Munich Reinsurance Company
Annual Report 2005

Münchener Rück
Munich Re Group

Munich Reinsurance Company

		2005	2004	2003
Gross premiums written	€m	**19,167**	19,243	21,748
Investments	€m	**78,326**	72,794	70,893
Net underwriting provisions	€m	**63,653**	55,102	52,099
Shareholders' equity	€m	**10,417**	11,866	11,375
Profit/loss for the year	€m	**–992**	777	511
Dividend	€m	**707**	457	286
Dividend per share	€	**3.10**	2.00	1.25
Share price at 31 December	€	**114.38**	90.45	96.12
Market capitalisation at 31 December	€m	**26,259**	20,766	22,067

Source: Datastream

Paving the way for opportunities: Five articles in this year's Munich Re Group Annual Report show what opportunities there are in risk and how Munich Re turns them into value – for every risk has two sides. You can read the articles at www.munichre.com.

Munich Reinsurance Company Report on the 126th year of business 1 January to 31 December 2005

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

Report of the Supervisory Board

Report
of the Supervisory Bord

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. We worked closely with the Board of Management, advising it on the management of the Company and constantly monitoring its conduct of the business, whilst it consulted us directly and without delay on all decisions of fundamental importance. The Board of Management satisfied its reporting obligations towards the Supervisory Board by briefing us regularly and in detail on all important business transactions. We discussed these written and oral reports intensively and openly with members of the Board of Management at our meetings. In order to prepare for important topics that were to be dealt with at the meetings, the shareholder representatives and the employee representatives met the Chairman of the Board of Management separately beforehand. In addition, I remained in contact with the Chairman of the Board of Management throughout the year under review regarding Munich Re's main business developments. Inspection measures in accordance with Section 111 para. 2 sentence 1 of the German Stock Companies Act were not required in 2005.

Focal points of the meetings of the full Supervisory Board

The full Supervisory Board met four times, with virtually complete attendances. Taking part as guests at two meetings were representatives of the German Federal Financial Supervisory Authority (BaFin), which for some years now has been making use of the powers granted to it in Section 83 of the German Insurance Control Act to routinely attend the Supervisory Board meetings of insurance and reinsurance companies. The Board of Management reported in depth at the meetings about the quarterly financial statements and the outlook for the 2005 results. We regularly discussed in detail the development of results in the Munich Re Group and in the business fields of primary insurance and reinsurance, also making comparisons between the Munich Re Group and its competitors. The Board of Management reported to us on the business situation of the major subsidiaries on an ongoing basis, and we took a critical interest in the development of American Re in particular. We devoted special attention in the year under review to the strategic alignment of the Group, dealing with this topic thoroughly on several occasions, as well as with the planning for 2006 and 2007. The Board of Management kept us informed about the Company's risk situation and profitability. We were given a presentation of the various initiatives in integrated risk management, which we then discussed intensively on the full Supervisory Board.
At the suggestion of the Board of Management, we considered and approved changes in the Board of Management's rules of procedure. The newly established Board of Management committees for Group and reinsurance operations will provide for more efficient management of the Group as a whole, with its business fields of primary insurance and reinsurance. We reviewed and further enhanced the process of succession planning for the Board of Man-

agement and appointment of new members. Other focal points dealt with at the meetings were the Board of Management's personnel report and the restructuring of its remuneration. The Supervisory Board kept a close eye on the state of the investigations being conducted by New York State Attorney General Spitzer in the USA and other authorities regarding broker transactions and finite reinsurance contracts, and on their possible consequences for Munich Re. We also obtained regular information on the status of Gloria, Munich Re's major IT project.
The Board of Management informed us, also between the meetings, about various current business transactions, including the effects of HypoVereinsbank's special write-down, the proposed merger between HypoVereinsbank and UniCredit, the reserve strengthening at American Re, the effects of Hurricanes Katrina, Rita and Wilma, and the sale of the Karlsruher Lebensversicherung AG, as well as about the scope and the impact of the natural catastrophe figures for 2005.

Work of the committees

The four committees of the Supervisory Board (Standing Committee, Personnel Committee, Audit Committee and Conference Committee) are each composed of shareholder and employee representatives. The membership of the Supervisory Board committees is shown in the overview on page 55.
Apart from preparing the Supervisory Board meetings, the Standing Committee devoted itself at its three meetings mainly to topics of corporate governance, share transfers and UniCredit's offer to HypoVereinsbank shareholders.
The Personnel Committee met four times in the year under review. It concerned itself with the Board of Management's remuneration, especially with the reorganisation of the compensation structure, with contract adjustments, and with the seats accepted by members of the Board of Management on external supervisory, advisory and similar boards. Besides this, it prepared the forthcoming appointments to the Board of Management and agreed on personal objectives with the Board of Management members.
The Audit Committee held a total of five meetings in 2005. It closely discussed the annual financial statements for the Company and the Group in the presence of the external auditor and carefully examined the quarterly financial statements. The Audit Committee welcomed the fact that in the year under review the Board of Management set up a Disclosure Committee, which was already able to participate in the annual accounting operations for 2004. The Audit Committee made preparations for the appointment of the external auditor, which has to be decided on by the full Supervisory Board, obtained the auditor's declaration of independence, commissioned the auditor, fixed focal points for the audit work and acquired from the auditor an overview of the type and scope of its non-audit-related services performed for Munich Re. Also at an extraordinary meeting, the Audit Committee considered American Re-Insurance Company's loss reserves and the consequences of their substantial increase. Beyond this, it discussed the Group's risk situation and the development of embedded values in life reinsurance business and in life and health business in 2004. The Audit Committee also obtained information on the ongoing investigations in the USA and other countries regarding broker business and non-traditional reinsurance and received the Internal Auditing Division's annual report for 2004.
The Conference Committee as per Section 27 para. 3 of the German Co-Determination Act did not need to be convened.
Regular and extensive information about the work of the committees was given at the meetings of the full Supervisory Board.

Annual 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 consolidated financial statements as at 31 December 2005, and the management reports for the Company and the Group. All members of the Supervisory Board received the auditor's reports promptly. The Audit Committee examined in advance the Company and Group financial statements and the management reports, and discussed them in detail with the auditor at the Audit Committee meeting on 12 March 2006, which also considered the auditor's reports, in order to prepare for the examination by the full Supervisory Board. The Audit Committee informed the full Supervisory Board at the balance sheet meeting on 13 March 2006 about its examinations and discussions with the auditor.

After the Audit Committee, the Supervisory Board also checked the Company financial statements, the Group financial statements, the Company management report, the Group management report 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 and after its own concluding examination also has no objections to the Company and Group financial statements. Consequently, on the basis of the Audit Committee's prior examination and the result of its own examination, the Supervisory Board approved the Company and Group financial statements at the balance sheet meeting on 13 March 2006. We unconditionally support the Board of Management's proposal for the appropriation of the net retained profits.

Corporate governance and declaration of compliance

Munich Re's Supervisory Board is fully committed to good corporate governance. At the 2005 Annual General Meeting, it therefore proposed an amendment to the Articles of Association to restructure the Supervisory Board's remuneration: the fixed remuneration has been increased so that overall remuneration is now less dependent on Company performance; the introduction of a result-oriented instead of dividend-oriented variable remuneration component ensures that the calculation basis is not directly influenced by the Supervisory Board. In the Board of Management's absence, we once again examined the efficiency of the Supervisory Board's work and monitored the implementation of the measures proposed.
On 8 November 2005, the Board of Management and the Supervisory Board published a declaration of compliance in accordance with Section 161 of the German Stock Companies Act, which is posted on the Company's website.

Composition of the Board of Management

With effect from 1 October 2005, we appointed Dr. Thomas Blunck to the Board of Management. Dr. Blunk, who has been with Munich Re since 1999, was latterly Divisional Unit Head in the Special and Financial Risks Division, which he has now taken charge of on the Board of Management, along with the Information Technology Division.
Also with effect from 1 October 2005, the Supervisory Board appointed Dr. Wolfgang Strassl a member of the Board of Management and, as from 1 January 2006, Board member in charge of industrial relations. Dr. Strassl has been with Munich Re since 1988 and was most recently Divisional Unit Head in the Life and Health Division, for which he is now responsible on the Board of Management, in addition to the Human Resources Division.
As at 31 December 2005, Mr. Stefan Heyd and Dr. Detlef Schneidawind retired as members of the Board of Management. We thank both gentlemen for their many years of successful work and their great personal dedication in responsible positions.
On behalf of the Supervisory Board, I would like to take this opportunity to thank the members of the Board of Management and all the staff most sincerely for their untiring commitment which enabled Munich Re, in its anniversary year, to post a new record result for the Group.

Munich, 13 March 2006

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. It is the parent company of the Munich Re Group, whose business encompasses reinsurance, primary insurance and asset management. There were no significant changes in the Company's international organisation in the business year 2005.

In 2005, Munich Reinsurance Company implemented a uniform Group-wide planning and controlling process together with the ERGO Insurance Group, its main subsidiary in primary insurance, and developed a Group directive governing the distribution of responsibilities and competencies between Group management and ERGO for key decisions in such areas as strategy, investments, risk management and accounting. There is now "unified control" within the meaning of the German Stock Companies Act. To maintain clearly defined strategic management of the equal-ranking business segments of primary insurance and reinsurance and to provide for a clear assignment of responsibility, the structure of Munich Re's Board of Management was altered with effect from 1 January 2006. Besides the Parent Board of Management, which will continue to represent Munich Reinsurance Company externally, the Board of Management has divided its responsibilities between two new Board committees: the Group Committee and the Reinsurance Committee.

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

Our reinsurance business is organised in seven operative divisions, six of which service our property-casualty business and special lines, and one of which deals with life and health reinsurance. Responsibility for the respective client accounts always lies in one pair of hands. The operative divisions are also responsible for our business units abroad, including our subsidiaries.

Europe 1

Munich, Athens, Moscow, Warsaw

Europe 2 and Latin America

London, Madrid, Milan, Paris

Bogotá, Buenos Aires, Caracas, Mexico City, Santiago de Chile, 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
Munich-American RiskPartners

Corporate Underwriting/Global Clients

London

Subsidiaries/Branches:
Munich Re Underwriting

Asia, Australasia and Africa

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

Accra, Cape Town, Johannesburg, Nairobi, Réduit

Auckland, Brisbane, Melbourne, Perth, Sydney

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, Hartford, Kansas City, Los Angeles, New York, Philadelphia, Princeton, San Francisco, Seattle, Montreal, Toronto, Vancouver

Subsidiaries/Branches:
Munich Reinsurance Company of Canada
American Re-Insurance Company
Temple Insurance Company

Life and Health

Atlanta, Brisbane, Chicago, London, Melbourne, Perth, Sydney, Toronto, Waltham

Subsidiaries/Branches:
Munich Reinsurance Company of Australasia
Munich American Reassurance Company
Munich Reinsurance Company Canada Branch (Life)
Munich Reinsurance Company UK Life Branch

The Life and Health Division 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 handle non-life business from our clients in Germany, Switzerland and Austria, Eastern Europe, Greece, and Turkey.
Europe 2 and Latin America services clients from northern, western and southern Europe, as well as from Latin America.
Asia, Australasia, Africa conducts property-casualty business with cedants in these three continents and the Pacific Islands.
The North America Division is responsible for our subsidiary American Re-Insurance Company and for Munich Reinsurance Company of Canada.
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 the important functions combined in our Group Corporate Centre: its staff clarify fundamental, cross-divisional issues of underwriting policy, are responsible for quality assurance, integrate actuarial methods in our business processes, and set standards for claims management. Further information on guidelines for underwriting and rating can be found on page 12.
Special and Financial Risks (SFR) is responsible for 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. Via Munich American Capital Markets (MACM), we structure and offer the transfer of insurance risks to the capital markets. In addition, SFR also attends to our own reinsurance (retrocession).
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 €153bn under management at the end of 2005 for the Group's insurance and reinsurance companies, €58bn from Munich Reinsurance Company. MEAG is responsible for direct investment in securities and real estate, and for the assets held in segregated managed funds (special funds). Beyond this, it offers its expertise and know-how both to institutional investors and to private clients.

Important tools of corporate management

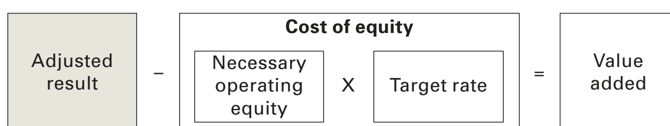
Munich Reinsurance Company's value-based management philosophy

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.
Increasing corporate value is therefore the key factor in our business decisions. This means optimising capital deployment and risk management.
Munich Re's approach to value-based management offers a number of advantages:

- It enables us to assess business activities not only according to their earnings potential but also relative to the extent of the risks assumed, which is material for the question of added value. Only the risk-return relationship reveals how beneficial an activity is from the shareholder's point of view.
- With clearly defined performance indicators, we ensure the necessary comparability of value-adding measures and initiatives. Fields of business that add value can be more easily identified and the use of resources optimised accordingly.
- Responsibilities are clearly assigned and levers for adding value made transparent, enabling management and staff to contribute more effectively to increasing corporate value.
- Strategic and operative planning are closely linked. All initiatives are ultimately geared to the overriding financial objective of enhancing corporate value.
- The consistent use of value-based management tools helps Munich Re respond to the tougher competition in the global capital markets and the increasing demand by institutional investors for more transparency and comparability.

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

In non-life business, we employ the following simple formula for measuring value creation and for managing and monitoring our business activities:



The adjusted result serves as the basis for determining value added. It consists of the operating result, 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 and the recognition of claims expenses at present value.

We compare this adjusted result with the requisite cost of equity. The basis for determining the cost of equity is the necessary operating equity, which is basically derived from the risk-based capital according to our internal model. If a business unit holds equity capital in excess of the risk-based capital in order to comply with market, rating or supervisory requirements, a return needs to be earned on this capital as well.

Any investment of capital in a company must – from the investor's point of view – achieve at least the return of an alternative risk-commensurate investment (opportunity costs). However, in order to significantly increase its corporate value, Munich Re aims to earn a return on necessary operating equity (return target) that is markedly higher than the opportunity costs.

Consequently, value is only added if the adjusted result exceeds the cost of equity. Given the generally short-term nature of non-life business, this procedure focuses on measuring single-period performance. In assessing the profitability of our underwriting business, we mainly use indicators from the income statement.

The products of life reinsurance are characterised by their long-term nature and the distribution of results over the duration of the policies. To account for this multi-periodic characteristic, we use key performance indicators for this business that relate to the respective portfolio value – the embedded value. By setting a minimum return requirement, we aim through value-based management to ensure that here, too, an adequate return is earned on the capital employed and appropriate value is added.

Our steering of Munich Re's investments is strongly geared to 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 the capital – best reflects the characteristics of our liabilities towards clients. Further information on asset-liability management is provided on page 22. 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 "scorecards", 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 integration of the financial and non-financial objectives into Board and senior-executive remuneration incentive systems supports the clear orientation towards value creation.

Value-based management is a holistic management system with which managers at all levels of the Group can steer their units in such a way that lasting value is created which also meets the expectations of external investors.

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 return target to risk-adjusted performance indicators, which are explained in more detail in the following section.

What we aim to achieve

A look back at 2005

For Munich Reinsurance Company, the past year was heavily influenced by the burdens from our US subsidiary. As a consequence of reserve adjustments at Amercian Re-Insurance Company for the underwriting years 1997 to mid-2002, a capital strengthening of €2.2bn was necessary there, which we had to write off at Munich Reinsurance Company in the year under review.

