167.7
Other invested assets				
Derivative assets	-	1.8	-	1.8
Short term investments	-	587.7	-	587.7
Total investments carried at fair value	<u>\$ 95.4</u>	<u>\$ 11,980.3</u>	<u>\$ 490.5</u>	<u>\$ 12,566.2</u>
Investments carried at cost				75.1
Investments carried at equity				506.7
Cash and cash equivalents				405.6
Total investments not carried at fair value				<u>987.4</u>
Total investments and cash				<u>\$ 13,553.6</u>

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The following table summarizes financial instruments for which the Company used significant Level 3 inputs to determine fair value measurements for the three months ended March 31, 2019 and 2018:

	Balance at Jan. 1, 2019	Net investment gains (losses)		Purchases	Sales	Settlements	Transfers into Level 3	Transfers out of Level 3	Balance at Mar. 31, 2019	Change in earnings due to assets still held
		In earnings ¹	In OCI ²							
Available for sale investments										
Corporate securities	\$ 125.5	\$ -	\$ 7.5	\$ -	\$ (3.7)	\$ -	\$ -	\$ -	\$ 129.3	\$ -
Asset-backed securities	292.7	-	1.8	-	-	-	-	-	294.5	-
Equity securities	72.3	0.4	-	-	(1.7)	-	-	-	71.0	-
Total	<u>\$ 490.5</u>	<u>\$ 0.4</u>	<u>\$ 9.3</u>	<u>\$ -</u>	<u>\$ (5.4)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 494.8</u>	<u>\$ -</u>

	Balance at Jan. 1, 2018	Net investment gains (losses)		Purchases	Sales	Settlements	Transfers into Level 3	Transfers out of Level 3	Balance at Mar. 31, 2018	Change in earnings due to assets still held
		In earnings ¹	In OCI ²							
Available for sale investments										
Corporate securities	\$ 147.5	\$ -	\$ (5.7)	\$ -	\$ (1.9)	\$ -	\$ -	\$ -	\$ 139.9	\$ -
Asset-backed securities	340.1	-	(0.3)	-	-	(4.4)	116.1	-	451.5	-
Equity securities	71.6	0.8	-	-	(1.4)	-	-	-	71.0	-
Total	<u>\$ 559.2</u>	<u>\$ 0.8</u>	<u>\$ (6.0)</u>	<u>\$ -</u>	<u>\$ (3.3)</u>	<u>\$ (4.4)</u>	<u>\$ 116.1</u>	<u>\$ -</u>	<u>\$ 662.4</u>	<u>\$ -</u>

(1) Includes gains and losses on sales of financial instruments and other-than-temporary impairments.

(2) "OCI" means other comprehensive income. Includes changes in market value of investments designated as "available for sale" ("AFS").

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The Company reviews its fair value hierarchy classifications quarterly. Changes in observability of significant valuation inputs identified during these reviews may trigger reclassification of fair value hierarchy levels of financial assets and liabilities. These reclassifications will be reported as transfers in or out of Level 3 at the end of the period in which the change occurs.

The fair value of the Company's investments in private placement fixed income corporate securities of \$129.3 and \$125.5 at March 31, 2019 and December 31, 2018, respectively, is based on a discounted cash flow model and is included in Level 3. The cash flow model uses significant observable and unobservable inputs, including: a risk free rate curve, a credit spread curve and an illiquidity spread. Changes to assumptions around rate curves or spreads may increase or decrease the fair value. In general, increases in risk free rates or credit and illiquidity spreads would decrease the fair value of the investment.

