

ARAG SE

2016 Annual Report

SINGLE-ENTITY FINANCIAL STATEMENTS



Dive into life.

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Overview

ARAG SE Key Figures

(€'000)	2016	Change	2015	2014
Sales revenue				
Gross premiums written	824,616	7.63%	766,127	727,541
Premiums earned for own account	814,252	7.69%	756,133	723,339
Expenses				
Claims incurred net of reinsurance	415,393	3.83%	400,070	403,026
Claims ratio (basis: premiums earned)	51.0%	-1.9% pts.	52.9%	55.70%
Own account insurance business operating expenses	364,385	5.69%	344,781	321,160
Cost ratio (basis: premiums earned)	44.8%	-0.8% pts.	45.6%	44.40%
Net income overview				
Underwriting result for own account	30,377	169.61%	11,267	403
Gains and losses on investments	72,679	1.48%	71,620	77,279
Other net income/expense	-35,028	-10.85%	-39,291	-35,805
Profit/loss from ordinary activities	68,028	56.04%	43,596	41,876
Net extraordinary income/expense	0	n.a.	0	0
Net income for the year	31,663	37.89%	22,963	27,503
Key ratios				
Technical provisions/ net premiums earned	156.5%	-9.7% pts.	166.2%	170.50%
Equity/premiums earned	51.9%	-1.8% pts.	53.7%	55.00%

Profile of the ARAG Group

Overview

The ARAG Group is the largest family enterprise in the German insurance industry and is one of the world's three leading providers of legal insurance. ARAG was established more than 80 years ago exclusively as a legal insurance company, but has now positioned itself as an international insurer of considerable renown offering innovative, high-quality insurance products. At the end of 2016, the Group sold ARAG Lebensversicherungs-AG as part of a strategic realignment to focus squarely on property and health insurance. The sale is subject to approval by BaFin. The Company aims to generate growth across all insurance segments in Germany and to exploit the potential for expansion in the international legal insurance business. Today, the ARAG Group operates in a total of 17 countries (Germany, 14 other European countries, the US, and – since 2016 – Canada) through branches, subsidiaries, and equity investments. It generates sales revenue and premiums of approximately €1.8 billion and employs more than 4,000 people.

ARAG SE is responsible for strategic Group management and the legal insurance operating business at both domestic and international levels. The other ARAG insurance and service companies are responsible for the operational management of their respective lines of business. ARAG Holding SE manages the assets and is the parent company of the Group from a company law perspective.

Legal insurance

In its core legal insurance segment, ARAG plays a major role in shaping its markets both in Germany and abroad with innovative products and services. For some years now, the international legal insurance business has been the Group's most significant area of activity. The international units involved in this business are a valuable source of impetus for the Group's growth. At the same time, ARAG SE is following a clear path to success in its German domestic market, where it is generating rising legal insurance premiums.

Casualty and property insurance

In a fiercely competitive market, ARAG Allgemeine is demonstrating its strength as an attractive provider of property, liability and accident insurance policies, which have been highly ranked in numerous independent performance comparisons. This company is also Europe's largest sports insurer, providing cover for over 20 million recreational sports participants and top-ranking athletes. ARAG Allgemeine's Interlloyd subsidiary specializes in brokering services in the commercial and private customer segments, adding a further dimension to the Group's portfolio.

Personal insurance

In the private health insurance market, ARAG Kranken (ARAG Health) offers a broad range of highly efficient products, emphasizing its appeal as a provider of full-coverage and supplementary health insurance. To complement its range of products for customers, ARAG Core Sales successfully offers pension products from its strategic partner Alte Leipziger.

Management Report of ARAG SE

I. Company Fundamentals

Business model

ARAG SE is the largest family-managed insurance company in Germany and is one of the world's three leading providers of legal insurance. It focuses on state-of-the-art product concepts aimed at both private and small business customers. The modular structure of these concepts means that insurance can be precisely tailored to the requirements of each customer.

An important role is also played by customized legal insurance products designed for particular target groups.

ARAG SE is the provider of legal insurance for private customers and small businesses. It is not involved in diversified corporate business with individual risks. In the international markets, it also operates travel insurance business in connection with its provision of legal insurance.

ARAG began to operate outside Germany for the first time more than 50 years ago. The main purpose was to set up separate international companies in the Group that could provide support for the German legal insurance customers in the event of a claim. It became clear that this model in itself was not sustainable. However, there was a demand for legal insurance within each of the countries themselves, as a result of which it was possible to develop new business models in line with the various circumstances and tap into new markets. Today, ARAG operates in a total of 17 countries (Germany, 14 other European countries, the US, and – since 2016 – Canada) through branches, subsidiaries, and equity investments.

In addition to the Group headquarters in Düsseldorf, ARAG SE maintains operational branches in Austria, Belgium, Greece, Italy, the Netherlands, Portugal, Slovenia, and Spain. This centralized, star-shaped organizational structure emerged from the merger of previously independent subsidiaries in 2012. The international branches run their operating businesses in their national markets independently, taking into account the specific local circumstances in each case.

