ERNST & YOUNG

MLP Lebensversicherung Aktiengesellschaft, Heidelberg
MLP-Lebensversicherung Aktiengesellschaft, Wien
MLP Versicherung Aktiengesellschaft, Heidelberg

Examination of the accounting methods for invoices relating to reinsurance contracts within the annual accounts at 31. December 2001

ERNST & YOUNG

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A. ASSIGNMENT AND TERMS OF REFERENCE

As a result of a resolution of the Managing Board of Marschollek, Lautenschläger und Partner Aktiengesellschaft, Heidelberg on 27. May 2002, which was passed by a resolution of the Supervisory Board on 28. May 2002, as well as of resolutions of the responsible executive bodies of the companies individually named below, we were assigned with examining the nature, reporting and valuation of invoices relating to reinsurance contracts (the reinsurance programme) of

MLP Lebensversicherung Aktiengesellschaft, Heidelberg (MLP Leben)
MLP-Lebensversicherung Aktiengesellschaft, Wien (MLP Leben Wien)
MLP Versicherung Aktiengesellschaft, Heidelberg (MLP Versicherung)

contained within the reporting of these companies and in their annual financial statements at 31. December 2001, with respect to compliance with the relevant statutory accounting requirements applicable to the named companies, and to provide a written report of the findings of this investigation to the Supervisory Board and the Managing Board of Marschollek, Lautenschläger und Partner Aktiengesellschaft as well as to the Supervisory Boards and Managing Boards of the above named companies.

The investigation of the valuation of the reinsurance programme also implicitly includes ascertaining if and to what extent the applicable or applied accounting norms and rules of orderly accounting could possibly lead to a commercially unjustifiable and incorrect presentation of the result achieved and the reporting of profits, particularly for the fiscal year 2001. Our valuation was based on the 2001 annual financial statements, audited by Rölfs WP Partner AG or KPMG Alpenhand-Treuhand GmbH and on the audited internal control systems, in so far as these concerned units of account allocated to reinsurance invoices, in particular the gross figures.

The methods used in this assignment and our responsibility and liability, including those towards Third Parties, are governed by the General Terms of Assignment for Auditors and auditing companies of the " Insitut der Wirtschaftsprüfer in Deutschland e. V" (Registered Institute of Auditors in Germany), as per 1. Jan 2002, which are contained in an appendix to this report. We refer particularly to section 9 of the General Terms of Assignment.

B SUMMARY OF FINDINGS

1. Compliance with accounting principles

Based on the documents made available to us and on conversations with the responsible members of the Managing Boards and with the relevant statutory auditor, we are of the firm opinion, that with respect to each of the annual financial statements at 31. December 2001:

The accounting and valuation methods used with respect to the reinsurance contracts are in accordance with the valid regulations relating to commercial and supervisory law.

The nature, reporting and valuation of all positions in the accounts as well as in the Profit and Loss account, relating to reinsurance contracts concluded by the companies, correspondingly derived from the relevant reinsurance invoices and from the gross figures audited by the Rölfs WP Partner AG or KPMG Alpen-Teuhand GmbH are correctly accounted for and appropriately valued.

2. Commercial Profit realisation

In the fiscal year 2001 the companies posted the following net result from reinsurance contracts and the following annual net profit

Company	Reinsurance profit Million €	Annual net eamings Million €
MLP Lebensversicherung, AG, Heidelberg	37.7*)	11.7
MLP-Lebensversicherung AG, Wien	9.2*)	1.5
MLP Versicherung AG, Heidelberg	2.0	2.2

*) The figures result from the addition of the depot interest, technical interest and account balance interest to the reinsurance balance in accordance with the statutory standards which is shown in the appendix.

a) Commercial profit realisation in life insurance

As explained in more detail in sections C to F, young, rapidly growing life insurance companies have increasing financing requirements as their new business expands due to the payment of acquisition commissions to agents. As is typical throughout this sector, a reinsurer is involved in the whole of the business including its financing, whereby the commercial added value is reconciled with the annual profits shown in the reporting.