The fair value of the Company's investment in collateralized loan obligations of \$294.5 and \$292.7, at March 31, 2019 and December 31, 2018, respectively, is based on pricing received from valuation groups at various brokers trading these securities in the marketplace. Prices are determined using a combination of matrix pricing of similar securities and observed transactions. By nature, a valuation group cannot give a binding quote considering they are an independent valuation group and not a trading desk. These prices are received by the Company's investment advisor and validated as part of their internal pricing process. In cases where a price is obtained from multiple brokers, the most conservative price is used. The investment advisor assesses market movements and volatility month-over-month by reviewing the spread movements across the sector based on published index data. This analysis provides indications of how securities performed based on market conditions over the pricing period and is used to validate the prices received from third parties. Spread movements that are not consistent with pricing movements are further reviewed, analyzed, and challenged with the broker if necessary. There were no transfers of collateralized loan obligations in or out of Level 3 during the three months ended March 31, 2019.

The fair value of the Company's Level 3 investment in equity securities of \$71.0 and \$72.3, at March 31, 2019 and December 31, 2018, respectively, is based on quarterly net asset values ("NAV") determined by the fund sponsors, and includes cumulative unrealized gains of \$17.7 at March 31, 2019, of which \$0.4 were recognized in the three months then ended. These equity securities are investments in privately placed real estate limited partnerships whose industry practice is to measure investment assets at fair value. These partnerships acquire investments in real estate within the United States for the purposes of generating capital appreciation and current income. The NAV determinations often include appraisals of operational properties, as well as those in various stages of development. The Company may redeem its interests with 90 days notice, subject to liquidity at the fund, as determined by the general partner. To the extent liquidity is not available, distributions are made on a pro-rata basis, based on availability of funds as determined by the general partner. Based on the Company's ownership interests in the funds, the Company does not expect liquidity to be a matter of concern, should it wish to redeem its interests. The Company does not expect such redemption to occur at an amount significantly different from the fund NAV. At March 31, 2019, the Company has not identified any investments in real estate limited partnerships which it intends to sell.

There were no transfers of securities between Levels 1 and 2 during the three months ended March 31, 2019 and 2018.

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5. Accumulated Other Comprehensive Income

The components of accumulated other comprehensive income (loss) are as follows:

	Net unrealized appreciation (depreciation) of investments	Defined benefit plan adjustment	Total
Balance at December 31, 2017	\$ 13.5	\$ (165.7)	\$ (152.2)
Cumulative-effect adjustment for accounting change	(5.3)	-	(5.3)
Tax effect	1.1	-	1.1
Period change	(173.1)	-	(173.1)
Tax effect	37.0	-	37.0
Reclassification adjustment for losses included in operations	(2.9)	1.1	(1.8)
Tax effect	0.6	(0.3)	0.3
Balance at March 31, 2018	<u>\$ (129.1)</u>	<u>\$ (164.9)</u>	<u>\$ (294.0)</u>
Balance at December 31, 2018	\$ (198.1)	\$ (145.2)	\$ (343.3)
Period change	300.7	-	300.7
Tax effect	(64.4)	-	(64.4)
Reclassification adjustment for losses included in operations	2.8	0.9	3.7
Tax effect	(0.6)	(0.2)	(0.8)
Balance at March 31, 2019	<u>\$ 40.4</u>	<u>\$ (144.5)</u>	<u>\$ (104.1)</u>

Amounts reclassified out of accumulated other comprehensive income from net unrealized appreciation (depreciation) of investments are included in net realized capital gains in the Consolidated Statement of Comprehensive Income. Amounts reclassified from the defined benefit plan adjustment are included in other expense. Activity for the 2018 period includes the reclassification of net unrealized gains on equity securities, net of tax, to accumulated deficit due to the adoption of new accounting guidance.