ARAG SE is one of the most internationalized insurers in Germany with 57 percent of its total gross premiums written accounted for by international business.

Scope of operations

In Germany, ARAG SE's activities are limited to just one class of insurance: legal insurance. In Italy, Spain, and Portugal, it also operates legal-insurance-related special service package business in addition to legal insurance business.

The territory covered by ARAG SE includes Germany as well as the Netherlands, Belgium, Austria, Slovenia, Italy, Spain, Portugal, and Greece. ARAG SE's business outside Germany is operated by the branches.

Legal insurance is also provided in the US, Norway, Sweden, and – since 2015 – Denmark. In each case the business is operated through legally independent affiliated companies, which are all managed uniformly by ARAG SE as the parent company.

In addition, ARAG SE operates in Switzerland via an equity investment in a legal insurance associate. In the United Kingdom, a Group company acts as a broker for legal insurance business and legal-insurance-related special service package business, passing this business to four UK primary insurers. Some of this insurance is then ceded to ARAG SE under quota-share reinsurance treaties. This intermediary model has been adapted for use in the Canadian market, where ARAG has been offering legal insurance through a Group company since the end of 2016.

ARAG SE also holds an equity investment in a legal insurance company in Luxembourg.

Sales organization

The Group's sales organization makes a fundamental contribution to ARAG's business success in Germany. ARAG Core Sales is the traditionally strong sales channel selling ARAG products exclusively: The 1,000-plus ARAG Sales Partners use the network of over 160 main branch offices and other branch offices across Germany to provide customers with professional, face-to-face support and advice at local level. This is underpinned by ARAG's holistic 'Red Thread' approach to insurance advice and support. For customer visits, ARAG Sales Partners can use either a paper version or a digital version for tablets that can be accessed via a proprietary advice app. Core Sales also uses digital touchpoints for greater connectivity, whether for contact with customers or to sign up new sales partners. Use of the holistic 'Red Thread' approach to insurance advice is an integral element of the basic training delivered by the ARAG sales academy, whose broad-based and regularly updated range of courses ensure the exclusive agents receive high-quality training and development on ARAG and its products.

ARAG Partner Sales is ARAG's successful sales channel specializing in brokers and non-exclusive agents. It has a wealth of experience in working with a wide variety of target groups, from specialist brokers to pool structures and sales outfits. Streamlined structures and processes minimize the effort involved for agents, while knowledgeable contacts in the Field Sales and Sales Administration organizations ensure that brokers and non-exclusive agents receive professional support in every regard. The online portal for brokers was completely revamped in 2016 and, besides being easier to use, includes plenty of useful new content.

In the year under review, the two main sales channels in Germany accounted for 42.8 percent (Core Sales) and 33.1 percent (Partner Sales) of new policies underwritten. Following the growth in 2015, ARAG saw a further increase in its customer base for online business to more than 200,000 customers in 2016. This equates to almost 10 percent of the German customer base. The online business is thus developing into a relevant sales channel with which ARAG can reach out to internet-savvy customer groups. In Germany, the ARAG sales channel mix also includes sales partnerships in which made-to-measure, high-performance ARAG insurance solutions are sold under partnership agreements with other insurance companies, banks, other companies, associations, and clubs.

Insurance portfolio

The breakdown of the insurance portfolio (number of policies) as of the end of the reporting year was as follows:

Insurance portfolio		
(No.)	Dec. 31, 2016	Dec. 31, 2015
German	1,446,227	1,423,702
International	2,692,257	2,339,667
Total	4,138,484	3,763,369

Types of insurance in the insurance business

The range of products offered by ARAG SE in Germany includes all the types of insurance in the legal insurance class of insurance listed in the General Terms and Conditions for Legal Insurance plus financial loss legal insurance for members of supervisory boards, advisory councils, and management boards, and for senior managers. Subject to special terms and conditions of insurance, ARAG SE offers legal insurance covering victims' proceedings, divorce, maintenance payments issues, and criminal proceedings; in collaboration with its subsidiary ARAG Allgemeine Versicherungs-AG, it also offers 'Recht&Heim Aktiv', a bundled product providing all-round cover. In addition, ARAG SE is increasingly operating inward reinsurance business with third parties.

In Spain and Italy, ARAG SE's range of legal insurance products is complemented by policies that mitigate the financial consequences if a policyholder loses his or her driver's license. The Company also operates travel insurance business in Spain and Portugal.

II. Report on Economic Position

Economic and sector conditions

Global economic growth is currently only muted but, from a historical perspective, is not unusually slow. In fact, it appears to be returning to normal levels following the extreme expansion rates and related overheating in the run-up to the global financial crisis in 2008.