According to our own analyses and plausibility judgements, the relevant commercial actuarial value added (increase in the "embedded value" of the business in force applicable to the individual companies) for the current fiscal year clearly exceeds the relevant reported annual net profit, including the earnings contribution contained therein, from reinsurance contracts for the fiscal year 2001. This verifies that the reported annual net profits of each of the companies for the fiscal year 2001 are covered by the actuarial value added of the business in force in this year.

From a commercial point of view as well, there are no objections to the way in which both life insurance companies have reported their profit.

b) Commercial profit realisation in casualty insurance

Due to the short terms of insurance of regularly one year with corresponding profit realisation, the business of MLP Versicherung, which is concentrated around motor vehicle insurance, is shown in a such a way that the commercial business progress is equated to the reported profit in accordance with HGB (German Commercial Code).

The positive result is influenced by revenue from business expansion commissions on behalf of the reinsurer which are not unusual during the building up phase of a company but which, in the case of unfavourable future claim rates, can lead to a limited increase in the reinsurance premiums which is commercially covered by the business in force.

Our judgement relating to this reinsurance programme is that there are no objections to the earnings reporting of this company.

3. Obligations towards reinsurers

Our evaluation and appraisal of all the reinsurance contracts presented to us and of the companies mentioned, does not suggest that:

- the contracts contain any obligations which, at the balance sheet date 31. December 2001, should have been allocated to liabilities within the accounts of the relevant insurance company, over and above the booked reinsurance invoices

- any future operational obligations existed on the part of the individual companies towards reinsurers which, according to the status of the contractual relations in force available to us on 17. July 2002 could possibly have been a necessary entry in the balance sheet as an accrual for impending loss.

There is therefore no evidence of erroneous or incomplete balance sheet preparation of the reinsurance relationships.

4. Overall evaluation

The overall evaluation is determined as follows:

- In the annual financial statements presented the reinsurance relationships based on the contractual foundations and upon the gross figures examined by the auditors Rölfs WP Partner AG and KPMG Alpen-Treuhand GmbH have been applied, evaluated and reported in accordance with the valid accounting practice regulations.
- The annual net profit posted including the profits from reinsurance agreements will be born to the full extent by the commercial actuarial value added of the individual companies for the financial year 2001.
- There are no discernible obligations relating to the reinsurance contracts that need to be included in the balance sheet apart from those obligations covered in the balance sheet relating to reinsurers as per the cut-off date December 31st, 2001.

As such there are no discernible reasons for querying the adequate and orderly accounting practice and/or the result or profit presentation of the reinsurance relationships at

MLP Lebensversicherung Aktiengesellschaft, Heidelberg
MLP Lebensversicherung Aktiengesellschaft, Vienna
MLP Versicherung Aktiengesellschaft, Heidelberg

for the fiscal year 2001.

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C. ASSIGNMENT DOCUMENTS AND ASSIGNMENT METHODS

1. Assignment documents

The following documentation from the companies involved was presented to us to conduct the evaluation:

Company/documentation	MLP Leben	MLP Leben Vienna	MLP Versicherung
With the report with the unqualified audit opinion regarding the audit of the annual financial statement for the company as per 31st December 2001 by Rölfs WP Partner, Frankfurt			
Rölfs WP Partner, Frankfurt	22.03.2002		22.03.2002
KPMG Alpen-Treuhand Wirtschaftsprüfungs- und Steuerberatungsgesellschaft		13.03.2002	
Documentation and notes from the auditors concerning the reinsurance related items in the balance sheet and Profit and Loss account	X	X	X
All valid reinsurance contacts including appendixes and addendums from the company effective for the business year 2001	X	X	X
Documentation concerning premium and cost calculation and post calculation of the major tariffs for the business completed by the company itself			
unit-linked life insurance (tariffs sold in 2001)	X	X	
motor insurance			X

Furthermore, the Managing Boards of the named companies each guaranteed in a written declaration of completeness for each individual company involved that:

- all reinsurance relationships relating to facts concerning the companies involved have been provided and disclosed and
- no other further subsidiary agreements or obligations exist, either in the form of possible pending, derived or other non-balance sheet related business transactions.