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6. Loss and Loss Adjustment Expense Reserves

The reconciliation of loss and loss adjustment expense reserves for the three months ended March 31, 2019 and 2018 is shown below:

	March 31,	
	2019	2018
Loss and LAE reserves at beginning of period	\$ 12,335.4	\$ 12,464.3
Reinsurance recoverables on unpaid losses	<u>(3,821.4)</u>	<u>(5,263.5)</u>
Net reserves at beginning of period	8,514.0	7,200.8
Net incurred related to:		
Current period	741.8	651.4
Prior periods	<u>(23.3)</u>	<u>19.9</u>
Total net incurred	718.5	671.3
Net paid related to:		
Current period	(36.1)	(42.5)
Prior periods	<u>(683.3)</u>	<u>(477.1)</u>
Total net paid	(719.4)	(519.6)
Deferred underwriting revenue	22.4	18.2
Foreign exchange increase in reserves	<u>(0.4)</u>	<u>0.4</u>
Net reserves at end of period	8,535.1	7,371.1
Reinsurance recoverables on unpaid losses	<u>3,694.0</u>	<u>5,345.9</u>
Loss and LAE reserves at end of period	<u>\$ 12,229.1</u>	<u>\$ 12,717.0</u>

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7. Reinsurance

The Company reinsures certain risks to limit its exposure to catastrophes and large or unusually hazardous risks. Although reinsurance agreements contractually obligate the Company's reinsurers to reimburse it for the agreed-upon portion of its gross paid losses, they do not discharge the primary liability of the Company. The income statement amounts for premiums written, premiums earned and losses and loss adjustment expenses ("LAE") are net of reinsurance. Direct, assumed, ceded and net amounts for these items are as follows:

	Three-month period	
	ended March 31,	
	2019	2018
Premiums written		
Direct	\$ 250.9	\$ 292.9
Assumed	1,120.7	1,187.5
Ceded	(92.1)	(143.3)
Net	<u>1,279.5</u>	<u>1,337.1</u>
Premiums earned		
Direct	272.9	303.8
Assumed	1,046.5	1,099.4
Ceded	(96.5)	(306.3)
Net	<u>1,222.9</u>	<u>1,096.9</u>
Losses incurred		
Direct	174.7	194.5
Assumed	634.6	677.5
Ceded	(90.8)	(200.7)
Net	<u>\$ 718.5</u>	<u>\$ 671.3</u>

8. Postretirement Benefits

The Company provides retirement benefits to its employees hired prior to 2006 under a qualified non-contributory defined benefit pension plan. It provides additional benefits to certain employees whose retirement benefits exceed maximum amounts permitted by current tax law under an unfunded, nonqualified pension plan. Benefits under both plans are based on years of service and the average of the employee's highest consecutive five years of compensation. Accrued costs represent estimates based upon current information. Those estimates are subject to change due to changes in the underlying information supporting such estimates in the future. These defined benefit pension plans were frozen in 2011, at which time employees in the plans ceased accruing benefits under the plans and commenced participation in the Company's defined contribution retirement savings plan.

The Company also provides post retirement health care benefits to individuals having attained the age of 55 by March 31, 2018, who also meet service eligibility requirements. The plan cost to the Company is capped at 150% of the cost as of January 1, 2009. Additional costs above the cap are paid by retiree contributions. The Company funds its obligation currently.

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Net periodic benefit cost is included in other expense in the Consolidated Statement of Comprehensive Income. The following table provides the components of net periodic benefit cost for the three months ended March 31, 2019 and 2018.

	<u>Pension Benefits</u>		<u>Other Benefits</u>	
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
Interest cost	\$ 6.9	\$ 6.5	\$ 0.5	\$ 0.4
Expected return on plan assets	(5.2)	(5.0)	-	-
Amortization of net loss	1.3	1.4	0.1	0.2
Amortization of prior service credit	-	-	(0.5)	(0.5)
Net periodic benefit cost	<u>\$ 3.0</u>	<u>\$ 2.9</u>	<u>\$ 0.1</u>	<u>\$ 0.1</u>

9. Commitments and Contingencies

Commitments

The Company has a senior secured fixed term loan commitment with a U.S. infrastructure entity in the amount of \$80.0, with \$14.0 remaining on the commitment at March 31, 2018. The timing and amount of future disbursements are dependent on the borrower meeting certain performance metrics over the period. The Company expects to fulfill this obligation in 2019.