The turmoil in international financial markets at the start of 2016, the unexpected result of the Brexit referendum in the United Kingdom last summer, and the surprising outcome of the US presidential election have not had a lasting detrimental effect on the pace of global economic growth. Although the vote for Brexit and the new political regime in the US created heightened uncertainty in financial markets for a time, the impact on the real economy has been limited so far. Capacity utilization in manufacturing continued to increase. At the same time, the situation in emerging markets stabilized, above all thanks to the strengthening of the Chinese economy. The steadying of the oil price is also likely to have had a positive effect on commodity-exporting emerging markets.

Industrialized countries are going through a phase of economic recovery. In most of them, capacity underutilization in the product and labor markets decreased further in the first half of 2016. Particularly in the eurozone and Japan, economic output rose faster than the estimated potential output. By contrast, growth in the US was slightly lower than expected in the first half of the year. The German Council of Economic Experts currently estimates that total global production grew by 2.5 percent in 2016.

The eurozone's economic recovery continued over the course of 2016. Production in the economy as a whole has been rising steadily for three years now. Employment has risen noticeably in recent years; at 10.1 percent, the unemployment rate is at its lowest since 2011. The economic recovery is driven, above all, by domestic demand. In particular, there is steady growth in consumer demand. At the same time, the fall in the oil price has helped to push up real disposable income. The expansionary monetary policy of the European Central Bank (ECB) has also played a key part in the eurozone's economic growth. The proportion of government bonds with negative yields over the medium to long term has risen sharply. Purchase programs for government bonds and other securities have been hugely expanded in the past two years. Quantitative easing led to depreciation of the euro and a significant increase in prices of equities, real estate, and other assets.

The German economy also generated substantial growth in 2016. The German Council of Economic Experts predicted a 1.9 percent rise in real gross domestic product (GDP). Improved consumer sentiment reflected the good situation in the labor market. The number of people in employment is predicted to see a further rise of more than 500,000 to 43.6 million this year. Effective wages are also going up, albeit more slowly than in previous years. This year, household incomes have also benefited from the raising of the basic tax threshold and the tax threshold for parents and from repayment of some of the tax receipts caused by bracket creep. According to the German Insurance Association (GDV), growth in households' nominal disposable income will have been 2.7 percent in 2016. The rate of inflation, projected to be around 0.3 percent, was roughly the same as in 2015. The low inflation rate meant that the purchasing power of German households again rose significantly. Given the low interest rates, consumer spending also continued to be boosted by a relatively low propensity to save. The savings ratio for households will again go up slightly this year, although the increase of 0.8 percentage points since 2013 to its current level of 9.8 percent of disposable income is modest. Overall, the GDV expected an inflation-adjusted increase in household consumption of 2.0 percent in 2016.

Following the sharp rise in the capital market rate (yield on listed German government securities with a residual maturity of nine to ten years) during the summer, this rate fell back again to an average for the year of around 0.2 percent as a result of the rate of inflation remaining low last year. Share prices benefited from favorable macroeconomic conditions. Whereas the EURO STOXX 50's increase of 0.4 percent was only small, the German DAX share index climbed by 6.9 percent to 11,481 points at the end of the year.

The GDV's most recent forecasts for the insurance industry as a whole predicted that premium income would hold steady, barely changing compared with 2015, which had not seen any noticeable increase in premiums. By contrast, gross premiums written in direct casualty and property insurance business increased by 2.8 percent (projected). The reasons included increases in the sums insured and some extension of the cover in property insurance. In legal insurance, there was even stronger growth in premiums at around 5.0 percent owing to the opportunities to adjust premiums as part of cost increases resulting from Germany's Second Act Modernizing the Law on Court Costs (Second KostRMoG). Premium growth in health insurance was around 1.8 percent. Life insurance continued to operate in tough conditions. This segment faces the difficult challenge of continuing to generate a guaranteed rate of return despite the persistently low interest rates. According to the GDV, the life insurance segment was likely to post a decline in premiums of 2.8 percent.

The property insurance segment had already taken a significant hit from the severe weather brought about by the low-pressure system Niklas back in 2015. In the year under review, it also had to deal with the adverse impact of heavy rain in some regions. According to GDV estimates, these extreme weather events between late May and early June 2016 gave rise to claims with a total value of €1.2 billion, substantially exceeding previous losses such as those caused by storm Ela in 2014. Nonetheless, as property insurers were spared any other major storms or hailstorms in 2016, it can be assumed that last year was slightly below average in terms of natural hazards. According to the GDV, a significant rise in the number of claims made caused claims incurred in the legal insurance segment to increase further, which means that the combined ratio in this insurance segment is likely to be around 100 percent for 2016. Overall, the GDV predicted that the combined ratio for direct casualty and property insurance business would stagnate at 97.0 percent.