In addition, we assumed burdens of €1.1bn from taking over American-Re-Insurance Company's discounted reserves for workers' compensation business, which have to be shown undiscounted under German accounting rules.

Without these exceptional burdens, the result for the year would have been a satisfying €2,295m, despite the exceptionally high costs of €2,492m for natural catastrophe losses in 2005.

The investment result made a very positive contribution of €2,555m (2,886m), representing a return on investment (including deposits retained) of 3.4% (4.0%).

Adjusted to eliminate the burdens from our US subsidiary, the return on investment for the business year 2005 amounts to 6.3%.

This return on investment is calculated as the ratio between the investment result and the average carrying amount of the investment portfolio in the business year 2005.

A much-heeded performance indicator in non-life insurance is the combined ratio. This is the percentage of total expenses for claims incurred, expenses for premium refunds, change in the provision for future policy benefits, interest on underwriting provisions (net in each case) and operating expenses (net) to earned premiums (net). 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. Not considered are the "other underwriting expenses" such as fire brigade tax, "other underwriting income" and "other net provisions". Also disregarded in the combined ratio are changes from the claims equalisation provisions.

The combined ratio in reinsurance includes the accident and health segment as well as property-casualty business. In 2005, the reinsurance combined ratio amounts to 117.0% (96.4%), a very high figure, largely due to the hurricane losses (19.7%) and the one-off effect from the assumption of the undiscounted reserves for workers' compensation business assumed from American Re-Insurance Company (8.7%).

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 – particularly true in the case of natural catastrophes, which may occur rarely, but are often very severe when they do.
- Another 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 prime factor we consider is economic value added, which cannot be properly reflected by the combined ratio. We pursue this target internally through our value-based management.

Further development of the return target for 2006

The return target we have used to date – the return on average IFRS equity (RoE) – is an important but insufficient indicator of an insurance company's added value. The reasons are:

- Some of the underlying parameters are influenced by accounting rules that do not adequately reflect economic realities. For example, a large portion of an insurance company's assets are classified as "investments available for sale" and measured at market value, whereas the liabilities in the balance sheet barely react to market fluctuations. This means that rising or falling capital

market prices usually have a direct impact on IFRS equity, thus indirectly increasing or decreasing an ROE result target in a way that makes little sense economically. In particular, interest-rate-induced increases in the prices of fixed-interest securities are not accompanied by any sustained additional earnings opportunities, since the prices of the securities systematically return to the face value on maturity.

– Furthermore, ROE does not reflect the risk assumed in a given business activity. All other things being equal, a high risk usually entails the expectation of a higher profit, which is bought at a cost of additional volatility. An ROE target that does not include any measure of risk might encourage management to focus too much on the earnings side and disregard the risk side. Hence the risk-return relationship, which is decisive for increasing corporate value, is not considered.

An insurance company – and especially a reinsurance company – whose exposure to risks is typically high, should consequently choose a target which takes into account the degree of risk assumed and minimises distortions from accounting. In accordance with this principle, risk – measured by risk-based capital – plays a central role in our internal value-based management.

Taking risk assumed into account in our return target

In summer 2005, for the first time, Munich Re officially presented its internal risk model in detail, including the Group-wide, risk-based capital position derived from the model, thus considerably enhancing transparency. Our risk-based capital was divulged for both the reinsurance and primary insurance segments, and according to the risk categories of underwriting, market and credit risk. The risk-based capital in question quantifies the risk of the individual units and enables us to make comparisons between non-life, life and investments and between reinsurance and primary insurance.

The next step – after publishing our risk-based capital – is to integrate the risk perspective into our external Group target. This move away from a return based on average IFRS equity to a risk-adjusted return target (return on risk-adjusted capital – RORAC) results in a closer convergence of our internal value-based management and the external communication of our targets.

The most important advantages of the risk-adjusted return target – particularly in comparison with our target to date – are the risk-based capital's independence from the above-mentioned IFRS effects on equity, and the disclosure of the annual result per unit of risk-based capital (important for measuring added value).

The calculation of the target is based on published figures that are regularly updated and are transparent to external audiences. With the additional information provided on the assumptions for important key indicators, shareholders will find it easier to assess the likelihood of the target being reached.

This will enable our investors to better judge Munich Re's business performance and economic value added in future.

What is behind RORAC?

RORAC is defined as follows:

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

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 necessary operating equity is the additional available equity, which is also necessary for rating and solvency purposes, as well as for profitable growth.

The additional available equity in the system presented here 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.

How high should the RORAC target be set?

For determining the concrete RORAC target figure, we start with our sustainable result expectation per unit of risk. In doing so, we use among other things capital market prices for comparable risks, bearing in mind that no precise

methodology exists. Thus, in setting our target, we consider it important to make the level ambitious but also realistic.
After weighing up many factors, we have decided to aim for a RORAC of 15% for the business year 2006.
On the basis of our current risk positioning and capitalisation, this corresponds to a consolidated profit of between €2.6bn and €2.8bn.

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 less than 97% in property-casualty and health reinsurance, which includes an amount equivalent to around 5.0% of premiums as projected claims expenditure for natural catastrophes that cost 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 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 health primary insurance, we will use key indicators based on European Embedded Value (EEV), parallel to the new RORAC perspective. Embedded value is a form of valuation for long-term portfolios whose performance cannot be reasonably measured on the basis of a single year. Specifically, 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. A key performance indicator in this case are EEV earnings. We aim to achieve EEV earnings of between 8.0% and 9.0% both in primary insurance and in reinsurance, in relation to the value of the overall business in force at the beginning of the year in each case. The life and health insurance business, managed and measured on an embedded-value basis, will also contribute to the IFRS consolidated profit and thus to reaching the RORAC target, even though IFRS consolidated results follow the narrower individual business-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. However, the development of our underwriting result under German Commercial Code accounting depends significantly on changes in claims equalisation provisions. In the case of another strong underwriting result, we take it that we will have to make markedly higher allocations again to claims equalisation provisions than in the business year 2005.
As far as the investment result is concerned, we expect a return of at least 4%, given moderate capital market development.
Overall, it should be possible for Munich Reinsurance Company to strengthen its revenue reserves again with its future profit for the year.

Binding standards for underwriting and rating

In reinsurance, CUGC is not only responsible for business with our global clients but also develops guidelines for the underwriting of our reinsurance business. Corporate Underwriting defines standards for the underwriting, pricing and claims management of the reinsurance group. In this way, we ensure that the quality of our business is constantly high throughout our reinsurance operations and that we respond swiftly to changes and new developments. Since Corporate Underwriting is closely linked to our operative business, needs-oriented products and services for our clients can be generated there as well.
For terrorism risks, we basically strive for exclusions or liability limits in our treaties. In particular, we do not provide coverage of terrorism in the case of risks and perils for which insurance protection can be obtained from a combined private-state solution or pools. In those cases where we offer cover against a separate premium, we do so subject to very restrictive underwriting criteria that ensure the liability accepted is transparent, strictly limited and thus controllable. For epidemics, we have exclusions or restrictive treaty conditions in place for particularly exposed regions. For major industrial risks, we have largely been able to maintain the conditions and liability limits we optimised in prior years. These measures consequently continue to make a sustained positive contribution to the risk profile of our portfolio.

Parameters

General parameters

Our business environment is marked to an increasing extent by growing complexity and the upward trend in natural catastrophes. But 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. Besides this, concentrations of values are increasing strongly, while economic units and regions are becoming more dependent on each other, giving rise to new risk potentials and accumulation hazards. These phenomena pose demanding challenges for the insurance industry. It is therefore imperative to carry on refining risk models and to swiftly incorporate new findings.

Economic parameters

The general economic parameters for the insurance industry became slightly less favourable in 2005. Despite higher oil prices, the global economy continued to expand, albeit with somewhat lower growth rates than in 2004. Share prices rose appreciably in Europe and Japan, compared with only a moderate upward trend in the USA. Long-term yields on the bond markets fell in the first half of the year. But after a further interim low in autumn they recovered, with the interest rate level in the USA – in contrast to Germany – higher at the end of the year than at the beginning.

Owing to higher energy prices, inflation rates climbed significantly throughout the world. In this environment, some central banks increased their interest rates. The US Federal Reserve raised its reference interest rate in eight steps from 2.25% at the start of the year to 4.25%. At the end of the year, the European Central Bank followed suit and increased its reference interest rate by 0.25 percentage points to 2.25%. Of the major central banks, only the Bank of England reduced its key interest rates.

The USA and China remain the engines of the global economy, their momentum driven by private consumption and corporate investment.

Economic development in the eurozone was somewhat more subdued than in 2004, albeit with marked regional differences. Growth in Spain and Ireland, for instance, was above average, whereas in Italy it remained below the average level. Especially the first half-year was characterised by weak domestic demand, mainly due to persistently low consumption. The high oil price was a detrimental factor, aggravated by the depreciation of the euro, and the main growth stimulus came from exports. For 2005 as a whole, real growth stood at 1.3%. In other words, compared with the USA, momentum in the eurozone was again weak.

At 0.9%, real economic growth in Germany in 2005 was considerably down on the previous year, which had had an above-average number of working days. Adjusted to eliminate this factor, real growth in 2005 was in fact 1.1%, as high as in 2004. Exports were again the mainstay of economic development, with corporate investment also increasing in the second half of the year. But domestic consumption remained very disappointing, curbing the growth rate of the economy as a whole. The persistently high unemployment rate (11.1% at year-end) and uncertainties about future reforms had a negative impact on consumer confidence.

In the UK, economic momentum slowed significantly compared with the previous year. Not least owing to weak domestic demand, the growth rate achieved in real terms fell to only 1.8%.

Growth in the emerging markets generally flattened slightly in 2005, a development even oil-exporting countries like Russia, Venezuela and Mexico were not spared. With a real growth rate of 9.9%, however, expansion in China continued almost unabated. India's economy also grew strongly, whereas economic momentum in the other Asian emerging markets slackened in line with the global economy.

With only a small increase in domestic demand and weakening exports to the EU, growth in the countries of central and eastern Europe also decreased.

Growth rates in Latin America slowed as well. In Brazil and Mexico, this was partly owing to interest-rate increases by the Brazilian and Mexican central banks.

By contrast, the mood on the capital markets was more optimistic. Prices on the international stock markets showed a largely upward trend in 2005. The EURO STOXX 50, for instance, improved by 21.3% and the DAX by 27.1%. The Japanese stock market performed particularly well, achieving an increase of 40.2%. Price gains in the USA were somewhat more modest, even though prices rose in the last few months of the year. By the end of 2005, the S&P 500 was up 3.2%.

Starting from a level of 3.7% at the beginning of the year, yields on ten-year German government bonds initially fell owing to an expected weakening of economic growth, recording a low of 3.0% in September. However, budding concerns about inflation and a somewhat more optimistic estimate of the economy caused them to turn upwards again to 3.3% by the end of the year. Having stood at 4.2% at the start of 2005, yields on ten-year US government bonds reached their low (3.9%) in June and rose to 4.4% at year-end.

The US dollar gained considerable ground against the euro and the Japanese yen in 2005. The euro closed at US$/€ 1.18 – a year-on-year loss in value of around 13.2%. The closing exchange rate for the yen stood at ¥/US$ 118.03, representing depreciation against the dollar of around 13.2%.

Writing business at risk-adequate prices was again the central issue on the insurance markets in 2005. Prices generally remained at a risk-adequate level in the renewals in reinsurance at the beginning of the year, at 1 April and at 1 July 2005. Virtually all market players gave priority to selective and result-oriented underwriting.

Whilst some price erosion was initially observable in property insurance, the high losses in the third quarter again underlined the need for appropriate prices, terms and conditions.

Hurricane Katrina caused the highest insured loss in the history of insurance. Quite a few market players and also risk modelling firms had to change their assessments of the frequency and size of loss potentials. In the case of some companies, the losses amount to more than half their equity capital. The windstorms of the last few years have also shown that it is no longer capital but knowledge that is the decisive factor required in reinsurance. Major reinsurers with extensive internal resources for risk modelling and own risk capital allocation are clearly at an advantage here compared with smaller companies that, in many cases, only use vendor models. All in all, the re-evaluation of the risk and loss estimations has stabilised the pricing environment, especially in property insurance.

Reinsurers' capital base continues to be good. Presentable underwriting results improved capitalisation in the first half of the year, until the heavy losses in the third quarter subjected it to a substantial burden. Altogether, however, it appears that the effects on the capitalisation of the insurance industry have been limited. On the one hand, the industry's other earnings are good; on the other hand, capital increases by some of the reinsurers particularly affected and the formation of new companies, mainly in Bermuda, have provided additional capacity. With the announced acquisition of GE Insurance Solutions by Swiss Re, moreover, the global reinsurance market's number 2 and number 5 in terms of premium are combining forces.

Demographic changes and increasing demand for private provision had a positive impact on the development of life reinsurance. Especially the ageing of society worldwide and the resulting pressure on social security systems are causing the market for private life insurance to grow more strongly than the overall economy. Besides this, there is a global and long-term trend towards liberalising state-run healthcare systems, whose financial situation is tight in a number of countries. Health insurance was again able to benefit from this.

The still relatively robust global economy was helpful for most insurance markets.

According to initial estimates, growth in premium income in property-casualty insurance cooled noticeably in the USA, the main causes being a slight decline in economic growth and cyclical aspects. Nevertheless, until the hurricane losses occurred, the insurers' technical results and profitability developed positively. The improved resilience and mechanisms of global reinsurance helped the industry to successfully cope with the record hurricane losses.

In line with the weak economic development in Germany, the nominal increase in gross premiums written by the German insurance industry in 2005 fell to just over 2.0% (3.0%) according to preliminary estimates, thus lagging somewhat behind nominal growth in the economy as a whole. Premiums in private health insurance climbed markedly (projected 3.7%). Nevertheless, this increase was lower than in the previous year, particularly because of uncertainties about future healthcare reforms. Life insurance recorded premium growth estimated at 6%.

The German Retirement Income Act led to a boom in life insurance at the end of 2004 in anticipation of the change in the law. Premium income in property-casualty insurance fell marginally by around 0.5%, essentially owing to the already high market penetration and increasing price competition.

Initial estimates indicate that premium volume in life insurance grew by a strong 14% in France. Based on the figures for the first three quarters, health and accident insurance also recorded solid growth, whereas the increase in premium income in property-casualty business is likely to be only very moderate overall. As preliminary estimates suggest, the Spanish life insurance market grew by 8.2%, with non-life insurance expanding at a rate of 7.3%. Growth in health insurance was above average, at 9.4%. In Switzerland, non-life premium income expanded at an estimated 2.7%. The increase in single life insurance was significantly lower, at about 1.3%, whereas group life business (occupational retirement provision) showed an estimated decline of 8.4% compared with the previous year. Premium volume in Poland's life insurance market recorded very marked growth of 19.1% in the first three quarters, while the rise in non-life insurance was more modest at 4.1%.
The Japanese insurance industry profited from a further improvement in its domestic capital markets, which should be particularly beneficial to life insurers.
Premium again grew most strongly in the emerging markets, where above-average macroeconomic growth was recorded and the insurance sector was gradually expanded further, reflected in increasing market penetration. In China, for instance, premium volume in life business showed a rise of 14.5% and the increase in non-life amounted to 12.8%. Premium growth in the Indian market remained healthy as well, with non-life premium rising by 15.4% in the first three quarters of the fiscal year 2005/2006.