As part of the common control acquisition in 2015, the Company assumed an agreement with U.S. Property Fund V GmbH & Co. KG ("USPF V"), a real estate investment partnership, to make contributions to the partnership totaling \$20.0. The Company has \$0.8 remaining on this commitment at March 31, 2019.

Surety bonds

The Company is contingently obligated as co-surety to certain surety bonds issued by its reinsured clients. In all such cases, an indemnification and hold harmless agreement is executed that limits the Company's exposure to the extent provided under the reinsurance contract in the event of a claim. As co-surety, the Company would only incur a loss in excess of the limits of the reinsurance contract if a default by both the bonded principal and the co-surety occurred. Based upon internal risk modeling, which takes into consideration the financial strength and rating of the co-surety, a co-surety loss on any of these agreements is deemed to be remote. At March 31, 2019, the Company's contingent obligation under all co-surety arrangements is \$474.8.

Guarantees

At March 31, 2019, the Company has provided guarantees in the amount of \$193.0 to certain counterparties of the weather and energy trading operations of an affiliate, Munich Re Trading, LLC ("MRTL") pursuant to a credit support facility between the Company and MRTL (the "Guarantees"). Pursuant to the facility, the Company, may, but is not obligated to, issue credit support of up to a maximum of \$350.0 for MRTL in furtherance of MRTL's trading business. The credit support will be in the form of guarantees wherein the Company guarantees the payment obligations of MRTL arising from certain transactions or contracts relating to the supply of energy services or weather related derivatives. The Guarantees remain in effect until the earlier of (i) the underlying transactions expire and all obligations are satisfied or (ii) the Guarantees are terminated pursuant to their terms. Upon payment of any obligations under the Guarantees, the Company has subrogation rights against MRTL. Based upon internal risk modeling, the current status of the payment risk on the Guarantees is deemed to be remote.

MUNICH RE AMERICA CORPORATION
Notes to Consolidated Interim Financial Statements
March 31, 2019
(Dollars in millions)
(unaudited)

Litigation

The Company is involved in non-claim litigation incidental to its business principally related to insurance company insolvencies or liquidation proceedings in the ordinary course of business. Also, in the ordinary course of business, the Company is sometimes involved in adversarial proceedings incidental to its insurance and reinsurance business. The amounts at risk in these proceedings are taken into account in setting loss reserves. Based upon its familiarity with or review and analysis of such matters, the Company believes that none of the pending litigation matters will have a material adverse effect on the consolidated financial statements of the Company. However, no assurance can be given as to the ultimate outcome of any such litigation matters.

10. Segment Reporting

Management reviews the Company's financial results focusing on its property and casualty ("P&C") business segments, comprised of its Reinsurance and Specialty Insurance divisions. The underwriting results of the P&C segments are management's key focus in evaluating the underwriting performance of the Company. These results are reviewed on a "gross less specific retrocessions" basis. Specific retrocessions are those underwritten within the business segment and generally designed to reduce the net liability on individual risks. Other retrocessional programs underwritten on a corporate basis and designed to protect the overall surplus of the insurance subsidiaries are not included in the property and casualty underwriting results. These retrocessions, in addition to the underwriting results of health care business, other business segments in run-off, and certain business written on behalf of Munich Re and its affiliated companies, are aggregated to reconcile the P&C segments underwriting results to the consolidated statements of operations. Elements of underwriting results are **bold**.

The Company does not allocate certain items of revenues and expenses, nor are they included in the assessment of the segment results as reviewed by the Company's management. The assets and liabilities of the Company are generally not maintained on a segment or geographical basis. An allocation of such assets and liabilities is considered by the Company to be impracticable.