Business performance

ARAG SE expanded its insurance business significantly in the year under review. Its gross premium income rose by 7.6 percent, from €766.1 million to €824.6 million. Both the German and the international legal insurance business contributed to this premium growth. In the international markets, this increase was mainly generated from indirect business. The insurance portfolio in the Netherlands was further expanded through broker sales, while in Spain a new reinsurance contract was signed with a large primary insurer. ARAG SE was able to maintain its business volume in Austria and Belgium, despite the saturation of the legal insurance markets in these two countries. In Germany, the insurance portfolio grew thanks to a solid increase in new business, a decline in policy cancellations, and premium adjustments.

Of the total premium income, €633.8 million (2015: €594.4 million) was derived from direct business. The international branches' volume of legal-insurance-related travel business came to €50.7 million (2015: €41.7 million). Direct legal insurance business accounted for €583.1 million (2015: €552.7 million). Gross premiums written in the direct legal insurance business in Germany increased by 6.6 percent, from €308.9 million to €329.3 million. This performance highlights the innovative product concepts and the underlying strong customer focus of the Company, which has achieved continuous premium growth in its domestic market of Germany since 2013. After deduction of the reinsurers' shares and changes in unearned premiums, the remaining net premiums earned for all legal insurance business amounted to €814.3 million compared with €756.1 million in 2015.

Despite the increase in business volume, claim payments dropped to 50.2 percent of premiums earned (2015: 52.2 percent). As neither the German market nor the international markets suffered any extraordinary loss events, the overall claims ratio of 51.0 percent was even lower than the strong prior-year figure of 52.9 percent. Claims incurred amounted to €415.4 million compared with €400.1 million in 2015.

Conversely, insurance business operating expenses declined. The cost ratio dropped from 45.6 percent in 2015 to 44.8 percent in the year under review. However, this decline is attributable to the change in the discount rate for provisions for pensions and other post-employment benefits, which had to be calculated as a ten-year average for the first time. This one-off positive factor was offset almost entirely by additional commissions incurred as a result of the increase in business volume and by rising staff costs for personnel to complete the additional administrative work.

After taking into account the sundry underwriting income and expenses (net income of €1.5 million), the underwriting result for own account before the equalization provision showed a very significant year-on-year improvement to a profit of €35.9 million compared with a profit of €12.8 million in 2015. A total of €5.6 million was added to the equalization provision in respect of the travel insurance business in Spain and Italy and the inward legal reinsurance business in a number of countries.

After the addition to the equalization provision, the underwriting result amounted to a profit of €30.4 million, meaning that the profit of €11.3 million achieved in 2015 was nearly tripled in the year under review. The net gains on investments (after deducting the corresponding expenses) came to €72.7 million (2015: €71.6 million). The continued fall in interest rates allowed significant reversals of write-downs and the realization of gains on disposals. With regard to other net income/expense, the net expense decreased from €39.3 million in 2015 to €35.0 million. This decline was mainly attributable to the one-off favorable effect of the changes to the discount rate for defined benefit obligations.

Overall, ARAG SE improved its profit before tax significantly, from €43.6 million to €68.0 million.

After deduction of the tax expense of €36.4 million (2015: €20.6 million), net income for the year amounted to €31.7 million compared with €23.0 million in 2015. The tax expense for the year under review included €24.7 million resulting from write-downs on deferred tax assets.

Financial performance by source country

Performance in Germany

Direct insurance business In the German legal insurance market, gross premiums written in direct business grew by 6.6 percent year on year. Gross premiums amounted to €329.3 million compared with €308.9 million in 2015. After deduction of reinsurance premiums and the change in unearned premiums, net premiums earned came to €324.6 million (2015: €305.1 million).

As a result of the increase in business volume, claim payments rose by 3.6 percent, from €187.4 million in 2015 to €194.1 million in the year under review. Claims incurred rose by 1.5 percent to €206.6 million in the reporting year. The higher volume of claims arising from the expansion of the insurance portfolio had a significant impact in this respect. Nevertheless, the claims ratio for 2016 (gross) at 63.6 percent was below the equivalent 2015 figure of 66.7 percent. A total of 427,276 claims (2015: 419,003 claims) were reported in the year under review, a year-on-year rise of 2.0 percent.

Reinsurers' shares amounting to €0.2 million (2015: €0.1 million) were recognized as income in 2016. The remaining recognized claims incurred came to €197.0 million as against €187.4 million in 2015. The claims ratio based on the recognized claims incurred was 60.7 percent compared with 61.4 percent in 2015.

Gross insurance business operating expenses rose from €139.7 million in 2015 to €140.2 million in the reporting year. As expected, commissions went up by 5.0 percent in 2016 from €74.1 million to €77.8 million in line with the increase in premiums. Other primary administrative expenses (before cost allocations) declined in the year under review from €170.9 million to €158.8 million. As well as a rise of €4.7 million in wages and salaries due to new hires, a reduction of €16.2 million in pension and other post-employment benefit expenses contributed significantly to this decrease. A change to the statutory discount rate, which was implemented by the government in view of the persistently low interest rates, led to this one-off fall in pension and other post-employment benefit expenses. As a result, the cost ratio dropped from 45.8 percent in 2015 to 43.2 percent in the year under review.