Legal parameters

The regulatory environment for German reinsurers is in a state of flux. 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.

At the initiative of the EU Commission, work has been going on in Europe for some time under the rubric of "Solvency II" to restructure insurance supervisory law as a whole. One of the core ideas is to consider individual risk exposure as far as possible in future (risk-based approach). Internal company risk models will play an important part in this, provided they meet certain quality criteria. The EU Commission plans to submit a draft Solvency II directive by mid-2007.
The 2004 amendment to the German Insurance Control Act (VAG), which entered into force on 21 December 2004, changes the rules governing direct supervision of reinsurance companies. Its main component is the introduction of statutory solvency requirements. They stipulate that in future a specified minimum capitalisation will be obligatory for reinsurance companies as well. Munich Re already meets these statutory solvency requirements. We therefore do not need to avail ourselves of the transitional period granted by the law, which allows the requirements to be complied with gradually by 1 March 2007. Further information on solvency can be found on page 24.
As far as investments are concerned, it remains the case that reinsurers are merely subject to the general investment principles of security, profitability, liquidity, mix and spread.
Since December 2005, the new EU reinsurance directive has applied. This makes supervision more efficient by stipulating that the supervisory authority of the reinsurer's home country is responsible for all questions relating to financial supervision. For Munich Re's European branches, this will be the German Federal Financial Supervisory Authority (BaFin) and not, as previously, the supervisory authority in the country where the branch in question is located. The member states have to implement the EU reinsurance directive by the end of 2007 (or by the end of 2008 for certain rules).

Overview and key figures

In 2005, Munich Reinsurance Company recorded gross premiums totalling €19.2bn, €76m less than in 2004. Without the influence of exchange rates, which had the effect of raising premium income by €184m, premium would have declined by 1.3%.
While premium volume in life reinsurance went up by €67m, premium income in non-life decreased again by €143m, essentially due to our very selective underwriting policy geared consistently to profitability. Premium reduced especially in liability, motor and fire business, mainly due to the termination of large-volume business. Some 78% (76%) of our premium income came from business with non-German clients.
Our underwriting result before claims equalisation provisions showed a loss of €1,958m in 2005, whereas in the previous year we had recorded a profit of €622m. The result in the year under review was impacted by exceptional burdens. Firstly, we had to bear €1,097m in costs for assuming the discounted claims reserves for workers' compensation business of our US subsidiary American Re-Insurance Company, which had to be posted undiscounted under German accounting regulations. Secondly, we were hit by a series of unusually strong Atlantic hurricanes in the second half of the year. The loss expenditure for Hurricane Katrina was particularly high, accounting for a net burden of €1,541m before tax. The combined ratio, which reflects the relation of claims and costs to net premiums earned, was 117.0% (96.4%). Excluding claims burdens from natural catastrophes, it amounted to 97.3% (91.2%).
Claims equalisation provisions were reduced by €252m in the year under review, compared with an increase of €1,129m in the previous year. After withdrawals from the claims equalisation provisions, our underwriting result showed a loss of €1,706m (507m).

Major losses over €5m (net)

All figures in €m	2005	2004	2003	2002	2001
Major losses total	3,092	1,164	921	1,666	2,593
Thereof natural catastrophes	2,492	675	245	527	130

Our investment result totalled €2,555m (2,886m), of which €1,164m (999m) was incorporated in the underwriting result as interest on underwriting provisions in compliance with accounting regulations.
Realised capital gains had a positive impact on the investment result in the business year 2005. We cut back our investments in German financial stocks by selling shares in Allianz and Commerzbank and also through the Hypo-Vereinsbank/UniCredit share exchange. We sold our stake in Karlsruher Lebensversicherung AG for strategic reasons, and also disposed of our indirectly held stake in MAN. However, the capital gains we realised were not high enough for us to achieve an increase in our overall investment result compared with the previous year, the main reason being that we had to make write-downs totalling US$ 2.7bn (€2.2bn) in the business year for the reserve strengthening and subsequent capital increase at American Re-Insurance Company (see page 20).
Munich Reinsurance Company's return on investment (including deposits retained on assumed reinsurance) stood at 3.4% (4.0%) as at 31 December 2005.
The following table shows Munich Reinsurance Company's result over the last five business years:

All figures in €m	2005	2004	2003	2002	2001
Underwriting result	–1,706	–507	–1,747	–2,529	–2,520
Investment result without interest on underwriting provisions	1,391	1,887	2,614	5,754	3,111
Other result	–278	–505	–343	–253	–70
Taxes	–399	–98	–13	–366	–80
Profit/loss for the year	–992	777	511	2,606	441
Net retained profits	712	459	287	1,303	221

In the business year 2005, we posted a loss for the year of €992m. After a withdrawal of €1,702m from the revenue reserves, our net retained profits totalled €712m. This is earmarked for the payment of an increased dividend of €3.10 per share.
No events have occurred since the balance sheet date which require separate disclosure.

Classes of business

In life reinsurance, premium income slightly surpassed the previous year's level, even though a large life reinsurance treaty in Germany is being gradually reduced as planned. The bulk of premium derived 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. In addition, the widespread and ongoing reduction of state benefits provided impulses for disability covers. The favourable development of the operating result reflects our rigorous profit-oriented strategy. For 2006, we expect premium income and result to remain stable, based on the continuing trend towards increased private provision and income protection and our strong position in key markets.
Health reinsurance showed a higher premium volume than in the previous year, which had been influenced by countervailing trends. Growth was due to a quota share agreement with our US subsidiary American Re-Insurance Company, which had been terminated as at 30 June 2004 but was renegotiated as at 1 January 2005. By contrast, our premium volume declined in the Netherlands, where we refrained, as planned, from renewing a multi-year treaty with a key account. A large-volume treaty in the UK also recorded a fall in premium income. We were not able to match the previous year's positive result. For 2006, we expect premium volume to fall owing to the lower intra-Group retrocessions of our subsidiary American Re-Insurance Company, but the result should improve.
In liability reinsurance, we recorded a distinct reduction in premium income, essentially because we terminated a large-volume treaty with a UK cedant. There was also a substantial shift in premium from liability reinsurance to accident reinsurance, as older treaties were reallocated to other classes of business. The result decreased again in comparison with the previous year, largely due to the premium shift. We are still in a phase of consolidation and stabilisation in this line of business and attach great importance in treaty design to transparent loss exposures, clearly defined scopes of cover and the avoidance of unlimited liability in motor third-party insurance. In the renewals at 1 January 2006, prices largely remained unchanged, but our selective underwriting policy is likely to lead to a further decrease in premium volume. Portfolio rehabilitation measures should bring about an improvement in the result.
Accident reinsurance showed strong premium growth, chiefly fuelled by the above shift in premium from liability. Our result in accident reinsurance was exceptionally negative. The main reason for this is the revaluation required by German commercial law in respect of the claims reserves for workers' compensation business taken over by the Company in 2005 from our subsidiary American Re-Insurance Company, where they had been discounted in accordance with US accounting rules.
German accounting law provides for claims reserves to be recognised at the future settlement value. This revaluation had a negative impact of €1,097m in the technical income statement. For the current business year, we expect premium income to be lower than last year, but the result should return to the profit zone.
Our premium income in motor reinsurance was appreciably lower than in the previous year, although we raised prices in some markets. In the final analysis, however, the price increases did not make up for the losses in premium attributable to the termination of large-volume quota share treaties. Nevertheless, the result improved considerably compared with the previous year and was even slightly positive. In the light of developments, we again strengthened the reserves for French motor third-party treaties written many years ago, albeit to a lesser extent than in 2004. For the current year, we anticipate that premium income will be marginally down, but we again aim to achieve a positive result.
In marine reinsurance, premium growth was significant, above all because of increases in prices for offshore energy insurance following the high hurricane losses. Since the losses from major natural catastrophes were very high, the result fell deep into the red. In 2006, premium volume is likely to reach the previous year's level. If the exceptional claims burdens do not repeat themselves, the result is likely to be back in the profit zone.
In aviation reinsurance, premium income declined, mainly due to the lower number of satellite launches insured and our withdrawal from individual aviation treaties with un-

attractive prices. As in the previous year, the underwriting result was again very satisfactory. The trend towards further reductions in rates remains unbroken, due to the relatively low market loss expenditure of the past two years compared with the long-term average. Nevertheless, prices are still at a risk-adequate level. For 2006, we anticipate a lower premium volume. If claims incidence is average, we are likely to achieve a positive result.

Fire reinsurance experienced a further decline in premium volume. In this segment, we terminated a large reinsurance treaty as scheduled and also consistently withdrew from treaties that did not meet our return requirements. Business experience was badly affected by the exceptional Atlantic cyclones. Hurricanes Katrina, Rita and Wilma resulted in unprecedentedly high natural catastrophe losses for the insurance industry. Particularly Hurricane Katrina hit us hard, although we were able to considerably reduce our claims burdens through retrocession. Nevertheless, our sound and profitable basic business did not compensate for these tremendous losses, so that the result of this class of business was clearly negative. In the latest renewals of reinsurance treaties, we adhered to our selective, profit-oriented underwriting strategy. We continue to be prepared to sacrifice premium volume if we cannot achieve risk-adequate conditions. For the current year, we therefore estimate that premium income will be lower than in the previous year. Provided there are no exceptional natural catastrophes or other major loss events, we expect a favourable result.

In engineering reinsurance (machinery, EAR, CAR, EEI, etc.), premium income showed a rise. Business performance was severely impacted by major loss events, above all the hurricane losses in the USA. Thanks to our good basic business, however, we achieved a very positive result. We assume that we will be able to maintain this high level in the current year, even though premium income is likely to decrease.

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. Although the combined result was below that of the previous year, it was still very satisfactory and benefited in the property reinsurance classes from an extremely low incidence of major losses in the year under review.

Owing to a marginal decline in the number of insolvencies in our core markets, the result we recorded in credit reinsurance was positive, despite one significant major loss. In 2006, premium volume should be on a par with last year and the result should also attain a very good level.

	Gross premiums written		Underwriting result	
All figures in €m	**2005**	2004	**2005**	2004
Life	**5,747**	5,680	**203**	164
Health	**1,199**	1,148	**–22**	6
Accident	**861**	758	**–1,093**	–44
Liability	**1,782**	1,985	**–477**	–345
Motor	**2,297**	2,443	**–2**	–154
Marine	**833**	702	**–150**	–10
Aviation	**773**	857	**89**	107
Fire	**2,973**	3,054	**–863**	484
Engineering	**1,176**	1,104	**276**	129
Other	**1,526**	1,512	**81**	285
Non-life combined	**13,420**	13,563	**–2,161**	458
Total	**19,167**	**19,243**	**–1,958**	**622**

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 underwriting reserves that serve to mitigate fluctuations in claims experience of future years and are established primarily for individual classes of property-casualty business.

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

Given the high claims expenditure, withdrawals were made above all for fire reinsurance, totalling €661m net. This amount comprises a withdrawal of €1,070m from the provision for natural hazards for losses from Hurricane Katrina and, on the other hand, an allocation of €393m to the claims equalisation provision itself, mainly due to the positive claims experience in fire reinsurance apart from the natural catastrophe losses. In addition, €14m was allo-

cated in fire reinsurance to the provision for terrorism risks and €2m to the provision for nuclear facilities. In liability, motor and marine reinsurance, a total of €184m was withdrawn, owing to the negative results. By contrast, substantial allocations were made in the following cases, owing to good results: €233m for "other classes of business" (thereof €115m for credit reinsurance), €192m for the engineering classes of business, and €165m for aviation reinsurance. See table (9) in the notes to the financial statements on page 51.

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. By concentrating our asset management within the Group in the business year 1999, we created the basis for optimising the Group's investment result.

Investment principles

We attach great importance to the security, liquidity and diversification of the investments we make. We reduce ↗ currency risks by matching our expected liabilities with assets in correlated currencies. In addition, we always keep sufficiently liquid funds available in order to meet our payment obligations at all times. We also take care that the maturities of our investments are geared to the patterns of our liabilities. Details on our asset-liability management are provided in our financial situation report on page 22, and the methods we use for limiting the various investment risks are described in detail in our risk report (page 28 ff.). Our investment strategy also takes account of sustainability criteria, our goal being to ensure that 85% of our equities and corporate bonds are included in recognised sustainability indices. We have already surpassed this target. In the case of government bonds, we have achieved a gratifying rate of around 99% compliance in terms of the indices in question.

Development and structure of investments

The carrying amount of Munich Reinsurance Company's investments (excluding deposits retained on assumed reinsurance) rose by 3.8% to €48.4bn (46.7bn) in the business year 2005.

Investment mix

All figures in €m	31.12.2005	31.12.2004	31.12.2003	31.12.2002	31.12.2001
Land, land rights and buildings, including buildings on third-party land	1,005	1,037	1,049	1,068	964
Investments in affiliated companies and participating interests	12,054	13,015	13,613	14,962	9,836
Loans to affiliated companies and participating interests	211	1,236	1,325	1,475	917
Shares, investment certificates and other non-fixed-interest securities	15,385	12,927	12,920	9,572	12,095
Bearer bonds and other fixed-interest securities	19,266	17,937	16,189	7,699	6,055
Other investments	522	502	370	465	309
Total	**48,443**	**46,654**	**45,466**	**35,241**	**30,176**

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

Investments in affiliated companies and participating interests

We accepted the exchange offer by UniCredito Italiano S.p.A. (five UniCredit shares for every HypoVereinsbank share) in the fourth quarter of 2005 and exchanged the 7.1% stake in HypoVereinsbank directly held by Munich Reinsurance Company into UniCredit shares. HypoVereinsbank was an associate of Munich Reinsurance Company. Since we do not exercise a significant influence on UniCredit, our stake in the latter is shown in the item "shares, investment certificates and other non-fixed-interest securities". As a result of the exchange transaction, Munich Reinsurance Company realised a capital gain of €337m; as at 31 December 2005, we had recognised the HypoVereinsbank shares at market value. After conclusion of the exchange, we sold UniCredit stock with a carrying amount of €341m, so that as at 31 December 2005 our stake in UniCredit was 2.3%

(Munich Re Group: 4.8%). Through its participation in the newly formed major European bank and the subsequent partial sale, Munich Reinsurance Company has further reduced its investment in the banking sector and has diversified internationally.
We sold Karlsruher Lebensversicherung AG in the business year 2005 for strategic reasons. Beyond this, we sold the stock we had held indirectly in MAN AG.
In the third quarter 2005, we strengthened the capital base of our 100% subsidiary Munich American Holding Corporation. Munich Reinsurance Company had to make a write-down of €895m for this capital injection. Munich American Holding Corporation, a 100% subsidiary of Munich Reinsurance Company, acts as Munich Re's US holding company. It owns 100% of the shares of American Re Corporation which, in turn, owns 100% of American Re-Insurance Company's shares.

Loans to affiliated companies and participating interests

The reduction of the carrying amounts is largely attributable to the capital strengthening at our US subsidiary. In connection with this measure, we wrote off a loan and a credit line that had been granted by Munich Reinsurance Company totalling €1.3bn.