MUNICH RE AMERICA CORPORATION
Notes to Consolidated Interim Financial Statements
March 31, 2019
(Dollars in millions)
(unaudited)

Three months ended March 31, 2019

	<u>Reinsurance</u>	<u>Specialty Insurance</u>	<u>Total P&C</u>	<u>Total Corporate & Other</u>	<u>Total</u>
<u>Revenues</u>					
Gross premiums written	\$ 944.8	\$ 262.2	\$ 1,207.0	\$ 164.6	\$ 1,371.6
Net premiums written	<u>944.5</u>	<u>187.2</u>	<u>1,131.7</u>	<u>147.8</u>	<u>1,279.5</u>
Premiums earned	869.2	204.9	1,074.1	148.8	1,222.9
Net investment income					83.7
Net realized capital losses					(1.4)
Other income					8.5
Total revenue					<u>1,313.7</u>
<u>Losses and Expenses</u>					
Losses and LAE	512.7	144.1	656.8	61.7	718.5
Underwriting expense	320.2	67.9	388.1	56.3	444.4
Interest expense					6.3
Interest on ceded funds held					3.7
Other expense					5.3
Total losses and expenses					<u>1,178.2</u>
Income before income taxes					<u>135.5</u>
Underwriting gain (loss)	<u>\$ 36.3</u>	<u>\$ (7.1)</u>	<u>\$ 29.2</u>	<u>\$ 30.8</u>	<u>\$ 60.0</u>
Losses and LAE Ratio	59.0 %	70.3 %	61.2 %	N/M	58.8 %
Underwriting Expense Ratio	<u>36.8</u>	<u>33.2</u>	<u>36.1</u>	N/M	<u>36.3</u>
Combined Ratio	<u>95.8 %</u>	<u>103.5 %</u>	<u>97.3 %</u>	N/M	<u>95.1 %</u>

N/M = not meaningful

MUNICH RE AMERICA CORPORATION
Notes to Consolidated Interim Financial Statements
March 31, 2019
(Dollars in millions)
(unaudited)

Three months ended March 31, 2018

	<u>Reinsurance</u>	<u>Specialty Insurance</u>	<u>Total P&C</u>	<u>Total Corporate & Other</u>	<u>Total</u>
<u>Revenues</u>					
Gross premiums written	\$ 1,013.5	\$ 269.3	\$ 1,282.8	\$ 197.6	\$ 1,480.4
Net premiums written	<u>1,013.2</u>	<u>203.3</u>	<u>1,216.5</u>	<u>120.6</u>	<u>1,337.1</u>
Premiums earned	767.1	201.6	968.7	128.2	1,096.9
Net investment income					77.3
Net realized capital losses					(15.0)
Other income					4.1
Total revenue					<u>1,163.3</u>
<u>Losses and Expenses</u>					
Losses and LAE	454.1	152.6	606.7	64.6	671.3
Underwriting expense	269.0	69.2	338.2	44.5	382.7
Interest expense					6.3
Interest on ceded funds held					7.3
Other expense					7.4
Total losses and expenses					<u>1,075.0</u>
Income before income taxes					<u>88.3</u>
Underwriting gain (loss)	\$ <u>44.0</u>	\$ <u>(20.2)</u>	\$ <u>23.8</u>	\$ <u>19.1</u>	\$ <u>42.9</u>
Losses and LAE Ratio	59.2 %	75.7 %	62.6 %	N/M	61.2 %
Underwriting Expense Ratio	<u>35.1</u>	<u>34.3</u>	<u>34.9</u>	N/M	<u>34.9</u>
Combined Ratio	<u>94.3 %</u>	<u>110.0 %</u>	<u>97.5 %</u>	N/M	<u>96.1 %</u>

N/M = not meaningful

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE COMPANY'S RESULTS OF OPERATIONS AND FINANCIAL CONDITION

RESULTS OF OPERATIONS

THREE MONTHS ENDED MARCH 31, 2019, COMPARED WITH THREE MONTHS ENDED MARCH 31, 2018

Underwriting Results and Combined Ratio

A key measure of the financial strength of a reinsurance company is a positive underwriting result, or an underwriting profit. A major goal of a reinsurance company is to produce an underwriting profit, exclusive of investment income. A company's underwriting result is measured by its premiums earned, net of losses and LAE incurred and underwriting expenses. If underwriting is not profitable, investment income must be used to cover underwriting losses.