Due to reduced administrative expenses, the underwriting result before the equalization provision in the direct insurance business recovered from a loss of €20.7 million in 2015 to a loss of €11.3 million in the reporting year.

There was no requirement to recognize an equalization provision pursuant to section 29 of the German Regulation on the Accounting of Insurance Undertakings (RechVersV) for the direct business.

Inward reinsurance business In Germany, the Company takes on inward reinsurance business from its subsidiary in the US and from third parties in the United Kingdom under five reinsurance treaties. Net premiums amounted to €22.5 million compared with €21.9 million in 2015. After taking into account claims incurred of €15.6 million (2015: €22.2 million) and administrative expenses of €1.1 million (2015: €1.1 million), this led to an underwriting profit before the equalization provision of €5.8 million (2015: loss of €1.4 million).

A sum of €0.4 million was added to the equalization provision. The underwriting result for the inward reinsurance business amounted to a profit of €5.4 million (2015: loss of €1.6 million).

Non-underwriting result

The unchanged monetary policy of the European Central Bank, which is causing interest rates to stagnate at an extremely low level without any prospect of change in the near future, is affecting current income from securities. Interest rates on low-risk investments even dropped into negative territory at times. As a consequence, ordinary income from investment fund shares/units sank from €20.8 million in 2015 to €15.8 million in the year under review. In response to low interest rates and as a consequence of market movements of non-fungible investments, it was possible to reverse write-downs – mainly on investment fund shares/units, shares in affiliated companies, and equity investments – in an amount of €7.3 million (2015: €3.6 million). On the other hand, only €0.9 million in write-downs on securities were incurred (2015: €9.4 million). Current income of €2.8 million was generated from land. This constitutes a slight increase on the 2015 figure of €2.7 million. This rise was achieved even though interests in indirectly held real estate were sold, resulting in the realization of gains on disposal.

Dividend income in the year under review fell by €6.2 million year on year. This is due to a change in the structure of the subsidiaries, which led to a one-time reduction of dividend payments. Equity investments in the US, UK, and Switzerland maintained their very sound financial performance. The profit transferred from ARAG Allgemeine Versicherungs-AG amounted to €14.0 million, which was slightly below the equivalent prior-year figure of €15.0 million.

Write-downs of €1.5 million were recognized on shares in affiliated companies, whereas in 2015 write-downs of €0.3 million had been recognized in respect of equity investments. In 2015, losses totaling €0.8 million had arisen on the disposal of land and on the sale of fixed-income securities. The pro rata sale of indirectly held real estate and the sale of fixed-income securities from the investment portfolio generated a total gain of €3.7 million in 2016. Net gains on investments came to €55.8 million, which was once again higher than the prior-year net gains of €54.3 million despite the unfavorable conditions in capital markets.

Ordinary gains and losses on investments – after deduction of the expenses for the management of the investments – amounted to a net gain of €47.2 million and led to a current average yield of 3.5 percent (2015: 4.6 percent).

Other net income/expense amounted to a net expense of €27.6 million (2015: 37.4 million). The other net income/expense figure includes the offset income and expense from the provision of services to Group companies and expenses to which income cannot be directly assigned, such as the addition of interest to the pension provision, Supervisory Board and Advisory Council remuneration, year-end costs, costs incurred in relation to the Solvency II regulatory regime, and the interest expense on subordinated liabilities. In the reporting year, a one-off reduction of the net loss occurred as a result of changes to the discount rate for defined benefit obligations for people who have already retired.

Net extraordinary income/expense

No extraordinary income or expense was recognized in 2016.

Taxes

Income taxes also include the impact on net income from deferred taxes in accordance with section 274 of the German Commercial Code (HGB). In the year under review, the change in deferred taxes led to a reduction in the net income for the year of €24.7 million (2015: €4.6 million), as it is expected that there will be no impact on current taxes at the projected time of reversal. Current taxes amounted to income of €0.8 million (2015: expense of €6.2 million) and were attributable in full to prior years. Taking into account the miscellaneous taxes, the total tax expense came to €24.8 million compared with €11.9 million in 2015.

Net income/loss for the year, Germany

The net loss for the year generated by the German business of ARAG SE amounted to €2.5 million (2015: €17.3 million).