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

We significantly increased the valuation reserves of our equities, owing to the good performance of the stock markets. The carrying amounts rose substantially, partly because we reinvested realised gains in shares and partly because the UniCredit stock we acquired as part of the exchange transaction was allocated to the above item. The carrying amount of our special funds was €1.1bn higher than in the previous year, largely due to exchange gains.
As part of our diversification and streamlining strategy, we continued to scale back our investments in German financial stocks in the business year 2005 (e.g. Allianz and Commerzbank shares).

Bearer bonds and other fixed-interest securities

The share of fixed-interest securities in our portfolio grew by 1.3% compared with the previous year, mainly because we invested the regular cash flow chiefly in fixed-interest securities.
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 5.7 (5.2) years. Owing to falling interest rates over the course of the year, the valuation reserves of our fixed-interest securities developed positively.

Valuation reserves

The difference between the carrying amount and fair value of the investments recognised at amortised cost developed very favourably overall.

Valuation reserves

All figures in €m	31.12.2005	31.12.2004	31.12.2003	31.12.2002	31.12.2001
Real estate	1,509	1,655	1,808	1,559	1,600
Equity investments	7,683	4,565	4,929	7,235	35,146
Fixed-interest securities	844	583	283	315	176
Total	**10,036**	**6,803**	**7,020**	**9,109**	**36,922**

Altogether, there were no negative valuation reserves on investments as at 31 December 2005. Reference is made to page 47 for the determination of the fair values.

Result

Prices on the European stock markets surpassed their upward trend of 2004, the EURO STOXX 50 rising by 21.3% and the DAX by 27.1% in the course of the year. The Japanese Nikkei registered an even more pronounced increase of 40.2% in the same period. The German bond markets for ten-year government bonds closed with a yield of 3.31%, whilst the yield on US government bonds stood at 4.39% at the end of the year.

Investment result

All figures in €m	2005	2004	2003	2002	2001
Regular income	2,873	2,616	6,285	3,063	3,415
Write-ups/write-downs	–1,948	–555	–207	–4,761	–339
Net realised capital gains	1,846	950	1,114	8,730	1,115
Other income/expenditure	–216	–125	–3,596	–165	34
Total	**2,555**	**2,886**	**3,596**	**6,867**	**4,225**

Our income from investments developed very satisfactorily, climbing by €1.3bn to €5.3bn compared with the previous year. This change was essentially due to the increase of €843m in capital gains and the rise of €341m in income from deposits retained on assumed reinsurance.
Investment expenses climbed from €1.1bn to €2.7bn year on year, mainly because of write-downs for impairments in value. In connection with the reserve strengthening at American Re-Insurance Company for underwriting years 1997 to mid-2002, we increased the capital base of Munich American Holding Corporation by US$1,108m (€895m) from available resources, and subsequently made a write-down for this capital injection (see page 19 f., Investments in affiliated companies and participating interests). In addition, we waived a credit line of €182m and a loan granted to Munich Re American Holding Company plus interest accrued up to 30 September 2005, totalling €1,113m (see page 20, Loans to affiliated companies and participating interests).
The previous year's figures contain €624m in write-downs for our HypoVereinsbank shares to their market value at 31 December 2004.
The investment result is €331m lower than in the previous year, as the increase in realised capital gains was insufficient to compensate for the special write-downs in the year under review.

Investment result by type of investment

All figures in €m	2005	2004	2003	2002	2001
Real estate	48	73	79	86	97
Investments in affiliated companies and associates	–104	–632	307	5,004	645
Loans to affiliated companies and participating interests	–1,234	87	63	68	17
Shares, investment certificates and other non-fixed-interest securities	1,570	1,504	1,691	251	2,093
Bearer bonds and other fixed-interest securities	930	845	542	434	296
Other investments	1,345	1,009	914	1,024	1,077
Total	**2,555**	**2,886**	**3,596**	**6,867**	**4,225**

Financial situation

Investments on the assets side of the balance sheet mainly serve to cover underwriting provisions (76.8% of the balance sheet total). Equity (12.6% of the balance sheet total) and subordinated loans classified as strategic debt (3.7% of the balance sheet total) are the most important funds.
As distinct from liabilities involving loans and securities issued, we cannot foresee with certainty how high our liabilities from reinsurance underwriting business will be and when they will occur. The payout pattern of the underwriting provisions varies from one line of business to another. In property insurance, for instance, a major portion of the reserves 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 on an ongoing basis and taking suitable measures.
To optimise our capital position and reduce capital costs, we have not only employed internal forms of financing in previous years but have also used strategic debt, in the form of subordinated loans and exchangeable bonds. A detailed analysis of the structure of our outside capital is provided in the section "Strategic debt".
In the year under review, the Company reduced outside capital by €1.2bn, mainly through redeeming our bonds exchangeable into Allianz AG shares.
Since we are an international reinsurance group, some of our funds are subject to restraints on disposal. For example, the supervisory authorities in some countries require foreign reinsurers to establish premium and reserve deposits with the primary insurer. As at the balance sheet date, investments totalling €6.5bn were subject to restraints on disposal.

Asset-liability management

The structure of our underwriting provisions and other liabilities is the basis for the Munich Re's investment strategy. The main focus of this strategy is asset-liability management (ALM), which is geared to ensuring that economic factors influence the value of our investments and the value of the underwriting reserves and liabilities in the same way. This stabilises our position with regard to capital market fluctuations and helps ensure sufficient coverage of our business with own funds. In ALM, we reflect important features of the liabilities (such as maturity patterns, currency structures and inflation sensitivities) on the assets side of the balance sheet. 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 multi-period inflation rates accumulate here. 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 47 of the notes to the financial statements.

Equity

In the year under review, our equity decreased by €1,449m or 12.2% to €10,417m.
This reduction was due to the following:

- In 2005, we recorded a loss for the year of €992m. This negative result is largely attributable to our US subsidiary American Re-Insurance Company, which in the year under review had to increase its reserves for the underwriting years 1997 to mid-2002 by US$ 1.4bn. In this connection, Munich Reinsurance Company strengthened Munich American Holding Company's capital base from available resources by US$ 1.1bn (€895m), which was passed on to American Re-Insurance Company to strengthen its equity capital. Munich Reinsurance Company had to make a write-down for this capital injection. In addition, a credit line of €182m and a loan granted to Munich Re American Holding Company were waived, along with the interest accrued up to 30 September 2005, totalling €1,113m.
- Furthermore, American Re-Insurance Company transferred to Munich Reinsurance Company the run-off of the claims reserves (now adjusted for legacy losses), with a volume of €5.5bn. These reserves largely involve asbestos-related claims and losses in workers' compensation insurance, which under US accounting rules were discounted. German accounting law, however, provides for claims reserves to be recognised at the future settlement value. This revaluation gives rise to a one-off

impact of €899m on Munich Reinsurance Company's result. To secure these underwriting obligations, we set up deposits of €4.7bn, with an agreed interest rate of 3.94% p.a. In addition, there was a further revaluation effect of €198m from a retrocession quota share treaty with American Re-Insurance Company, which also included workers' compensation business.

- This remediation in connection with American Re-Insurance Company totalling €3,287m enabled a line to be drawn under the issue of reserve strengthening for past losses. For Munich Reinsurance Company, too, the measures were geared to freeing the investment in our US subsidiary from legacy problems and making it value-producing.
- If the result for the year is adjusted to eliminate this exceptional burden, the outcome is a profit for the year of €2,295m – proof of the quality of Munich Re's business. This is also reflected in the record result of the Munich Re Group totalling €2.7bn. To enable Munich Re's shareholders to participate in this success, the dividend is to be raised from €2 per share for the previous year to €3.10 per share for the year under review. This means that the overall amount to be distributed will increase to €707m.
  The dividend distribution and the negative annual result reduce the uncommitted revenue reserves, and consequently equity from €11,866m to €10,417m.
- Valuation reserves increased from €6.8bn to €10bn in the year under review. The upward trend on the stock markets resulted in growth of €3.1bn in the hidden reserves of our equity investments alone in the year under review. Further information on the valuation reserves can be found on page 20.

Equity and valuation reserves

All figures in €bn	31.12.2005	31.12.2004	31.12.2003	31.12.2002	31.12.2001
Equity	10,417	11,866	11,375	7,115	4,449
Valuation reserves	10,036	6,803	7,020	9,109	36,922

Strategic debt

We define as strategic debt all borrowing with the character of outside financing that does 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. The following table shows the status of such items as at 31 December 2005:

All figures in €m	31.12.2005	Prev. year
Subordinated loans from Munich Re Finance B.V., Amsterdam	3,051	3,038
Exchangeable bonds of Munich Reinsurance Company, Munich	–	1,239
Total	**3,051**	**4,277**

In 2003, the Munich Re Group strengthened its capitalisation with the subordinated bonds issued by Munich Re Finance B.V. 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 a subordinated loan.

We issued the exchangeable bond in order to manage the underlying shareholding. In the second quarter of the business year ended, we redeemed the Munich Reinsurance Company bond exchangeable into Allianz AG shares with the very strong cash flow from our operating activities. The strategic debt was incurred to finance our operating activities in the long term. There are currently no plans to expand our financing with outside funds.
We show the interest expenses for strategic debt separately in the income statement under "other expenses".

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. 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 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. Despite the loss for the year, Munich Reinsurance Company's capital easily meets the statutory minimum requirement of 100%.

Analysis of the cash flow

Munich Re's cash flow is strongly influenced by the special features of our underwriting business. We first collect the premiums for the risks assumed and do not make payments until later in the event of loss. The timing of payments, which depends on such factors as the type of business written and the loss event in question, can vary greatly. The cash flow statements of insurance companies are therefore of limited relevance.

Compared with the previous year, cash inflows from underwriting business decreased. This development is partly due to our strategy of gearing our business to sustained profitability. The cash flow in yen was affected by high claims payments for Typhoons Songda and Tokage, which occurred in 2004. For Hurricane Katrina, we expect a significant part of the claims payments to be made in the business year 2006, owing to the complex claims situation and the only gradually ascertainable extent of the flood losses – especially business interruption and damage to buildings.

The cash flows from investing activities are determined by the outflows for the acquisition of investments and inflows from investment sales and maturities. In 2005, we undertook some extensive restructurings, in particular further cutting back our investment in the financial services sector (reduction of our stakes in Allianz and UniCredit and sale of Karlsruher Lebensversicherung AG).

The cash outflows for financing activities mainly stem from the redemption of the bonds exchangeable into Allianz shares, the dividend payment for 2004, and interest payments for the subordinated bonds.

Overall, in the year under review cash – which includes cash with banks, cheques and cash in hand – showed an increase of €87m to €604m.

Other success factors

Instrumental in securing the Munich Re Group'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 some 5,000 corporate clients from around 160 countries. These include captives as well as traditional insurers.
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. Besides this, our clients can benefit from our strengths that go beyond actual risk protection: our financial strength, our knowledge, our solution-oriented approach, and the treatment of our clients as partners. We also share our know-how with our cedants.
In 2005, for instance, we again organised a large number of seminars on fundamental topics in all lines of insurance. We also stage numerous specialist events at our clients 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.
Via our internet client portal, connect.munichre, we provide our cedants with round-the-clock assistance: useful knowledge, services, analysis and quotation tools from the property-casualty and the life and health segments. This both supports primary insurers in their daily business and presents a direct and secure interface to Munich Re. With its interactive facilities, connect.munichre supplements and optimises Munich Re's range of services and rounds off personal client relationships. The portal is already used by over 200 insurers worldwide.
Last but not least, our cedants worldwide 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 and continue to be their preferred partner in risk.

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 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 and jewellers' block – a line of insurance covering all the risks of jewellery business and diamond trade – and also workers' compensation.
Last but not least, Knowledge Management provides the methodological and institutional foundations for the constant updating and exchange of knowledge within the Munich Re Group. In over 50 operative topic networks, staff from 20 countries work with our most important natural resource for a successful future: our knowledge, of which ever greater demands are being made in a rapidly changing environment. Our experts expand our know-how, package it, and act as contacts for colleagues and clients alike.

In 2004, we set up six cross-divisional innovation teams in underwriting, 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. We combine resources in this way in order to come up with intelligent solutions, which we are convinced are the key to a profitable future. Collaborating with the staff responsible in the divisions, our innovation teams develop new products, services and distribution channels. Our cedants benefit from their 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, solutions have been devised for motor own damage cover for a leasing fleet that redefine the interaction of brokers, primary insurers and reinsurers.

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 consistently in further developing their skills.

Facts and figures

In 2005, an average of 3,433 (3,265) staff were employed with the Company, representing an increase of 5.1%.

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 2005, an average of 40 (39) 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. 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. In 2005, candidates were nominated for the scheme from Asia, Australia, South Africa, North America, the United Kingdom and Germany.

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, we work for the reduction of greenhouse gases from the 20 economies with the highest emission levels and the 500 largest firms.

Social commitment

Munich Re accepts its responsibility towards society and supports various social and cultural projects – for 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, the Munich Re Foundation can build on the highly developed risk knowledge of its benefactor.

IT processes

IT security

Munich Re ensures the security of all its data, computers and networks through a system of complementary functions and processes.
The Chief Information Security Officer sees to it that there is an active exchange of information between the primary insurance and reinsurance groups on information security issues. In DISK (the Munich Re data protection and information security group), all the parties responsible meet regularly to discuss project results and risk evaluations, compare notes, utilise synergy effects and launch ideas for Group-wide projects.
Beyond this, 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 global standards and guidelines applied by all the companies. 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 staff.
Regular external audits have confirmed that Munich Re's information security is at a high level. Nevertheless, given that we see security as a process rather than a state, we are constantly refining our strategies and standards. In doing so, we are concentrating especially on reducing those risks which are related to the "human factor" in the broadest sense.

Gloria

Our reinsurance platform Global Reinsurance Application (Gloria) will provide 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.
The project is very complex, and the risks are considerably higher than they would be if we were implementing proven standard products. We have therefore incorporated additional test cycles, especially for the accounts closing process, and put back the roll-out originally planned for 2005 to 2006. This will begin with Munich Re Munich and its branches and will be extended to the subsidiaries in the following years, starting with American Re-Insurance Company.

Risk report

Recent years have shown that Munich Re's risk landscape can change quickly and without warning, owing to a wide range of events and influences. We are constantly refining the tools with which we monitor and manage risks, so that in our view they have now reached a high degree of sophistication. 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 natural limits. There cannot – and never will be – absolute security when it comes to identifying risks at an early stage, measuring them sufficiently, or correctly estimating their real hazard potential. This was clearly shown last year by the unexpectedly high losses we incurred from Hurricane Katrina.

The risk report is based on German Accounting Standard DRS 5–20. In accordance with IFRS 4, Insurance Contracts, it is supplemented by "Disclosures on the uncertainties of future cash flows from insurance contracts".

Functions, organisation and important tools

We adopt a holistic risk management approach. The main objective of this is to analyse and control the interdependencies between risks on the asset and liability sides, and between strategic and operational risks.

By separating accountability and monitoring, we ensure the effective management of our risks. The functions and responsibilities of all participants – be they members of the Board of Management, executives, decentralised and central risk controllers and risk managers – are clearly defined.