Combined ratio is also an industry-wide measure of a reinsurance company's profitability. Combined ratio is the sum of the loss ratio and the underwriting expense ratio. The combined ratio is calculated, on a GAAP basis, as the sum of the losses and loss adjustment expenses incurred and underwriting expenses, divided by net premiums earned. These ratios are relative measurements that describe the cost of losses and expenses for every \$100 of net premiums earned. The combined ratio presents the total cost per \$100 of premium production. A combined ratio below 100% demonstrates underwriting profit; a combined ratio above 100% demonstrates underwriting loss.

In addition to reviewing the overall underwriting results and ratios of the Company at a corporate level, or consolidated financial statement level, management focuses on "property and casualty underwriting results" in evaluating the underwriting performance of the Company. The property and casualty ("P&C") underwriting results represent the aggregated results of the P&C business segments on a "gross less specific retrocessions" basis. The underwriting results of business segments in run-off, retrocessional programs designed to protect the overall surplus of Munich Reinsurance America, Inc., health care business, and certain business written on behalf of Munich Re and its affiliated companies are not included in these P&C underwriting results.

The underwriting results and combined ratios for the Company for the three months ended March 31, 2019 and 2018, are as follows:

	<u>2019</u>	<u>2018</u>
	<u>(Dollars in millions)</u>	
Premiums earned	\$ 1,222.9	\$ 1,096.9
Less: Losses and LAE	718.5	671.3
Commission expense	376.0	318.9
Operating expense	68.4	63.8
Underwriting gain (loss)	<u>\$ 60.0</u>	<u>\$ 42.9</u>
Loss ratio	58.8 %	61.2 %
Expense ratio	<u>36.3</u>	<u>34.9</u>
Combined ratio	<u>95.1 %</u>	<u>96.1 %</u>

Financial Statement Results

The Company reported net income to its common stockholder of \$134.8 million for the three months ended March 31, 2019, compared to net income of \$61.5 million for the same period in 2018.

Revenues

Premiums. Gross premiums written for the three months ended March 31, 2019 decreased 7.3% to \$1,371.6 million from \$1,480.4 million for 2018.

Net premiums written by the Company's P&C segments, which exclude corporate retrocessional programs, decreased 7.0% to \$1,131.7 million for the three months ended March 31, 2019, from \$1,216.5 million for the same

period in 2018. The Reinsurance segment experienced a 6.8% decrease in net premiums written to \$944.5 million for the three months ended March 31, 2019, from \$1,013.2 million in the same period in 2018. This decrease is generally attributable to a decrease in the property line of business, partially offset by an increase in the casualty line of business. The Specialty Insurance segment experienced a 7.9% decrease in net premiums written to \$187.2 million for the three months ended March 31, 2019, from \$203.3 million in the same period in 2018. This decrease was primarily the result of a decrease in the casualty line of business. The decrease in premiums written by the P&C segments, partially offset by an increase in business not included in the P&C segments, resulted in a 4.3% decrease in consolidated net premiums written to \$1,279.5 million for the three months ended March 31, 2019, from \$1,337.1 million for the same period in 2018.

The Company's net premiums earned increased 11.5% to \$1,222.9 million for the three months ended March 31, 2019, from \$1,096.9 million for the same period in 2018. The increase in premiums earned is the result of the timing of the earnings of premiums in force during the respective periods.

Investment Income. Net investment income increased 8.3% to \$83.7 million for the three months ended March 31, 2019, from \$77.3 million for the same period in 2018. This increase is primarily due to higher average book yields on fixed income securities, increased income from infrastructure and real estate investments, decreased losses from foreign exchange forward contracts, and income from the sale of equity funds, partially offset by decreased income from treasury inflation-protected securities for the three months ended March 31, 2019, compared to the 2018 period.