Branch performance

ARAG SE's eight European branches generated significantly higher gross premium income of €472.9 million (2015: €435.3 million). The branches accounting for the highest level of premiums written were ARAG Netherlands with premiums written of €140.1 million (2015: €133.6 million), ARAG Spain with €124.5 million (2015: €107.9 million), and ARAG Italy with €118.4 million (2015: €106.4 million). The premiums earned for own account amounted to €467.2 million (2015: €429.1 million). Thanks to the expansion of the brokerage business in the Netherlands, the acquisition of a reinsurance portfolio in Spain, and the systematic refinement of insurance products, services, and sales channels, growth in gross premiums of 8.6 percent was achieved. With claims incurred at €202.8 million (2015: €190.4 million) and insurance business operating expenses at €223.1 million (2015: €204.0 million), the claims ratio decreased slightly year on year to 43.4 percent (2015: 44.4 percent), while the cost ratio remained steady at 47.8 percent (2015: 47.5 percent). Including miscellaneous underwriting income and expenses of €0.2 million, the underwriting result before the equalization provision generated by the international legal insurance business amounted to a profit of €41.5 million – a significant improvement on the prior-year profit figure of €35.0 million. After an addition to the equalization provision of €5.2 million (2015: €1.4 million), a profit of €36.3 million remained in the underwriting account (2015: €33.6 million).

The investments assigned to the branches generated a total net gain on investments of €16.9 million (2015: €17.3 million). Other net income/expense amounted to an expense of €7.4 million (2015: expense of €1.9 million). This increase is attributable to restructuring costs and amortization of goodwill in Spain and to costs incurred for the expansion of the online business in the Netherlands. The branches' profit from ordinary activities came to €45.7 million (2015: 49.0 million). Including deferred taxes, the tax expense came to €11.6 million (2015: €8.7 million). The net income for the year of €34.1 million (2015: €40.2 million) generated by the European branches made a substantial contribution to the overall net income of ARAG SE.

Overall net income for the year

The financial performance of ARAG SE over the reporting year was again characterized by the expansion of business activities both in Germany and in other European markets. The improvement in performance was held back slightly by increased staff costs due to additional administrative work. Pension and other post-employment benefit expenses in Germany, Spain, and Austria were virtually eliminated as a result of changes to the way in which the statutory discount rates applied in the discounting of defined benefit obligations are calculated. This is a one-off effect that had a favorable impact on the financial performance of all units. The continued strong expansion of business and the favorable trend in claims, especially in Germany and Austria, again provided a boost to the underwriting result before the equalization provision in the reporting year, which came to a profit of €35.9 million (2015: €12.8 million). After the addition to the equalization provision, which was required in particular for the inward reinsurance business segments, a profit of €30.4 million (2015: €11.3 million) remained in the underwriting account.

The net gains on investments (after deducting the corresponding expenses) came to €72.7 million (2015: €71.6 million). The ECB's sustained policy of zero interest rates caused further declines in interest rates, which led to reversals of write-downs, especially on investment fund shares/units. As a result, a slight improvement in gains and losses on investments was achieved, despite decreasing dividends and profit transfers from Group companies. Other net income/expense improved substantially year on year, thanks to the changes to the discount rate for defined benefit obligations for people who have already retired and the stronger brokerage business. The profit before tax amounted to a total of €68.0 million, which represents a 56.0 percent increase compared with the 2015 figure of €43.6 million.

After deduction of the tax expense, net income for the year amounted to €31.7 million (2015: €23.0 million). The tax expense increased due to changes in deferred tax assets.

After taking into account the profit carried forward from 2015, the net retained profit to be presented to the Annual General Meeting for a decision on appropriation is €31.7 million (2015: 23.0 million).

Financial position

The objective of the management of financial resources is to ensure that the Company holds adequate capital and manages its liquidity such that it is able to satisfy its obligations arising from the insurance business at all times and to exceed, rather than simply satisfy, the regulatory requirements concerning the solvency capital adequacy of insurance entities. The subordinated liabilities reported on the balance sheet qualify as basic own funds in accordance with section 89 (3) no. 2 of the German Insurance Supervision Act (VAG). These subordinated liabilities comprise a registered bond with a value of €30.0 million that matures on July 29, 2024.

The underwriting liabilities are covered by investments of €1,805.1 million (December 31, 2015: €1,685.9 million). In addition to current bank balances and cash on hand of €67.9 million (December 31, 2015: €85.0 million), the Company has investments at its disposal that can be sold on the capital and financial markets at short notice, thus ensuring that the Company is able to satisfy its payment obligations under insurance contracts at all times.

Further information on the extent of investments, purchases of intangible assets, and changes in the liquidity of the Group in the year under review can be found in the cash flow statement on page 18.