2. Assignment methods

We conducted our audit between June 3rd and July 19th 2002 in the offices of each respective company, at the responsible auditing company and in our own offices as follows:

- Viewing and evaluation of the annual and audit reports
- Judgement of the accounting practices applied and explained in the appendix for adherence to the norms which must be applied in legal/supervisory terms
- Viewing the auditor's notes for compliance with the original information in the reinsurance program used as a basis and the assignments and invoices as well as explanations of the applied fundamental accounting practices and the effect of the reinsurance programs on the commercial situation of the companies
- Viewing and judgement of the reinsurance programs regarding compliance with contractual terms and conditions for assignments and invoices
- Transition of the reinsurance invoices for reporting purposes in the annual financial statement as per 31st December 2001
- Judgement of the reinsurance programs regarding the commercial profit realisation and the profit statement in the balance sheet
- Examination of the development of the commercial added value and the "embedded value" of business completed by the company before the background of the reported profit performance for the 2001 fiscal year
- Checking the plausibility of the development of the commercial value of the life insurance business in force regarding the new business for the fiscal year 2001, determined by third parties or from companies themselves based upon the products sold and expected economic and company-specific assumptions
- We did not examine the units of account upon which the reinsurance invoices are based, nor in particular the gross business figures or the internal controlling systems at each individual company, but instead referred to the audits in the annual financial statements by the respective auditing companies as per 31st December 2001.

D. REPORTING PRINCIPLES AND COMMERCIAL CONSEQUENCES

1. According to fundamental accounting practices to be applied under HGB (German Commercial Code)

In addition to the generally binding fundamental accounting practices in paragraph 242 ff. of the German Commercial Code (HGB) the paragraphs 341 to 341 as well as the Ordinance Regulating Accounting Practice in Insurance Companies (RechVersV) also contain supplementary, binding fundamental accounting procedures which are to be applied for insurance companies. Reinsurance relationships that are to be reported in compliance with the modified net principle (gross amounts in the pre-columns, net amounts after reinsurance in the main column) should be treated accordingly.

It is worthy of particular mention that paragraph 248 section 3 of the German Commercial Code (HGB) generally prohibits that the acquisition costs paid to the insurance agents be capitalised. Therefore a capitalisation cannot be considered either as an accrued item, as a debt or as a balance sheet aid (cf. ADS paragraph 248 III, 26). And the zillmering of insurance related reserves generally applicable in the conventional life insurance sector (paragraph 25, section 1 RechVersV) cannot be considered for MLP Leben and MLP Leben Wien because of the tariff and contractual terms for unit-linked life and pension insurance cover.

Since the acquisition costs for young, fast growing companies make up an over proportionally high share of the total costs, this means that poor results or even losses must be reported, which are higher the higher the new business is in comparison to the existing business in force.

Commission payments for business negotiated by reinsurers for the corresponding reinsurance contracts must hence be collected as income.

By Austrian trade law the accounting practices for insurance companies are largely applied as under German law, so that these do not require separate explanation.

2. Suitability of fundamental accounting practices for adequate profit reporting in the life insurance sector

Since the investor risk for the so-called “savings portion” of the insurance premium is borne by the policyholder for unit-linked life insurance and the risk and cost profits are partially also credited to the policyholder, the insurance company makes its profit from the margin worked into the contract, in particular from investment funds, as well as from possible risk and cost profits not credited to the policyholder.

Upon completion of a contract the policyholder is obliged to pay premiums for the contract period from which acquisition, administration, risk costs and the calculated profit flow proportionately to the company. The amount of profit resulting from the finalised life insurance policies only now depends upon how may policies are cancelled in the time frame (cancellation risk), from how many insured people die during the contract period (death risk) and whether the actual costs are less or higher than the calculated costs (cost risk). This limitation means that the profit value is known to the company upon contract completion and is to be valued as commercially realised.

These risks are valued in actuarial terms to define the profit earned in a financial year from new business, so that the amount of the actuarial added value ("embedded value" growth) generated in the business year following suitable risk reductions is known.

The comparison of this commercial dimension with the profits reported according to different accounting practice regulations results over time in clear imbalances between the added value and the balance sheet report, which are explained below.