The Board of Management is responsible for the cross-divisional planning, steering and controlling of the risk landscape as a whole. It has to be consulted regarding measures that may appreciably alter the composition of the risk capital and also where there are cross-divisional concentrations or loss scenarios, significant operational risks and operational measures or risks that may have a negative impact on Munich Re's reputation. The tasks that are the preserve of the Board of Management and its committees include the following:

- Defining an investment portfolio which synchronises as closely as possible with fluctuations in the value of underwriting provisions and liabilities and on the basis of which investment opportunities and risks can be specifically identified
- Determining Munich Re's risk capital
- Deciding on optimisations of the net underwriting portfolio
- Selecting suitable measures to reduce accumulations across the balance sheet where required
- Ensuring that supervisory requirements for risk management are met

In the Munich Re Group, Integrated Risk Management, headed by the Chief Risk Officer, is centrally responsible for preparing these Board decisions and for identifying, assessing, controlling, monitoring and communicating risks on the asset and liability sides. At the beginning of 2006, Central Risk Controlling and important functions (such as asset-liability management, the control of risk accumulations across the balance sheet and capital modelling) were integrated into this unit. We manage the business portfolio by assigning return expectations, derived from the size of the risks assumed, to individual business activities. Our internal risk model, which also includes our subsidiaries, 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 the investments of the reinsurance group. 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 only to be expected every 100 years. In the next step, the capital so determined is allocated proportionately to the individual divisional units on a proportional basis in line with the volatility of their business activities. In this way, we provide incentives to manage risks efficiently. Mismatched risks between assets and liabilities, for example, are significantly diminished by means of appropriate investment and hedging strategies, thus reducing the risk capital required while improving capital productivity.

The staff of Central Risk Controlling inform the Board of Management about the current risk situation and check measures relating to risk policy, proposing new ones where necessary. Central risk management/controlling sets standards and develops methods and tools as a basis for consistent risk management. The decentralised risk controllers in the units adapt these to the current situation when necessary.

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

The basis for handling risks is determined by management requirements and decisions on risk tolerance, which are defined by the risk strategy and risk policy, and geared to capitalisation as well as liquidity. Before we assume underwriting liabilities, for instance, we examine what claims burdens can be borne or are still tolerable in the event of catastrophes. We also use simulations of pre-defined catastrophe scenarios to ensure that extremely improbable events are also considered.
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 and by the external auditor as part of the annual audit.

Main underwriting risks

One of the risks relevant for insurance business is the risk of change, meaning how changes in risk parameters and unforeseen factors may result in unexpectedly large claims. Often the risk of change coincides with the risk of random fluctuations, making it more difficult to identify and quantify the risk potential. For instance, the exceptional hurricane seasons in 2004 and 2005, with greater storm frequencies and intensities, led to record losses in Florida and the Gulf of Mexico. With a market loss estimated at US$ 45bn, Hurricane Katrina caused the largest insured loss in insurance history. Such increased exposures, which are attributable to the natural climate cycle on the one hand and anthropogenic climate change on the other, look set to continue in the next few years. At the same time, we are witnessing an increasing regional concentration of insured values, especially in highly exposed flood-prone regions. Extensive know-how, well-maintained data resources and underwriting based on this information are imperative for determining risk-adequate prices and conditions in these circumstances. Prior to the hurricanes of the last two years, we had essentially observed the weather phenomena correctly, foreseeing the risks from windstorms, and had largely taken them into account in our models. What we underestimated, however, was the extent of the storm surges that could occur with the cyclones, as well as the price increases resulting from shortages of loss inspectors and adjusters, craftsmen and building materials after severe natural catastrophes. Particularly the latter effect was exacerbated by the subsequent Hurricanes Rita and Wilma, which inflated the costs for Katrina. Therefore, the losses from Hurricane Katrina were significantly higher than we would have expected on the basis of our models for a hurricane of comparable strength. From such experience, current geoscientific research, far-reaching proprietary loss analyses and models, and benchmarking of our models against external calculations, our Geo Risks Research Unit obtains the necessary findings used in underwriting.
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).
In addition, scientific and technological innovations such as new products or production methods result in industry risk concentrations. New pharmaceutical products, for example, can give rise to very large losses in connection with pharmaceutical product liability and professional indemnity, and possibly also as a result of exposures from other lines of insurance, thus resulting in very large losses. This concentration effect is intensified by socio-political trends like increased litigiousness.
Large losses in industry may also impact our investment portfolio if the firms affected suffer a fall in the prices of their shares or bonds. We consistently control the relevant accumulation risks across the balance sheet as far as possible, so that the resulting residual risk remains within the risk tolerance limits defined by management. The close link between knowledge management and risk management at Munich Re is an advantage in this respect, as is the analysis of historic major losses. These provide valuable pointers for identifying the respective risk drivers and incorporating them as parameters to be monitored in future in a suitable early-warning system.
The potential effects of the risk of change influence both our premium calculations and our reserves. Through selective underwriting, close collaboration with clients in claims handling and various methods for calculating appropriate claims reserves, we endeavour to minimise balance sheet risks emanating from expenses that can often drastically increase many years after the losses occur.

The notes to the financial statements include details of the methods we use to calculate adequate claims reserves and an analysis of the factors influencing the underwriting provisions in property-casualty insurance, such as estimating claims expenditure.

Our combined ratios, which in addition to other key indicators are important for us in monitoring the premium/claims risk in non-life reinsurance (see page 51), developed as follows over the last ten years:

Combined ratios (in %)

	2005	2004	2003	2002	2001	2000	1999	1998	1997	1996
Including natural catastrophes	117.0***	96.4	93.8	108.3**	127.4*	115.7	120.6	101.9	98.8	97.8
Excluding natural catastrophes	97.3***	91.2	92.1	104.8**	126.1*	111.7	107.2	98.9	97.9	97.7

*Thereof World Trade Center: 15.9%.
**Thereof World Trade Center: 3.5%.
***Thereof effect from the assumption of American Re's discounted claims reserves: 8.7%.

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 account of future trends. We calculate the biometric risk mainly on the basis of tables relating to mortality and claims development, published by national actuarial associations. These tables are modified in accordance with the termination rates observed in the reinsured portfolios. Lapse risks can be reduced 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.
We exclude the interest-guarantee risk in many cases by means of suitable treaty design. Furthermore, as a matter of principle, we use prudent assumptions regarding the probable interest rate when fixing the actuarial interest rate in premium and reserve calculations.

Control measures for underwriting risks

The selective acceptance of risks in primary insurance and reinsurance business is at the core of Munich Re's business model. As a global reinsurer, we can systematically diversify our portfolio through the broadest possible mix and spread of individual risks, thus significantly reducing the volatility of total underwriting payments and substantially increasing the value added by all divisional units.
To ensure optimal diversification of our portfolio, we use a balanced range of measures, of which risk measurement is a central prerequisite for the controlled management of our portfolio.

Risk measurement is based on our internal risk model, with which we analyse diversification and concentration effects. The diversification approach has its limits, however, where systematic effects such as fluctuations in interest rates, exchange rates and inflation impact a majority of the treaties or even whole classes in equal measure, so that an overall balance within the portfolio cannot be achieved. To control such systemic risks, we use asset-liability management, which simultaneously monitors investments, underwriting provisions and other liabilities. Its aim is to synchronise fluctuations in the value of assets with those in the value of underwriting provisions and other liabilities, thus stabilising corporate value. The section "Financial situation" on page 22 deals with the topic of asset-liability management in greater detail.
Since the Company's overall risk profile can be broken down into its individual components, we can measure the effects of significant risks. This allows us to accept risks on the basis of conscious economic decisions. In accordance with the principles of value-based management, capital is only made available at conditions that promise an appropriate return. Thanks to the regular evaluation provided by the internal risk model, we are in a position to respond promptly to any errors identified, to changes in individual parameters or in our portfolio composition and to resultant alterations in our overall risk situation, by taking suitable action.
For events with low occurrence probabilities but potentially high severity, we devise scenarios with which we test the robustness of our portfolio on both the asset and liability sides. In addition to risk measurement, we use the following tools for controlling risks, including concentration effects.

Binding underwriting guidelines and limits and clear underwriting authorities precisely regulate who is authorised and accountable for concluding insurance and reinsurance contracts at Munich Re and at what conditions. We regularly check compliance with these guidelines and closely observe market developments, reacting where necessary with appropriate measures that are translated without delay into underwriting guidelines if required. As a general rule, our treaties and original business ceded to us contain clear liability limits (exception: unlimited motor liability cover, which still exists in certain markets).
Reinsurers assume very large liabilities for earthquake and windstorm losses, and to a lesser extent for hailstorm and flood risks, which often affect many clients at the same time. We monitor and control our liabilities by means of established accumulation assessment and control systems and a clearing process. This preventive risk-controlling measure, with which we limit concentrations, was introduced many years ago for the hazards earthquake and windstorm in the form of accumulation budgets for reinsurance. Although we regularly check the loss scenarios underlying the accumulation budgets, we are nevertheless not immune to misestimation. Thus the effects of Hurricane Katrina significantly exceeded our expectations with regard to a natural catastrophe of this type and intensity.
An excellent tool for risk prevention, and thus for risk controlling, is careful reserving to ensure that sufficient funds are available to cover future IBNR claims – losses which have been incurred but not yet reported or not reported enough, and have not yet been settled. Therefore, using recognised underwriting methods, we set up appropriate provisions for IBNR (incurred but not reported) losses and for known claims (case reserves). In addition, where required under rules of insurance supervision and accounting, we post provisions for fluctuations in claims experience. Further information on how claims reserves are posted is provided in the notes to the financial statements.
A further important risk control measure in the field of underwriting is the cession of a portion of our risks to third parties via external retrocession. The core component of our retrocession is an accumulation excess-of-loss cover placed on the international reinsurance market, which provides protection against losses from natural catastrophes. This enabled us, for instance, to reduce the burdens from Katrina by approximately €400m. In addition, Munich Re is the sponsor and potential beneficiary of a catastrophe bond for windstorms in Europe. This bond covers windstorm losses in the United Kingdom, the Netherlands, Belgium, France and Germany. Its term began in mid-November 2005 and will end on 31 March 2009. As a result, we have additional protection from the capital markets for almost four years of seasonal windstorm activities and, if the specifically defined criteria are met, will receive payments totalling €110m.

Risks from defaults on receivables from underwriting business

1.7% of all our receivables on underwriting business at the balance sheet date were outstanding for more than 90 days. The average default rate of the last three years amounts to 0.3%.
As at 31 December 2005, our accounts receivable on ceded business were split between the following rating categories, based on those of Standard & Poor's:

AAA	21.3%
AA	64.3%
A	3.8%
Without external rating	10.6%

Main investment risks and important control measures

In the investment sector, the Company is guided by the following principles: only investments are to be made from which an appropriate return can be expected and which offer a high degree of security, as reflected in high-quality ratings of the relevant issuers and counterparties, for example. Also important is sufficient liquidity at all times to cover obligations from underwriting business, as is a targeted diversification in terms of region and type of investment. In addition, Munich Re meets the regulatory solvency requirements stipulating a specified minimum capitalisation.
In line with our asset-liability management, we match the maturities of our bond investments with the calculable cash outflows. In other words, besides return and risk aspects, our investment strategy considers requirements relating to underwriting, supervisory regulations, accounting, tax, liquidity and currencies.
Besides this, for individual products involving explicit financial risks, such as interest-rate or currency risks, we carry out asset-liability management already at micro level when the product is being designed. This is especially the case with life business but also long-tail property-casualty business, owing to the long settlement periods involved.

Market-price risks in investments are measured and controlled using the value-at-risk approach, which is also employed in our strategic investment planning to model the optimum investment portfolio according to risk preference. Applying stress tests, sensitivity and duration analyses, we also simulate market fluctuations and devise strategies for counteracting them where necessary.
The following sensitivity analyses for market-price risks serve to estimate potential changes in the value of investments under hypothetically possible market scenarios. The basis for the review are the holdings of the Company at 31 December 2005.
The changes in share price assumed in these scenarios, ±10% and ±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 ±10%, would produce the following changes in market value:

Change in share prices	Change in market value of investments sensitive to share prices
Increase of 20%	+€5.137bn
Increase of 10%	+€2.562bn
Decrease of 10%	–€2.550bn
Decrease of 20%	–€5.088bn
Market values at 31.12.2005	€26.313bn

Change in interest rates	Change in market value of investments sensitive to interest rates
Increase of 200 BP	–€2.836bn
Increase of 100 BP	–€1.474bn
Decrease of 100 BP	+€1.587bn
Decrease of 200 BP	+€3.286bn
Market values at 31.12.2005	€29.368bn

Change in exchange rates	Change in market value of investments sensitive to exchange rates
Increase of 10%	+€2.491bn
Decrease of 10%	–€2.491bn
Market values at 31.12.2005	€20.531bn

We only run currency risks to a very small extent, since we practise a policy of currency matching. This means that for the main currency liabilities in underwriting business, matching items are established on the assets side.
We use derivative financial instruments to hedge parts of the portfolio against price fluctuations, to optimise earnings and to implement planned purchases and sales.

Credit risks in the investment portfolio are measured and limited using the credit-value-at-risk approach. The main elements for measuring the credit risk are the investment volume, the term of the investment, the quality of the collateralisation, and the default probability of the individual issuers in the portfolio.
Beyond this, our counterparty system restricts default risks in respect of individual issuers at Group level. It takes into account the issuer's individual rating, its capitalisation as a basis for covering the liability, the quality of the collateralisation and of the respective issue, the sector concerned, and our internally defined risk tolerance. Our investments were not affected by any significant defaults in 2005.
Detailed liquidity planning ensures that we are able to make the necessary payments at all times. This planning concept, which has been in place for many years, has proved its value after major loss events such as the recent severe hurricanes in Central and North America.

Main operational risks

By operational risk we mean the possibility 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 opportunities for change and improvement. To this end, we organise seminars and information events, support open communication in the field of risk management.
The Compliance Officer ensures that inside information is handled in conformity with the law and checks whether the other insider regulations are complied with. The Compliance Officer is also responsible for seeing that all price-sensitive information directly concerning the Company and legally requiring an ad-hoc announcement is published without delay. Finally, he makes sure that all the relevant supervisory regulations are adhered to.

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. 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 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 requires a networking of our business units and systems worldwide, both organisationally and technically. The consequence of this is a growing dependency on electronic communications technology, the complexity of which is continually increasing. The significance of the processed information is also growing. As a result, we are also increasingly exposed to IT risks such as breakdowns and outages, disruptions due to viruses, attacks by hackers and theft of data.
These risks are identified and limited by decentralised security organisations that liaise closely.
Various major projects are currently being realised that will, among other things, develop integrated information architecture in the back-office area. 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 aim of our Gloria project is to unify our IT and process landscape on the basis of an SAP standard product. We plan to put the system into operation at Munich Reinsurance Company in 2006.

Risks in the human resources sector

Munich Re has binding rules setting out minimum standards of corporate integrity for conduct within the Company itself, our business transactions and other relationships with external parties. The clear separation of management and control functions limits the risk of internal and external regulations being breached.
Staff who have to deal with confidential information undertake to comply with the relevant regulations and to handle the information responsibly.
The main human resources risks are shortages of qualified personnel, insufficient adaptation, demotivation and loss of staff. We identify these risks by means of appropriate indicators and metrics. 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. Individual development planning and suitable training offers enable our staff to adapt to current market requirements. Modern management tools and monetary and non-monetary incentives ensure a high level of motivation. Our human resources tools as a whole serve to strengthen our staff's ties with the Company and consequently to safeguard our business intelligence.

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 reinsurer 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 (PSA) 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.
– In late 2004, the US Securities and Exchange Commission (SEC) and the Office of the New York State Attorney General (NYSAG) 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 Re and various of its subsidiaries. We are fully cooperating in these inquiries.