Cash flow statement*

(€)	2016	2015
Cash flows from operating activities		
Profit for the period	31,662,538	22,963,455
Increase (+)/decrease (-) in technical provisions, net	17,696,276	23,251,307
Increase (-)/decrease (+) in deposits with ceding insurers and in receivables from reinsurance business	- 10,189,058	- 17,328,353
Increase (+)/decrease (-) in deposits from reinsurers and liabilities from reinsurance business	- 303,228	- 1,652,946
Increase (-)/decrease (+) in receivables from direct insurance business	- 2,526,034	914,254
Increase (+)/decrease (-) in liabilities from direct insurance business	1,938,400	- 324,480
Increase (-)/decrease (+) in miscellaneous receivables	6,832,836	7,374,752
Increase (+)/decrease (-) in miscellaneous liabilities	4,908,701	6,005,930
Change in miscellaneous balance sheet items not related to investing or financing activities	- 96,252,619	30,017,821
Other non-cash income and expenses, and adjustment of the profit/loss for the period	5,095,278	17,983,055
Gain (-)/loss (+) on the disposal of investments, property and equipment, and intangible fixed assets	- 8,546,203	- 2,697,168
Expenses for/income from extraordinary items	0	0
Income tax expense/income	35,156,509	19,101,082
Cash receipts from extraordinary items	0	0
Cash payments for extraordinary items	0	0
Income taxes paid	17,551,628	- 18,896,762
Cash flows from operating activities	3,025,023	86,711,947
Cash flows from investing activities		
Proceeds from disposal of property and equipment	33,608	1,078,070
Proceeds from disposal of intangible fixed assets	45,807	745,993
Payments to acquire property and equipment	- 2,515,568	- 4,702,910
Payments to acquire intangible fixed assets	- 2,693,879	- 7,078,074
Proceeds from disposal of investments related to fund-linked life insurance	0	0
Payments to acquire investments related to fund-linked life insurance	0	0
Cash receipts from extraordinary items	0	0
Cash payments for extraordinary items	0	0
Cash flows from investing activities	- 5,130,031	- 9,956,921
Cash flows from financing activities		
Proceeds from capital contributions by shareholders	0	0
Cash payments to shareholders from the redemption of shares	0	0
Cash receipts from extraordinary items	0	0
Cash payments for extraordinary items	0	0
Dividends paid	- 15,000,000	- 15,000,000
Proceeds (+)/cash payments (-) related to miscellaneous financing activities	0	- 50,000,000
Cash flows from financing activities	- 15,000,000	- 65,000,000
Net change in cash and cash equivalents	- 17,105,008	11,755,026
Effect on cash and cash equivalents of exchange rate movements and remeasurements		
Cash and cash equivalents at beginning of period	85,017,850	73,262,824
Cash and cash equivalents at end of period	67,912,842	85,017,850

* The cash flow statement has been prepared in accordance with German accounting standard GAS 21 appendix 3.

Net assets

Investments The breakdown of investments, which increased by €119.2 million or 7.1 percent to €1,805.1 million as of December 31, 2016, was as follows:

Investments breakdown

<i>(€ million)</i>	Dec. 31, 2016		Dec. 31, 2015	
Land and buildings	97.6	5.4%	101.2	6.0%
Affiliated companies and equity investments	241.9	13.4%	236.1	14.0%
Lending to affiliated companies	1.7	0.1%	2.5	0.1%
Equities and investment fund shares/units	625.5	34.7%	614.6	36.5%
Bearer bonds	301.5	16.7%	300.1	17.8%
Loans secured by mortgages or land charges and fixed-income receivables	4.0	0.2%	4.8	0.3%
Registered bonds	140.5	7.8%	149.5	8.9%
Promissory notes, loans	244.0	13.5%	218.0	12.9%
Sundry lending	0.1	0.0%	0.1	0.0%
Bank deposits	98.6	5.5%	17.7	1.1%
Other investments	5.3	0.3%	5.2	0.3%
Deposits with ceding insurers	44.4	2.4%	36.1	2.1%
Total	1,805.1	100.0%	1,685.9	100.0%

Pursuant to section 341 b HGB, equities and investment fund shares/units with a carrying amount of €605.8 million had been classified as fixed assets as of the balance sheet date (December 31, 2015: €582.2 million). Bearer bonds with a value of €10.0 million (December 31, 2015: €15.1 million) (carrying amounts) were treated as fixed assets.

The fair value of investments as of December 31, 2016 amounted to a total of €2,271.0 million compared with €2,143.9 million as of December 31, 2015. After taking into account the premium and discount amounts recognized under prepaid expenses and accrued income and under deferred income and accrued expenses in connection with the securities recognized at their nominal amount in accordance with section 341 c HGB, the valuation reserves therefore amounted to €465.9 million as of the balance sheet date (December 31, 2015: €457.9 million).

Further information on the structure and changes in investments can be found in the overview under the non-underwriting disclosures in the Notes.

Non-financial performance indicators

The ARAG Group has set out its self-image very clearly in its corporate guidelines: ARAG is the internationally successful, innovative quality insurer – independent and family-owned. For more than 80 years, the business concept has been based on the aim of establishing equality of opportunity. Accordingly, the ARAG Group helps its customers create scope to make personal choices – at all stages of their lives. Based on innovative insurance products and beneficial services, ARAG minimizes the risks faced by its customers, so that customers can concentrate entirely on the opportunities available to them, leading an active,

independent life. This is also clearly reflected in the brand tagline 'ARAG. Dive into Life'. ARAG again added a wide range of content to the section with the same title on its website www.ARAG.de in 2016. It also ran new and attractive adverts as part of the successful advertising campaign launched in 2015. The aim is to demonstrate the day-to-day relevance of ARAG products and services. The brand promotion film, which was shown on TV and in movie theaters throughout Germany before selected movies likely to reach a wide audience, complemented three online commercials featuring ARAG product innovations. A radio commercial was added to the Germany-wide campaign in the autumn.