3. **International comparison**

a. Under the German Commercial Code (HGB) all acquisition costs are to be reported as expenditure (if necessary with the exception of the zillmering in life insurance, which is however not applied by MLP Leben or MLP Leben Wien for unit-linked life and pension insurance cover), the insurance company's proportionate profit margin is taken into account for the earnings only upon premium payment (realisation principle), so that a profit can only then be reported if the total of all margin shares exceeds that of the costs to be treated directly as expenditure items. As such commercially eared profits are moved to the future over long periods in the balance sheet.
b. Under US-GAAP accounting practice regulations variable acquisition costs are, in as far as they are included in later premium payments, initially captialized and depreciated over a medium duration period for an insurance portfolio, so that they can then be charged against the later proportionate profit deposits as a deferral item. As such a balance sheet presentation of the profit course is achieved that corresponds better to the commercial actuarial added value, without considering the delayed courses of payment for acquisition costs and premium earnings. The fact that the realised profit has not yet been collected as a payment, is not relevant here in terms of the profit distribution on the company's part. This method would not lead to a limitation on profit distribution under US-GAAP regulations.
c. A DRSC position paper also recommends that the acquisition costs be capitalised so that a similar course of profit can be assumed as under US-GAAP.
d. The Draft Statement of Principles by the International Accounting Standards Board defines a capitalisation and accrual of payment

flows valued with cash values made up from primary and reinsurance contracts. As such all future profit shares are implicitly collected upon contract agreement and should thus be included in the balance sheet in a similar way to the commercial actuarial added value course.

The conclusion from this synopsis is that the profit presentations in compliance with German Commercial Code fundamental accounting practices correspond far less to the commercial course of profit than in compliance with other fundamental accounting methods, meaning that further information be provided concerning the business processes for the disclosure under the German Commercial Code (HGB to facilitate a useful commercial judgement.

These considerations do not fundamentally apply for the MLP Versicherung business with a focus upon motor insurance due to the short-term nature of the contracts of usually one year with the corresponding profit realisation, meaning that this company has not been included further in the more detailed report.

4. Commercial consequences of accounting practices under German Commercial Code (HGB) for life insurers.

As a major balance sheet phenomenon for a young and/or fast growing life insurance company the treatment of the immediate expense clearance of the acquisition costs means that further growth is only possible if

a. either a balance sheet loss that has to be reported can be compensated for by keeping considerable capital resources (e.g. legal reserves required by company bylaws, organisation funds) on one’s books
b. or if there is at least a balanced relationship between the acquisition costs and other expense/earning items paid to agents (e.g. earnings from reinsurance commission payments).

Without this prerequisite rules as established under the German Public Limited Company Law, such as under paragraph 92 of German Public Limited Company Law (which specifies specific measures if half of the equity capital is lost), and supervisory requirements related to a company’s solvency mean that growth can be considerably restricted.

In general the practice of keeping considerable capital reserves on one’s books is viewed as too expensive for growth companies in the life insurance sector, because on the one hand the yield requirements on equity capital are much higher than, for example, capital market yields for fixed interest investment forms, and on the other hand the volume of the capital to be kept on the books cannot be defined in advance for a longer period of time.

As a result life insurers in the situation described generally involve reinsurance companies in the expansion and growth of their own life insurance portfolios by properly forming their reinsurance programs.

E. REINSURANCE IN LIFE INSURANCE

The reinsurer acquires an interest in the business generated by the original insurer with his policyholder and participates in his performance by taking on risk from the original insurer under " shared fate" between the original insurer and the reinsurer. Under the terms of the signed reinsurance contracts, the scope, duration and risk content of the "shared fate" can be varied and optimised based on the individual assessment of the contracting parties. In doing so, however, the principle is upheld that premium payments to the reinsurer relating to the premium payments by policyholders, and claims payments to the insurance client related to claim payments by the reinsurer are made proportionally. By way of reinsurance commissions, the reinsurer participates in the administration and contract-signing costs of the original insurer, particularly in the acquisition commission paid to insurance agents.

In this respect, it follows that the original insurer has *no receivables or liabilities to be reported* other than the reported receivables or liabilities that result directly from the contractual reinsurance invoices. Future receivables or liabilities relating to the continued operation of the contracts, such as original insurer revenue from due premium revenue and from reinsurance premiums, are only to be reported when they legally arise.