The following are a few examples of how legal risks may develop:

- In the US states hit by Hurricane Katrina, there are various lawsuits pending which are aimed at circumventing the exclusion of flood damage routinely included in private buildings insurance policies.
- Legislative procedure for the Fairness in Asbestos Injury Resolution Act of 2005 in the USA.
- Ultimate claims burden in connection with the attack on the World Trade Center of 11 September 2001.

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.

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 developments so that, if necessary, suitable risk minimisation measures can be taken.

Strategic risks arise if the strategy at overall Company level or business-segment level is not compatible with existing and future client requirements, market conditions or other parameters (e.g. economic or regulatory). In our strategic planning, we carefully analyse the strategic risks, which are evaluated in individual projects using scenarios and at an aggregate level on the basis of “wild cards”. In addition, we systematically perform SWOT analyses (strengths, weaknesses, opportunities, threats) and, building on these, specify what action is to be taken.

One of the main risks for any company is being too conservative and failing to recognise new business opportunities. We counter this danger by, among other things, integrating innovation teams into our operative 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.

Outlook

The external requirements for risk management will increase further as a result of the continued development and introduction of national and international initiatives such as IFRS, which is setting new standards for accounting, and Solvency II, which is fundamentally restructuring state insurance supervision. Rating agencies increasingly and explicitly take the quality and effectiveness of risk management into account in their ratings, a trend we welcome. Insurance associations and research institutions such as the Geneva Association, actively promote an exchange of views on best practices and their establishment.

In keeping with its leading market position, Munich Re provides input for these initiatives. The European Commission’s Solvency II project continues to be actively partnered by interdisciplinary working groups, and we have ensured internal transfer of the relevant knowledge in our divisional units and central divisions. We constantly review changes in the parameters affecting our product portfolio as well as those of our clients and evaluate the resultant business opportunities. Besides this, we participate in working groups and projects of actuarial associations (Groupe Consultatif, DAV), industry associations (CEA, GDV) and research institutions (the Geneva Association, CRO Forum) at national and international level, thus playing a major role in shaping future parameters like those of Solvency II.

Summary of the risk position

Despite the high costs for the reserve increase at American Re-Insurance Company and the Atlantic hurricanes, we see ourselves on course to sustain the level of profitability we have achieved. We therefore assess Munich Re’s risk situation as controlled and viable. The particularly heavy burdens from the reserve strengthening at American Re-Insurance Company and the natural catastrophes in 2005 contrast with the good performance of our basic business and the high realised capital gains from the reduction of our

portfolio of participating interests. We cannot expect comparably high investment earnings in future, but are convinced that we have taken adequate measures to control our risks from investments and reinsurance. Where we identify a need for further action, we will initiate the necessary steps.
With our risk management instruments, we will systematically control the risks in our reinsurance business and, against the background of last year's natural catastrophe losses, ensure that we firmly adhere to our policy of risk-adequate prices and conditions (e.g. exclusions), even if this means having to refrain from participating in some business.
By making the Chief Risk Officer, who is vested with cross-divisional responsibilities, a non-voting member of the Munich Re's central Risk Committee, we are consistently pursuing the integrated management of our risks, to which we attach high priority.
We see opportunities and risks as inextricably linked. Only through first-class identification, analysis and continual monitoring of our risks can we also recognise business opportunities and exploit these decisively for the benefit of our shareholders, clients and staff.
This principle and the above examples demonstrate how we concern ourselves with the whole of Munich Re's risk landscape and consider all facets of possible and necessary control measures.
According to our assessment, there are no risks which could have a significant, lasting adverse effect on the assets, liabilities, financial position and results of our Company.

Prospects

There is a growing tendency among some capital market players to sue 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 Company 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 pages 28 ff.

In the renewals at 1 January 2006, our focus remained on adequate prices, terms and conditions. We will continue to pursue our strategy of profit before growth.

In property reinsurance and offshore energy business, prices for natural catastrophe covers rose significantly in the wake of the exceptional hurricane season in 2005. Especially for loss-affected treaties and in the coastal regions of the USA and the Caribbean, price increases were substantial.

In classes of business and markets not directly affected by exceptional catastrophe losses, prices, terms and conditions have largely remained stable. Here we expect greater competitive pressure, which will tend to result in higher retentions and changes to non-proportional forms of cover.

The reinsurance of natural hazards will continue to be a significant part of our business. With Atlantic cyclones becoming potentially more frequent and more extreme, we must be prepared for further exceptional burdens in future. However, we consider these risks insurable, provided prices and conditions remain commensurate with the risk.

In life reinsurance, the strong growth of the past few years is unlikely to be repeated. We expect premium rates to remain stable or rise slightly. At present, a host of opportunities for growth in various business models are opening up worldwide in the health segment.

Against this background, we expect our premium volume in 2006 to reach the same level as last year, unless there are exceptional movements in exchange rates.

Given an average incidence of major losses, especially as regards very large natural catastrophe losses, our underwriting result should be substantially better than last year's.

Macroeconomic parameters and the situation on the capital markets will be somewhat less bright in the coming year. The current investment environment is in a pronounced low-interest-rate phase, the end of which is still not in sight. Despite interest-rate increases by a number of central banks, there seems to be only limited scope in this environment for markedly higher long-term yields on the bond markets. We thus expect the interest income from bonds, which constitute a large part of our investment portfolio, to be lower than in past years. Consequently, the upward trend on the stock markets is likely to be only moderate.

The arguments indicating continued structural disinflation in the global economy – such as high productivity growth and increased competition due to the unbroken trend of globalisation – are still valid, so that inflation risks remain limited.

Uncertainties facing the insurance industry are macroeconomic and political risks, such as fiscal policy and a possible reform of the German health insurance system. The significance of political influences has steadily increased in recent years and is making business management calculations difficult. In addition, there are regulatory risks, because demands made of reporting and valuing types of business are changing.

Markets continue to be subject to the risk that surprisingly intense competition – whether from new or established providers – may have a negative impact on the insurance cycle. A clear focus on profitability before growth, and efficiency of management systems, remain crucial for success.

Despite the various uncertain factors, barring any extraordinary developments on the claims side or in the capital markets, there is every prospect of a successful business year 2006.

Financial statements

Balance sheet as at 31 December 2005

Assets	Notes	T€	T€	T€	T€	Prev. year T€
A. Intangible assets	(1)				98,916	116,487
B. Investments	(2, 3)					
I. Land, land rights and buildings, including buildings on third-party land				1,004,552		1,036,821
II. Investments in affiliated companies and participating interests						
1. Shares in affiliated companies			11,934,454			11,929,167
2. Loans to affiliated companies			184,483			1,193,029
3. Participating interests			120,079			1,085,811
4. Loans to participating interests			26,158			43,209
				12,265,174		14,251,216
III. Other investments						
1. Shares, investment fund certificates and other non-fixed-interest securities			15,384,914			12,927,179
2. Bearer bonds and other fixed-interest securities			19,266,054			17,937,158
3. Mortgage loans			7,090			10,045
4. Other loans						
a) Registered bonds		5,420				4,300
b) Loans and promissory notes		142				2,724
c) Miscellaneous		190				169
			5,752			7,193
5. Deposits with banks			310,411			379,199
6. Miscellaneous investments			198,963			105,037
				35,173,184		31,365,811
IV. Deposits retained on assumed reinsurance				29,883,303		26,139,706
					78,326,213	72,793,554
C. Receivables						
I. Accounts receivable on reinsurance business Thereof from – affiliated companies: T€659,958 (741,547) – participating interests: T€5,088 (4,616)				2,793,610		2,159,221
II. Other receivables Thereof from – affiliated companies: T€451,498 (258,535) – participating interests: T€77 (826)				812,207		643,773
					3,605,817	2,802,994

Assets	Notes	T€	T€	T€	T€	Prev. year T€
D. Other assets						
I. Tangible assets and inventories				54,944		54,244
II. Cash at bank in current accounts, cheques and cash in hand				294,052		138,213
III. Own shares				11		113
IV. Miscellaneous				–		605
					349,007	193,175
E. Deferred taxes					156,037	352,004
F. Other deferred items						
I. Accrued interest and rent				314,837		331,747
II. Miscellaneous deferred items				18,351		2,684
					333,188	334,431
Total assets					82,869,178	76,592,645

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			2,285,548		3,987,254
IV. Net retained profits			711,699		459,160
				10,417,009	11,866,176
B. Subordinated liabilities	(5)			3,050,652	3,037,910
C. Underwriting provisions	(6)				
I. Unearned premiums					
1. Gross amount		4,631,778			4,251,243
2. Less for retroceded business		263,978			207,875
			4,367,800		4,043,368
II. Provision for future policy benefits					
1. Gross amount		19,635,549			21,192,143
2. Less for retroceded business		1,412,532			1,377,373
			18,223,017		19,814,770
III. Provision for outstanding claims					
1. Gross amount		34,340,573			23,764,386
2. Less for retroceded business		1,914,721			1,240,536
			32,425,852		22,523,850
IV. Provision for premium refunds					
1. Gross amount		8,685			11,252
2. Less for retroceded business		–			–
			8,685		11,252
V. Claims equalisation provision and similar provisions			7,782,804		7,959,827
VI. Other underwriting provisions					
1. Gross amount		864,275			765,353
2. Less for retroceded business		18,976			15,972
			845,299		749,381
				63,653,457	55,102,448

Equity and liabilities	Notes	T€	T€	T€	Prev. year T€
D. Other accrued liabilities	(7)				
I. Provisions for employees' pensions and similar commitments			344,533		318,888
II. Provisions for tax			804,386		608,333
III. Other provisions			787,581		606,662
				1,936,500	1,533,883
E. Deposits retained on retroceded business				1,611,409	1,451,234
F. Other liabilities					
I. Accounts payable on reinsurance business Thereof to – affiliated companies: T€144,134 (299,172) – participating interests: T€651 (1)			1,778,834		1,937,296
II. Notes and debentures	(8)		–		1,239,426
III. Amounts owed to banks			149,046		127,176
IV. Miscellaneous liabilities Thereof towards – affiliated companies: T€133,956 (141,741) – participating interests: T€– (3) Thereof from taxes: T€9,489 (7,110) Thereof for social security: T€4,310 (4,089)			271,144		295,012
				2,199,024	3,598,910
G. Deferred items				1,127	2,084
Total equity and liabilities				82,869,178	76,592,645

Income statement for the business year 2005

Items	Notes	T€	T€	T€	Prev. year T€
I. Technical account					
1. Earned premiums for own account					
a) Gross premiums written		19,167,183			19,242,562
b) Retroceded premiums		1,307,872			1,112,748
			17,859,311		18,129,814
c) Change in gross unearned premiums		–112,462			87,712
d) Change in retroceded share of unearned premiums		48,362			–1,371
			–64,100		86,341
				17,795,211	18,216,155
2. Interest on underwriting provisions for own account	(10)			1,091,081	880,373
3. Other underwriting income for own account				–6,469	15,744
4. Claims incurred for own account					
a) Claims paid					
aa) Gross amount		7,682,716			12,197,217
ab) Retroceded amount		477,495			959,416
			7,205,221		11,237,801
b) Change in provision for outstanding claims					
ba) Gross amount		8,644,965			1,357,642
bb) Retroceded amount		606,758			–259,411
			8,038,207		1,617,053
				15,243,428	12,854,854
5. Change in other underwriting provisions for own account					
a) Net provision for future policy benefits			–180,998		–487,283
b) Other net underwriting provisions			9,582		62,615
				–171,416	–424,668
6. Expenses for premium refunds for own account				7,818	2,727
7. Operating expenses for own account	(11, 14)				
a) Gross operating expenses			5,693,665		5,463,899
b) Less commission received on retroceded business			296,109		287,391
				5,397,556	5,176,508
8. Other underwriting expenses for own account				17,947	31,133
9. Subtotal				–1,958,342	622,382
10. Change in claims equalisation provision and similar provisions				251,875	–1,128,936
11. Underwriting result for own account	(9)			–1,706,467	–506,554

Items	Notes	T€	T€	T€	T€	Prev. year T€
II. Non-technical account						
1. Investment income	(12)					
a) Dividends from participating interests Thereof from affiliated companies: T€154,873 (63,586)			160,107			69,484
b) Income from other investments Thereof from affiliated companies: T€703,062 (461,253)						
ba) Rents from land and buildings, including buildings on third-party land		131,136				134,983
bb) Income from other investments		2,582,116				2,411,701
			2,713,252			2,546,684
c) Income from write-ups			494,769			289,194
d) Realised gains on investments			1,912,117			1,069,044
e) Income from profit-transfer agreements			181			–
				5,280,426		3,974,406
2. Investment expenses	(11, 13, 14)					
a) Expenses for the management of investments, interest paid and other expenses for investments			216,189			123,707
b) Write-downs of investments			2,443,216			844,299
c) Realised losses on investments			66,020			119,383
d) Expenses from loss transfers			2			954
				2,725,427		1,088,343
				2,554,999		2,886,063
3. Interest income on underwriting provisions				1,163,949		999,260
					1,391,050	1,886,803
4. Other income					447,321	298,637
5. Other expenses	(14)				725,186	804,195
6. Operating result before tax					–593,282	874,691
7. Taxes on income				393,041		91,539
8. Other taxes				5,806		6,193
					398,847	97,732
9. Profit/loss for the year					–992,129	776,959
10. Profit brought forward from previous year					2,122	721
11. Withdrawal from/transfer to revenue reserves					–1,701,706	318,520
12. Net retained profits					**711,699**	**459,160**

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 bearer papers and zero bonds issued to affiliated companies and participating interests, 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. Own shares are valued at acquisition cost or market value, whichever is the lower.

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

Underwriting provisions
The underwriting 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 we have.
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 account of the risks of change, error and random fluctuations. 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 underwriting 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.
Underwriting provisions apportionable to the business retroceded by us have been calculated in accordance with the terms of the retrocession agreements.