The Company realized net capital losses of \$1.4 million on the sale of fixed income securities for the three months ended March 31, 2019, compared to \$14.6 million for the same period in 2018. The 2018 period also included write-downs of \$0.4 million, based on the Company's intent to sell certain fixed income securities as part of the active management of the portfolio.

Expenses

Losses and Loss Adjustment Expenses. Net losses and LAE incurred increased 7.0% to \$718.5 million for the three months ended March 31, 2019, from \$671.3 million for the same period in 2018. This increase is primarily due to increased net premium earned for the three months ended March 31, 2019 compared to 2018.

Underwriting Expense. Underwriting expense, consisting of commission expense plus operating expense, increased 16.1% to \$444.4 million for the three months ended March 31, 2019, from \$382.7 million for the same period in 2018. This increase was due to a 17.9% increase in net commission expense to \$376.0 million for the three months ended March 31, 2019, from \$318.9 million for the same period in 2018. The increase in commission expense is primarily due to increased net premiums earned and increased commission rates on proportional business. Operating expense increased 7.2% to \$68.4 million for the three months ended March 31, 2019, from \$63.8 million for the three months ended March 31, 2018.

Interest Expense on Ceded Funds Held Balances. Interest expense on funds held under reinsurance treaties decreased 49.3% to \$3.7 million for the three months ended March 31, 2019, from \$7.3 million for the same period in 2018. This decrease was primarily attributable to net decreases in the interest on the fund balances for the variable quota share program and another retrocessional quota share program with Munich Re.

FINANCIAL CONDITION

Total consolidated assets increased 1.6% to \$23,847.2 million at March 31, 2019, from \$23,472.5 million at December 31, 2018. Total consolidated liabilities increased slightly to \$20,182.1 million at March 31, 2019, from \$20,180.4 million at December 31, 2018.

The total financial statement value of investments and cash increased 3.0% to \$13,965.2 million at March 31, 2019, from \$13,553.6 million at December 31, 2018, primarily resulting from an increase of \$303.5 million in unrealized market value adjustments and \$122.4 million of net cash flow from operating activities.

At March 31, 2019, the Company recognized a cumulative unrealized gain of \$40.4 million due to the net adjustment to fair value on fixed income investments available for sale, after applicable income tax effects, which was reflected in stockholder's equity as a component of accumulated other comprehensive income. This represents a

net increase to stockholder's equity of \$238.5 million, from the cumulative unrealized loss on debt and equity securities of \$198.1 million recognized at December 31, 2018.

The Company may, from time to time, redeem all or part of its 7.45% Senior Notes due 2026 (the "Notes") pursuant to the terms of the indenture under which the Notes were issued (the "Indenture"), or purchase them in privately negotiated transactions, tender offers or otherwise. The indenture contains certain covenants, including, but not limited to, covenants imposing limitations on liens, and restrictions on mergers and sale of assets. At March 31, 2019, \$333.8 aggregate principal of Notes remain outstanding.

Common stockholder's equity increased 11.3% to \$3,665.1 million at March 31, 2019 from \$3,292.1 million at December 31, 2018. This increase was the result of comprehensive income of \$374.0 million. The statutory surplus of the Company's insurance subsidiaries was \$3,983.4 million at March 31, 2019, compared to \$3,901.4 million at December 31, 2018.

LIQUIDITY AND CAPITAL RESOURCES

The Company is an insurance holding company whose only material investment is in the capital stock of Munich Reinsurance America, Inc. The Company has been dependent on management service agreements, dividends and tax allocation payments, primarily from Munich Reinsurance America, Inc., in order to meet its short- and long-term liquidity requirements, including its debt service obligations. The payment of dividends to the Company by the insurance subsidiaries is subject to limitations imposed by the Delaware Insurance Code. Based on these restrictions, Munich Reinsurance America, Inc. cannot pay dividends in 2019 without the prior approval of the Insurance Department. In March 2019, AAIC and Princeton E&S declared and paid dividends to the Company of \$44.6 million and \$8.8 million, respectively. In the future, the Company believes that its long-term debt service obligations will be provided for by available cash of the Company, dividends and/or tax allocation payments from its subsidiaries, and/or through other forms of financing.