F. RISK TRANSFER

While all companies in the non-life and accident cover insurance sector require passive reinsurance to insure themselves against larger claims, the necessity in the classic (capital formation) life insurance sector for life insurers with large in force portfolios is seldom for risk coverage with reinsurance cover. Normally only in such cases when the death risk in one of several policies is viewed as untenably high or if the amount at risk is not acceptable for an individual life insurance company's business scope should claims arise. In the case of young and fast growing life insurance portfolios the insurer's performance risk is ahead of the funds made available to date as insurance related reserves so that this risk is transferred to a reinsurer.
In such cases of reinsurance the focus is directly upon the risk transfer.
Other accounting practice and liquidity-related aspects may also form additional motives for taking out reinsurance cover for these companies:
The commissions to be paid by the primary insurer to his agents or brokers become an expense in the year of contractual agreement or payment to the agent in the HGB agreement – with the exception of a so-called zillmering share (indirect capitalisation of acquisition costs as so-called negative insurance related reserves) for the classic life insurance cover.
Under the German Commercial Code (HGB) strong growth leads to income statements that do not correspond to a company's commercial added value. At the same time the outflow of funds means that funds are not always directly available to pay acquisition commissions for further new business because the insurer's capital investments are bound in the premium reserve fund.
In such cases (only) a (sub) holding by a reinsurer can create the required income and liquidity scope for further growth with a so-called quota contract (= quota holding by the reinsurance company in the total risk and income of the reinsured business).
So some reinsurance contacts are thus agreed with the aim of balancing out the expenses for commission payments to agents and at the same time collecting corresponding liquid funds through the acquisition payments made by the reinsurance company to the primary insurer (as for the completion of the insurance contract with the individual policyholder), which is to be viewed as income under the German Commercial Code (HGB).

2. Regulatory principles to be noted

In as far as no transfer of actuarial risk is intended in these contracts, one speaks of financial reinsurance contracts that have to be reported separately by the primary insurer to the Federal Institute for Financial Services Supervision (BAFin). Such contracts violate the fundamental borrowing ban for life insurance companies in Germany under paragraph 7 of the VAG Law and are prohibited. On the other hand the Federal Institute for Financial Services Supervision (BAFin) does not define how much risk transfer a contract must include in order not to be classified as financial reinsurance. The auditing reports by the primary insurer must include a description of the

reinsurance program in order to give the supervisory authorities an assessment option.
However it is not always easy to identify such contracts as hidden borrowing with their clauses concerning risk bearing and invoicing formalities etc. Additionally, the reinsurer does not necessary have to make a loss from his contracts. The possibility here of making a loss is seen as a criterion for presenting a contract with a risk transfer. If the auditor sees that there are unauthorised contractual structures, then he is obliged to inform the authorities. If there is a suspicion of irregularities or if untypical or critical business structures have been disclosed, then experience has shown that the authorities require detailed reports and take direct corresponding action if necessary.

3. Judgement of the life insurance companies' reinsurance program

The judgement of a reinsurance program for a fast growing life insurance company can hence be reduced to the main criteria:

- How much risk transfer takes place?
- How high is the financing effect of the program?

There are two main types of contract for the MLP Leben and MLP Leben Wien reinsurance contracts:

- quota share insurance
- surplus.

Both types of contract are specified in the reinsurance program (including the contract addendums) for MLP Leben and MLP Leben Wien as such that there is a clearly identifiable transfer of the insurance risk and hence no questionable financing contracts in possible regulatory terms.

4. Judgement of the non-life insurance company's reinsurance program

There are two types of contract for the MLP Versicherung reinsurance contracts:

- quota share insurance of the motor insurance business
- excess of loss.

In the case of the excess of loss policies there is a clear risk transfer, since neither profit sharing nor premium adjustments are provided for explicitly in the contract.
In the case of the quota share insurance contracts the future premiums may increase if business develops poorly, or there may be premium refunds if business runs very well. However different scenarios show that these adjustments do not lead to a freedom of risk on the part of the reinsurer, but that a risk transfer certainly takes place.

Stuttgart, July 19th 2002
Ernst & Young
Deutsche Allgemeine Treuhand AG
Wirtschaftsprüfungsgesellschaft

signature Epperlein	signature Dr. Widmann
Joachim K. Epperlein	Dr. Ralf Widmann
Auditor	Actuary (DAV)