Other accrued liabilities

The amount recognised for the provision for employees' pensions is derived from the IAS approach using the corridor method. With this method, the provision is determined from the amount of the liability less unrecognised actuarial losses.
For calculating the amount of the liability, an actuarial interest rate of 4.0% (5.0%) is applied and future increases in entitlement and pensions are taken into account. The actuarial assumptions used are the Heubeck 2005 G tables. On this basis, the amount of the liability is €453m.
The actuarial losses recognised in the corridor amount to €108m (41m). Of the increase in the actuarial losses, €57m is due to the reduction in the actuarial interest rate and €10m to the changeover to the Heubeck 2005 G tables.
The reserve amount is €86m above the net present value of future pension payments computed using the entry age normal method in accordance with 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 2.8% (3.0%), 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. For the balance sheet, foreign currencies have been translated using the respective year-end exchange rates. In the income statement, moving average exchange rates are used.
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		Income statement	
	31.12.2005	Prev. year	**31.12.2005**	Prev. year
Australian dollar	**1.60800**	1.73395	**1.63209**	1.68959
Canadian dollar	**1.37790**	1.62860	**1.50867**	1.61701
Pound sterling	**0.68710**	0.70795	**0.68391**	0.67878
Rand	**7.48125**	7.65770	**7.91096**	8.00423
Swiss franc	**1.55460**	1.54565	**1.54848**	1.54385
US dollar	**1.17955**	1.35925	**1.24458**	1.24402
Yen	**139.22200**	139.28200	**136.84200**	134.42000

Notes to the balance sheet – Assets

The intangible assets and investments developed as follows in the year under review:

	Carrying amount 31.12.2004 T€	Currency translation effects T€	Additions T€	Reclassifications T€	Disposals T€	Write-ups T€	Write-downs T€	**Carrying amount 31.12.2005 T€**
(1) Intangible assets	116,487	–	18,157	–	–34	–	–35,694	**98,916**
(2) Investments								
Land, land rights and buildings, including buildings on third-party land	1,036,821	–	3,944	–	–1	1,759	–37,971	**1,004,552**
Investments in affiliated companies and participating interests								
– Shares in affiliated companies	11,929,167	17	1,235,964	–	–294,030	27,523	–964,187	**11,934,454**
– Loans to affiliated companies	1,193,029	145,385	197,429	–	–18,304	–	–1,333,056	**184,483**
– Participating interests	1,085,811	753	198,783	11,110	–1,181,177	6,482	–1,683	**120,079**
– Loans to participating interests	43,209	3,200	–	–	–20,251	–	–	**26,158**
	14,251,216	149,355	1,632,176	11,110	–1,513,762	34,005	–2,298,926	**12,265,174**
Other investments								
– Shares, investment fund certificates and other non-fixed-interest securities	12,927,179	629,402	3,770,937	–11,110	–2,197,413	335,816	–69,897	**15,384,914**
– Bearer bonds and other fixed-interest securities	17,937,158	719,406	24,345,997	–	–23,689,227	11,301	–58,581	**19,266,054**
– Mortgage loans	10,045	–	519	–	–3,474	–	–	**7,090**
– Other loans								
– Registered bonds	4,300	782	338	–	–	–	–	**5,420**
– Loans and promissory notes	2,724	–	40	–	–2,622	–	–	**142**
– Miscellaneous	169	31	–	–	–10	–	–	**190**
– Deposits with banks	379,199	29,593	7,427	–	–105,808	–	–	**310,411**
– Miscellaneous investments	105,037	–	745	–	–5,493	117,965	–19,291	**198,963**
	31,365,811	1,379,214	28,126,003	–11,110	–26,004,047	465,082	–147,769	**35,173,184**
Total investments (2)	**46,653,848**	**1,528,569**	**29,762,123**	**0**	**–27,517,810**	**500,846**	**–2,484,666**	**48,442,910**

In the business year 2005, the write-ups and write-downs of investments have been shown at year-end exchange rates, whereas in the income statement they have been measured using average 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 land and buildings totals €220m (254m).
Of the total write-downs of investments in affiliated companies and participating interests, €182m is for a credit line granted to American Re Corporation and €1,113m for a loan granted to Munich American Holding Corporation, which were waived along with the accrued interest. Besides this, in connection with the reserve strengthening at American Re-Insurance Company, we increased the capital base of Munich American Holding Corporation from available resources. Our subsequent write-down of this capital injection amounted to €895m.
The item "miscellaneous investments" is largely made up of swaptions (see Derivatives).
Of our total investments (excluding deposits retained on assumed reinsurance) with a carrying amount of €48,443m (46,654m), an amount of €6,110m (5,125m) is deposited with ceding companies or foreign governments or in the custody of trustees nominated by us. In addition, investments of €337m (326m) are subject to a restraint on disposal, having been transferred to the custody of a trustee solely to safeguard pension commitments and the provision for comparable benefits.

Derivatives	Balance sheet item	Carrying amount T€	Fair value T€	Notional principal amount T€
Equity and index risks				
Long stock options	Shares, investment fund certificates and other non-fixed-interest securities	40,352	45,145	732,527
Total return swaps (hedge fund certificates)	Other deferred items	12,166	15,778	100,000
Interest-rate risks				
Interest-rate swaptions	Other investments	198,267	198,267	1,524,950
Interest-rate guarantee	Other provisions	–198,267	–198,267	–1,524,950
Interest-rate swaps	Other provisions	–	9,230	67,967
Currency risks				
Currency forwards	Other provisions	–1,880	–1,880	577,381
Other transactions				
Credit default swaps	Other investments	696	696	16,000

Derivative financial instruments (derivatives) are financial instruments whose fair value is derived from one or more underlying assets.
We generally use derivatives only for hedging parts of the portfolio, optimising earnings, and implementing 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.
Besides this, to hedge an interest-rate risk (interest-rate guarantee) assumed in underwriting business, we have purchased interest-rate swaptions
In relation to the balance sheet total, the volume of open positions at the balance sheet date and all the transactions concluded in the period under review was negligible.
Derivatives are generally valued at the acquisition cost or their 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.
The only exceptions are interest-rate swaptions, which are always accounted for at fair value.
All the derivatives are over-the-counter products. Recognised valuation methods are used to determine their fair values: the present-value method for interest-rate swaps, credit default swaps and currency forwards; the Black-Scholes model for equity options; and the Black model for interest-rate swaptions and interest-rate guarantees. Valuation on the basis of these methods includes parameters such as interest rate curves, volatility factors, default rates, and current market and transaction prices (interest rates, share prices and exchange rates) for the underlying financial instruments.
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 fair value of investments recognised at acquisition cost (without deposits retained on assumed reinsurance), in accordance with Section 54 of the German Accounting Regulations for Insurance Companies, amounts to €57.7bn (52.7bn). The relevant carrying amount totals €47.7bn (45.9bn). This results in valuation reserves of €10.0bn (6.8bn) for the business year 2005.
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 capitalised earnings value. In the case of 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 to determine fair values.
Altogether, there were no hidden negative valuation differences on financial instruments as at 31 December 2005.

(3) List of shareholdings

The information to be disclosed in accordance with Section 285 item 11 of the German Commercial Code is filed with the commercial registry in Munich.

Notes to the balance sheet – Equity and liabilities

(4) Equity

The total share capital of €587,725,396.48 as at 31 December 2005 is divided into 229,580,233 registered no-par-value shares, each fully paid up and entitled to one vote.
On 26 May 2004, the Annual General Meeting voted to replace Authorised Capital Increase 2002, which amounted to €89,662,858.24 following its partial utilisation, by a new amount of €280m (Authorised Capital Increase 2004).
The capital authorised for capital increases comprises the following items:

All figures in €m	31.12.2005
Authorised Capital Increase 2004 (until 25 May 2009)	280.0
Authorised Capital Increase 2001 (until 18 July 2006)	3.8
Total	**283.8**

The contingent capital is as follows:

All figures in €m	31.12.2005
To safeguard conversion rights or subscription rights from convertible bonds or bonds with warrants (Contingent Capital Increase 2005 I)	100
To safeguard subscription rights from exercise of warrants (Contingent Capital Increase 2003 I)	35
Total	**135**

The withdrawal from the revenue reserves amounts to €1,702m. The revenue reserves contain a reserve for own shares amounting to T€11.
Net retained profits include a profit of T€2,122 carried forward from the previous year.
By resolution of the Annual General Meeting on 26 May 2004, Munich Re was authorised to buy back shares amounting to a maximum of 10% of the share capital up to 25 November 2005. This authorisation was cancelled by the Annual General Meeting on 28 April 2005 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 27 October 2006.
On 31 December 2005, a total of 1,572,570 Munich Re shares with a calculated nominal value of €4,025,779.20 were held by Group companies. This represents 0.68% of the share capital.
13,564 shares were purchased at an average price of €87.81 for the employee share programme set up by Munich Reinsurance Company in 2005. After subscription by the employees in 2005 and taking into account the 1,436 shares remaining from the employee share programme in 2004, a total of 130 shares remain. In addition, one subsidiary holds 1,203,269 shares to safeguard stock appreciation rights granted to the Board of Management and top Munich Re executives since 2000. A total of 400,000 shares were acquired for this in 2005 at an average price of €85.02 each.
In the business year 2005, companies of the ERGO Insurance Group acquired 147,374 shares at an average price of €89.78 each to cover future commitments from the long-term incentive plans launched since 2003, and sold 64,361 shares at €115.18 each and 3,478 shares at €97.85. Together with the remaining Munich Re shares acquired in the years 2002–2004 to safeguard stock appreciation rights issued, the ERGO Group thus had a total portfolio of 300,235 shares at 31 December 2005.
Europäische Reiseversicherung AG also acquired a further 5,300 Munich Re shares at a price of €85.40 each and 7,372 shares at a price of €94.34 in the year under review to safeguard future obligations from its long-term incentive plan set up in 2003. As at 31 December 2005, together with the shares acquired in 2003 to safeguard the long-term incentive plan, it had a total portfolio of 16,872 shares.
MEAG MUNICH ERGO AssetManagement GmbH acquired 20,843 shares at an average price of €94.77 each in the business year 2005, also to safeguard obligations from its long-term incentive plan, and thus holds a total portfolio of 52,064 Munich Re shares.
The acquisition costs of all Munich Re shares in the possession of Group companies at the end of the business year totalled €201,144,896.75.
The Company has received the following notifications pursuant to Section 21 para. 1 of the German Securities Trading Act regarding voting-right percentages:

- UniCredito Italiano S.p.A., Genoa (Italy), notified us that on 9 December 2005 it held 4.8920% of the voting rights in Munich Reinsurance Company, stating that these were not held directly but were attributable to UniCredito Italiano S.p.A. in accordance with Section 22 para. 1 sentence 1 item 6 of the German Securities Trading Act.
- At the same time, Bayerische Hypo- und Vereinsbank Aktiengesellschaft, Munich, notified us that on 9 December 2005 it held 4.8879% of the voting rights in Munich Reinsurance Company, 0.0094% of which were attributable to it in accordance with Section 22 para. 1 sentence 1 item 6 of the German Securities Trading Act.

– Allianz Aktiengesellschaft, Munich, notified us that AZ-Arges Vermögensverwaltungsgesellschaft mbH, Munich, held 7.06% of the voting rights in Munich Reinsurance Company on 26 September 2005, following an intra-group share transfer. In addition, Allianz Aktiengesellschaft informed us that its percentage of voting rights in Munich Reinsurance Company had not changed in a notifiable manner.

(5) Subordinated liabilities

The income 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 business year 2003. The period to redemption of each bond is more than five years. To improve transparency, these legal transactions are shown separately under the item "B. Subordinated liabilities". In the business 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) Underwriting provisions

Broken down by class of business, the net underwriting funds and provisions are as follows (in €m):

	Unearned premiums	Provision for future policy benefits	Claims provision	Claims equalisation provision	Other provisions	**Total**	**Reserves as % of net premiums**
Life	1,391	16,609	1,314	5	581	**19,900**	**371**
Health	95	912	410	2	31	**1,450**	**127**
Accident	95	702	3,801	–	4	**4,602**	**557**
Liability	391	–	11,392	1,547	10	**13,340**	**770**
Motor	381	–	5,651	657	83	**6,772**	**308**
Marine	219	–	1,208	159	8	**1,594**	**201**
Aviation	283	–	923	954	–	**2,160**	**358**
Fire	664	–	5,027	2,437	116	**8,244**	**309**
Engineering	539	–	1,546	924	6	**3,015**	**275**
Other classes	310	–	1,154	1,098	14	**2,576**	**179**
Non-life combined	2,977	1,614	31,112	7,778	272	**43,753**	**350**
Total	**4,368**	**18,223**	**32,426**	**7,783**	**853**	**63,653**	**356**

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:

	31.12.2005 T€	Prev. year T€
Claims equalisation provision	**7,106,411**	6,359,078
Provision for major risks	**286,301**	249,087
– For nuclear facilities	**68,223**	65,365
– For pharmaceutical product liability	**60,936**	56,703
– For terrorism risks	**157,142**	127,019
Provisions for natural hazards	**390,092**	1,351,662
Total	**7,782,804**	**7,959,827**

The provision for anticipated losses totals T€0 (1,783) in the year under review.

(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 "Versorgungskasse der Angestellten der Münchener Rückversicherungs-Gesellschaft", the Munich Re staff pension fund.
There are pension provisions of T€51,980 (51,731) for former members of the Board of Management or their surviving dependants.
The other provisions include, in particular, provisions of T€394,343 for currency risks. They also include a provision of T€198,267 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€146,779 have been posted for personnel expenses not yet due at the balance sheet date.

(8) Notes and debentures

The Company's bonds exchangeable into Allianz AG shares were redeemed from available funds in June 2005.

Notes to the income statement

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

	Gross premiums written		Underwriting result		Change in claims equalisation provisions		Combined ratio in %	
	2005	2004	**2005**	2004	**2005**	2004	**2005**	2004
Life	5,747	5,680	203	164	–2	–2	**–**	**–**
Health	1,199	1,148	–22	6	–1	–1	**101.9**	**99.4**
Accident	861	758	–1,093	–44	–	–	**227.4**	**105.8**
Liability	1,782	1,985	–477	–345	69	349	**126.5**	**117.4**
Motor	2,297	2,443	–2	–154	64	–6	**100.2**	**106.3**
Marine	833	702	–150	–10	51	–50	**119.4**	**102.2**
Aviation	773	857	89	107	–165	–205	**85.3**	**82.9**
Fire	2,973	3,054	–863	484	661	–739	**131.2**	**82.8**
Engineering	1,176	1,104	276	129	–192	–195	**73.8**	**87.6**
Other classes	1,526	1,512	81	285	–233	–280	**94.3**	**80.7**
Non-life combined	13,420	13,563	–2,161	458	254	–1,127	**117.0**	**96.4**
Total	**19,167**	**19,243**	**–1,958**	**622**	**252**	**–1,129**	**–**	**–**

(10) Interest on underwriting provisions

We have calculated the interest on underwriting 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.

(11) Personnel expenses

The management expenses include the following personnel expenses:

	2005 T€	Prev. year T€
Wages and salaries	**309,353**	247,537
Social insurance contributions and voluntary assistance	**66,789**	49,938
Expenses for employees' pensions	**32,392**	21,480
Total	**408,534**	**318,955**

They also include expenses for a long-term incentive plan, which links compensation for the Board of Management and top executives of the Munich Re Group to the performance of Munich Re's share price.

(12) Investment income

The write-ups result from the reversal of no longer required write-downs.

(13) Investment expenses

Of the write-downs of investments, T€2,340,929 (790,480) comprised write-downs for impairment as per Section 253 para. 2 sentence 3 of the German Commercial Code.

(14) Long-term incentive plans

Since 1 July 1999, at yearly intervals, 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. The participants receive a certain number of stock appreciation rights. The relevant initial share price for the stock appreciation rights 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 2005 long-term incentive plan is €88.10 (88.65).

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 previous years, the personnel expenses and income incurred for the stock appreciation rights were determined on the basis of the change in the intrinsic value (difference between current share price and initial share price for the stock appreciation rights). As from 1 January 2005, the calculation is made on the basis of the change in the fair value of the underlying options, as this takes into account not only the intrinsic value but also the possibility of growth in value up to the date of forfeiture or expiry of the rights.
At each balance sheet date, the fair value of the stock appreciation rights is measured and reserved on the basis of recognised valuation models, with due regard to the exercise conditions. The personnel expenses recognised in the income statement therefore correspond to the change in the provision in the year under review, taking into account any rights exercised.
In the year under review, a total of 487,544 (456,336) stock appreciation rights were granted, 138,833 (133,803) of these to Board of Management members. As from 2005, the overall total includes stock appreciation rights held by the reinsurance subsidiaries. Altogether, as a result of this, 134,783 stock appreciation rights were transferred to the Company. The previous year's figure has been adjusted accordingly. Munich Re shares have been acquired to cover future obligations arising from the long-term incentive plans.
In 2005, provisions of €46.8m (4.6m) had to be posted, with personnel expenses amounting to €44.9m (–1.1m). Of this, €16.6m is due to a one-off adjustment required by the change in accounting method in the business year 2005.
The weighted average share price for the stock appreciation rights exercised in 2005 was €106.69 for plan year 2003. The intrinsic value of the exercisable stock appreciation rights amounted to €8.7m at the balance sheet date.
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 in control"), all plan participants may exercise their stock appreciation rights within 60 days after the change in control becomes effective, even if the prerequisites for exercising the rights are not yet met at that juncture.