The Company's cash flow from operations may be influenced by a variety of other factors, including cyclical changes in the property and casualty reinsurance market, insurance regulatory initiatives, and changes in general economic conditions. Liquidity requirements are met on a short- and long-term basis by funds provided by operations and from the maturity and the sale of investments. Cash provided by operations primarily consists of premiums collected, investment income, and reinsurance recoverable balances collected, less paid claims, retrocessional payments, underwriting and interest expenses, and income tax payments. Cash flows provided by operations were \$122.4 million and \$67.8 million, respectively, for the three months ending March 31, 2019 and 2018 respectively.

Cash and cash equivalents of \$665.4 million and \$405.6 million at March 31, 2019, and December 31, 2018, respectively, are maintained for liquidity purposes and represented 4.8% and 3.0%, respectively, of total financial statement investments and cash on such dates.

MARKET AND INTEREST RATE RISK

The Company is subject to market risk arising from the potential change in the value of its various financial instruments. These changes may be due to fluctuations in interest and foreign exchange rates, credit spreads, and equity prices. The major components of market risk affecting the Company are interest rate and foreign currency risk.

Interest rate and equity price risk. The Company has both fixed and variable income investments with a value of \$12,546.2 million at March 31, 2019, that are subject to changes in value due to market interest rates. In addition to interest rate and foreign exchange risk, the Company's common equity security portfolio of \$160.3 million at March 31, 2019, is subject to changes in value based on changes in equity prices.

Foreign currency rate risk. Foreign currency rate risk is the potential change in value, income and cash flow arising from adverse changes in foreign currency exchange rates. Although the majority of the Company's remaining international operations are in run-off, the Company generally maintains investments in local currencies to meet its foreign obligations. The Company's primary foreign currency exposures are the Canadian Dollar, Australian Dollar, and the Euro.

Management of market risk. The Company seeks to minimize its foreign exchange rate exposure by matching the currency and duration of its foreign investments with the corresponding loss reserves. Where such a match cannot be achieved, foreign currency forward contracts may be used. At March 31, 2019, the Company had three open foreign currency forward contracts with a notional value of \$162.6 million. The Company may also use other derivative instruments, such as futures, to economically hedge the duration of fixed income assets due to anticipated changes in the interest rate environment. At March 31, 2019, the Company had no open futures positions. Derivatives, depending on the type of instrument, are inherently at risk to changes in interest rates, foreign exchange rates and price movements. The market valuations are also a function of the volume of transactions and the terms of the given agreement.

FORWARD-LOOKING INFORMATION

The Company has disclosed certain forward-looking statements concerning its operations, economic performance and financial condition, including, in particular the likelihood of the Company's success in developing and expanding its business and the risks related thereto. These statements are based upon a number of assumptions and estimates that are inherently subject to significant uncertainties and contingencies, many of which are beyond the control of the Company, and reflect future business decisions that are subject to change. Some of these assumptions inevitably will not materialize, and unanticipated events will occur which will affect the Company's results. Such statements may include, but are not limited to, projections of premium revenue, investment income, other revenue, losses, expenses, earnings, cash flows, plans for future operations, common stockholder's equity, investments, capital plans, dividends, plans relating to products or services of Munich Re America, Inc., estimates concerning the effects of litigation or other disputes, adverse state or federal legislation or regulation, adverse publicity or news coverage or changes in general economic factors as well as the assumptions for any of the foregoing and are generally expressed with words, such as "believes," "estimates," "expects," "anticipates," "plans," "projects," "forecasts," "goals," "could have," "may have" and similar expressions.