Munich Re's incentive plans 1999–2005

	1999	2000	2001	2002	2003	2004	2005
Plan commencement	1.7.1999	1.7.2000	1.7.2001	1.7.2002	1.7.2003	1.7.2004	1.7.2005
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
Intrinsic value 2005 for one right	–	–	–	–	€33.53	€26.90	€27.45
Fair value 2005 for one right	€0.09	€0.05	€0.51	€2.91	€39.30	€37.31	€39.44
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	–	–	–	–	117,748	–	–
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
Exercisable at year-end	78,981	77,394	106,286	133,772	259,678	–	–

(15) Boards of the Company

The Board of Management

Dr. jur. Nikolaus von Bomhard
(Chairman of the Board of Management)

* 1956, lawyer, with Munich Re since 1985
Group Development (formerly Strategic Planning)
Press
Internal Auditing
Executive Offices, Group Top Executives

Dr. rer. pol. Thomas Blunck (from 1 October 2005)

* 1965, graduate in business management, with Munich Re since 1999
Special and Financial Risks
(until 31 December 2005 together with Dr. Jeworrek)
Information Technology (until 31 December 2005 together with Dr. Jeworrek)

Georg Daschner

* 1949, chartered insurer, with Munich Re since 1965
Europe 2 and Latin America

Dr. jur. Heiner Hasford

* 1947, lawyer, with Munich Re since 1978
Group Investments, Corporate Finance, M&A
(from 1 January 2006 without Reinsurance Investments)
Legal and Regulatory Affairs, Compliance (since 1 January 2006)
General Services
Organisational Design and Development

Stefan Heyd (until 31 December 2005)

* 1945, lawyer, with Munich Re since 1975
Corporate Underwriting/Global Clients
(from 1 October 2005 together with Dr. Jeworrek)

Dr. rer. nat. Torsten Jeworrek

* 1961, mathematican, with Munich Re since 1990
Corporate Underwriting/Global Clients
(from 1 October 2005; until 31 December 2005 together with Mr. Heyd)
Reinsurance Investments (from 1 January 2006)
Accounting, Controlling and Central Reserving for Reinsurance
(from 1 January 2006)
Special and Financial Risks
(until 31 December 2005; from 1 October 2005 together with Dr. Blunck)
Information Technology (until 31 December 2005; from 1 October 2005 together with Dr. Blunck)

Christian Kluge

* 1941, chartered marine insurer, with Munich Re since 1964
Europe 1
Corporate Communications

John Phelan

* 1947, underwriter, with Munich Re since 1973
North America

Dr. phil. Detlef Schneidawind (until 31 December 2005)
(Board member in charge of industrial relations, within the meaning of Section 33 of the German Co-Determination Act)

* 1944, lawyer, graduate in business management, with Munich Re since 1973
Life and Health (from 1 October 2005 together with Dr. Strassl)
Human Resources

Dr. jur. Jörg Schneider

* 1958, business graduate, lawyer, with Munich Re since 1988
Group Accounting (from 1 January 2006 without Accounting for Reinsurance)
Group Controlling (from 1 January 2006 without Controlling for Reinsurance)
Integrated Risk Management
Taxes
Investor Relations

Dr. oec. publ. Wolfgang Strassl (from 1 October 2005)
(Board member in charge of industrial relations, within the meaning of Section 33 of the German Co-Determination Act) (from 1 January 2006)

* 1956, graduate in economics, with Munich Re since 1988
Life and Health (until 31 December 2005 together with Dr. Schneidawind)
Human Resources (from 1 January 2006)

Karl Wittmann

* 1945, chartered insurer, with Munich Re since 1961
Asia, Australasia, Africa

The Supervisory Board

Chairman

Dr. 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
Co-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. e.h. Dipl.-Ing. Bernd Pischetsrieder
Chairman of the Board of Management of Volkswagen AG

Dr. rer. nat. Jürgen Schimetschek
Employee of Munich Reinsurance Company

Dr. jur. Dr. h.c. Albrecht Schmidt
Chairman of the Supervisory Board of Bayerische Hypo- und Vereinsbank AG (until 27 November 2005)

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 Võ
Employee of Munich Reinsurance Company

Membership of the Supervisory Board committees

Personnel Committee

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

Standing Committee

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

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 Võ

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)	–
Dr. rer. pol. Thomas Blunck (from 1 October 2005)	–	New Reinsurance Company, Geneva* (Chairman)
Georg Daschner	–	Münchener Rück Italia S. p. A., Milan* (Chairman)
Dr. jur. Heiner Hasford	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* WMF Württembergische Metallwarenfabrik AG	American Re Corporation, Wilmington, Delaware*
Stefan Heyd (until 31 December 2005)	EXTREMUS Versicherungs-AG Münchener und Magdeburger Agrarversicherung AG	–
Dr. rer. nat. Torsten Jeworrek	–	–
Christian Kluge	Karlsruher Versicherung AG (Chairman) Mercur Assistance AG Holding (Chairman)	–
John Phelan	–	American Re Corporation, Wilmington, Delaware* (Chairman) American Re-Insurance Company, Princeton* (Chairman) Munich Reinsurance Company of Canada, Toronto*
Dr. phil. Detlef Schneidawind (until 31 December 2005)	DKV Deutsche Krankenversicherung AG* Hamburg-Mannheimer Sachversicherungs-AG* Hamburg-Mannheimer Versicherungs-AG* Karlsruher Lebensversicherung AG (Chairman) Mecklenburgische Kranken Versicherungs-AG Mecklenburgische Leben Versicherungs-AG	Munich American Reassurance Company, Atlanta*
Dr. jur. Jörg Schneider	MEAG MUNICH ERGO Kapitalanlagegesellschaft mbH*	American Re Corporation, Wilmington, Delaware*
Dr. oec. publ. Wolfgang Strassl (from 1 October 2005)	DKV Deutsche Krankenversicherung AG* Hamburg-Mannheimer Sachversicherungs-AG* Hamburg-Mannheimer Versicherungs-AG*	Munich American Reassurance Company, Atlanta*
Karl Wittmann	–	Jordan Ins. Co. p. l. c., Amman Saudi National Insurance Company E. C., Jeddah

[1] Status: 31 December 2005/1 January 2006 (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	Deutsche Telekom AG METRO AG	
Ulrich Hartmann	Deutsche Bank AG Deutsche Lufthansa AG E.ON AG (Chairman) Hochtief AG IKB Deutsche Industriebank AG (Chairman)	Henkel KGaA Arcelor S. A., Luxembourg
Prof. Dr. rer. nat. Henning Kagermann	DaimlerChrysler Services AG 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 Thomas Cook AG LSG Lufthansa Service Holding AG* Lufthansa Cargo AG* Lufthansa CityLine GmbH* (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 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. e. h. Dipl.-Ing. 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

[2] Status: 31 December 2005.
* Own group company within the meaning of Section 18 of the German Stock Companies Act.

(16) Remuneration and loans for Board members

In the year under review, after allocation to the appropriate periods, the remuneration of Munich Re's Board of Management showed an overall rise of T€6,324 or 39.6% from T€15,949 to T€22,273. Of this, T€410 was attributable to an increase in the fixed components and T€3,803 to growth in the variable remuneration, mainly due to the good result for the year under review. In addition, with a comparable calculation approach for the long-term incentive plan, there was an increase of T€ 2,111 resulting largely from the appreciation in the share price.

Expenses for the total compensation of the members of the Company's Board of Management in the year under review amounted to T€29,804 (14,755), of which T€7,531 (1,786) is apportionable to previous years. This includes the remuneration components that Mr. Phelan received for his work as member of the Company's Board of Management, namely annual bonus and medium-term incentive plan, as well as his travel expenses from the USA to Munich. The accounting method for the long-term incentive plans was changed in 2005 from measurement at intrinsic value (difference between current share price and initial share price for the stock appreciation rights) to measurement at fair value. The latter takes into account not only the intrinsic value 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. From now on, we will include the personal expenses for the stock appreciation rights granted in the year under review so that the stock appreciation rights granted are transparent and presented in relation to the correct periods. In addition, we show the

All figures in T€	2005 For 2005	2005 For prev. years	2004 For 2004	2004 For prev. years
Total remuneration[1]	22,273	7,531	12,969	1,786
Fixed components	5,775		5,365	
Basic remuneration	5,340		4,838	
Remuneration in kind/fringe benefits	435		527	
Statutory social benefits	22		20	
Voluntary social benefits	33		35	
Company car	100		97	
Healthcare	4		4	
Security measures	–		–	
Insurance	49		47	
Special remittances[2]	90		163	
Tax for remuneration in kind/fringe benefits	137		161	
Variable components	16,498	7,531	7,604	1,786
Annual bonus 2003				
Expenses[3]				1,635
Annual bonus 2004				
Allocation to provision			4,860	
Reduction of provision[4]		–71		
Annual bonus 2005				
Allocation to provision	7,682			
Medium-term incentive plan (2003–2005)[5]				
Allocation to provision	3,340		2,430	832
Long-term incentive plan[6]				
Personnel expenses for newly granted stock appreciation rights	5,476		314	
Personnel expenses for stock appreciation rights granted in previous years		7,602[7]		–681

[1] Presentation on an accruals basis as from 2005. The previous year's figures have been partially adjusted for comparative purposes.
[2] For example, gifts on special birthdays/anniversaries, travel expenses for Mr. Phelan (Princeton–Munich)
[3] Annual bonus payment for 2003 higher than estimated and reserved bonus payment.
[4] Annual bonus payment for 2004 lower than estimated and reserved bonus amount.
[5] The provisions for the medium-term incentive plan 2003–2005 total T€8,042 as at 31 December 2005.
[6] 2004 provisions shown on the basis of intrinsic value; as from 2005 personnel expenses shown on fair-value basis. Higher expenses in 2005 for previous years derive from one-off adjustment required.
[7] Thereof T€526 for the stock appreciation rights of retired members of the Board of Management, who were granted these rights during their period of active service on the Board.

personnel expenses incurred in the business year from the development of stock appreciation rights issued in previous years. The higher personnel expenses shown in 2005 for previous years derives primarily from the one-off adjustment required by the new accounting method. If the stock appreciation rights granted in 2004 had been measured using the new accounting method, the personnel expenses for these would have amounted to T€3,365. This figure compares with T€5,476 for 2005. The expenses incurred in 2005 for previous years would be reduced accordingly. Basic remuneration made up 24% of overall compensation for 2005, and remuneration in kind and fringe benefits amounted to 2%. The variable remuneration includes allocations to provisions for the annual bonus probable on the basis of current estimates, for the medium-term incentive plan and the long-term incentive plans. Whether these amounts 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. In accordance with the plan conditions, no payments were made under the medium-term incentive plan in the business year. 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.
In 2005, the average level of provision for the pension entitlements of the members of Munich Re's Board of Management amounted to 40% (38%) of basic remuneration. Personnel expenses of T€1,618 (2,158) were incurred for the increase in the pension obligations for active members of the Board of Management. As at 31 December 2005, the pension provisions and provisions for comparable benefits for the active members of the Board of Management amounted to T€33,595 (30,409).
Payments to retired members of the Board of Management or their surviving dependants totalled T€4,271 (4,258). Personnel expenses of –T€18 (+1,324) were incurred for the increase in the pension provisions and provisions for comparable benefits of retired members of the Board of Management. As at 31 December 2005, the pension provisions and provisions for comparable benefits for former members of the Board of Management amounted to T€50,999 (51,731).
The remuneration of the Supervisory Board was restructured by resolution of the 2005 Annual General Meeting. With effect from the business year 2005, it provides for a fixed remuneration component of T€45 (instead of the previous T€25) and a variable result-related (instead of dividend-related) remuneration component. The remuneration of members of the Supervisory Board in the year under review totalled T€1,865 (1,799). This includes variable remuneration of T€677 (1,168).
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 have been entered into on their behalf.

(17) Number of staff

The number of staff employed by the Company in Munich and at its offices abroad in the business year 2005 averaged 3,433 (3,265).

(18) Auditor's fees

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

	2005 T€
Audits of financial statements	774
Other assurance and appraisal services	142
Tax consultancy services	446
Other services	2,378
Total	**3,740**

KPMG has supported Munich Re in connection with the Gloria project, primarily with assurance and appraisal services, e.g. in relation to the migration of data 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".

(19) Contingent liabilities, other financial commitments

The Company has given a customary market guarantee and a guarantee required by supervisory law for the liabilities of one foreign subsidiary.
For three foreign subsidiaries, guarantees have been given in connection with a loan obligation of US$ 250m and two rent guarantees of US$ 1m and £0.5m.
Besides this, in conjunction with a sale of shares, the Company has assumed a liability towards the purchaser totalling a maximum of £2m.
The transfer to ERGO of part of the income from the subordinated bonds issued by Munich Re Finance B.V. results in a contingent liability of €386m for the Company.
Otherwise, there are no contingent liabilities of significance for the assessment of the Company's financial position.
There are other financial commitments amounting to €607.8m. These result mainly from open forward exchange transactions (€576m) and various agency agreements concluded by the Company.

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

"Between the last declaration of compliance in December 2004 and 20 July 2005, Munich Re fulfilled the recommendations of the Government Commission's German Code of Corporate Governance in the version of 21 May 2003, with the exception stated below. Since 21 July 2005, Munich Re has fulfilled the recommendations of the Government Commission's German Code of Corporate Governance in the version of 2 June 2005 (published on 20 July 2005) and will continue to fulfil these recommendations, with the exception stated below:

- Item 4.2.4 sentence 2
  For the business year 2004, the remuneration of the members of Munich Re's Board of Management was shown in detail for the whole Board in the notes to the consolidated financial statements, broken down according to fixed compensation, performance-related components and components with long-term incentive effect, although not individualised as recommended by the German Code of Corporate Governance. For the business year 2005, too, the Board of Management's remuneration will be published in detail for the whole Board but not individualised."

(21) Proposal for appropriation of profit

The net retained profits at the disposal of the Annual General Meeting amount to €711,698,722.30.
We propose that this amount be appropriated as follows: distribution of a dividend of €3.10 on each share entitled to dividend, with the amount apportionable to own shares 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 or sale of own shares. In this case, a suitably modified proposal for the appropriation of the profit, with a dividend of €3.10 per share entitled to dividend, will be made to the Annual General Meeting.

Munich, 24 February 2006

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 business year from 1 January 2005 to 31 December 2005. 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 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, 3 March 2006

KPMG Bayerische Treuhandgesellschaft Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Herbert Loy	Dr. Frederik Boetius
Wirtschaftsprüfer	Wirtschaftsprüfer
(Certified public accountant)	(Certified public accountant)

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Responsible for content
Accounting
Corporate Communications

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