Another major, and logical, step taken in 2016 was the modernization of ARAG's logo. The family enterprise is thus reflecting the lasting changes that have taken place in recent years. The new ARAG logo, which had last been updated 13 years ago, was launched at the end of March 2016 at the same time as the new campaign. The word ARAG is a lot more prominent and easier to read, and the crossed swords have been removed. This new and modernized logo is thus more suited to the broad product portfolio of ARAG, which today offers appealing legal insurance products in Germany and 16 other countries and is also a successful provider of attractive health insurance and casualty and property insurance.

In the year under review, the ARAG Group again systematically expanded its products and services – always clearly guided by the constantly changing requirements and needs of customers and consumers. Based on optimum integration between these innovative product activities, a highly efficient workforce, a state-of-the-art brand presence, and clear strategic positioning as an independent, international provider of high-quality insurance products and services, ARAG has established the best possible foundations for further sustainable growth.

Innovation Innovativeness is a key driving force for ARAG and one of its major strengths. Besides refining the portfolio, the Company has implemented new and groundbreaking ideas for products and services that are always geared to meeting customer requirements and creating benefits for them. Two accolades awarded in 2016 are external recognition of ARAG SE's ability to innovate: At the Plus X Awards, the Premium variant of ARAG's legal insurance won the Most Innovative Brand Award in 2016 in the insurance category, while ARAG's new Sofort legal insurance product for motorists won a Golden Bull award (third place) in the Insurance Innovation of 2016 category. This is the third time that ARAG's legal insurance products have been among the winners in this competition run by the *€uro* and *€uro am Sonntag* magazines: ARAG web@ktiv online legal insurance was a prizewinner in 2013 and ARAG Aktiv Immobilie premium legal insurance for real estate was a prizewinner in 2015.

ARAG's Sofort legal insurance for motorists, which is unlike any other product available in the market, represents a new approach for the Group. For the first time, cover is provided for legal insurance claims incurred before the policy was taken out. This applies to administrative offenses and to claims for damages following a road accident. Since launching the product, ARAG has already provided immediate assistance in several

hundred cases even though the insurance policy was not in place at the time the claim was incurred. Feedback has been very positive. Besides this retroactive insurance, customers have also benefited from the three-year period (starting on the first day the policy is taken out) of the extensive benefits provided with the Komfort variant of ARAG legal insurance for motorists, including legal insurance in matters of contract law, property law, criminal law, administrative law, and tax law.

In the reporting year, the ARAG Group again impressed customers with a variety of digital innovations. As well as continuously expanding the existing live chat function, which is heavily used by customers as an alternative means of communication, the Group introduced a number of new features. These include alternative methods of payment, with which ARAG entered uncharted territory for the insurance industry last year: Since May 2016, customers have also been able to pay recurring insurance premiums by credit card or PayPal for the first time. This new feature was first introduced for private legal insurance products that can be taken out online.

In autumn 2016, ARAG became the first insurance company in the market to offer a digital service card. Available for legal insurance and casualty and property insurance customers, the ARAG Wallet-Card can be installed on a smartphone, so customers can access all their important data, such as their policy number or the contact details for headquarters and their advisor, while on the go. Telephone numbers can be dialed and emails and websites opened directly from the app. Since the end of 2016, legal insurance and casualty and property insurance customers have also had their policy number sent to them in a text message when they take out the policy; they also receive a link that enables them to install the ARAG Wallet-Card easily and directly.

There were also a number of innovations for the sales partners of ARAG Core Sales in the year under review. Many new features were added to the advice app that had been launched in 2015, including navigating to the customer, downloading sent advisory documents, transmitting appointments and contacts via QR code, scanning policy numbers using the camera, recording spoken notes, using digital signatures, and selling legal insurance directly from the app. Not only the branch offices but also all individual partners of ARAG Core Sales now receive a complete ARAG-branded website with all the functions, including simple page navigation with clear product information, that has been optimized for use on tablets and smartphones. Policies taken out online via sales partners' websites are allocated directly to the respective partner.

ARAG's website has also been optimized at international level and standardized in order to strengthen the brand. This included establishing a central online platform for European countries that is progressively being rolled out to them. It features a standardized content management system with an identical navigation concept. The system can be maintained in the relevant local language, and its responsive design ensures that page content is automatically presented in an optimum manner for the various end devices, including smartphones and tablets. An integrated analysis tool collects details of the usage behavior of visitors and customers, thus enabling the website to be adapted and optimized specifically for users in each country.

Products As an innovative provider of high-quality insurance, the ARAG Group does more than simply launch brand new and innovative product concepts. It also constantly refines its existing broad range of products and services for the German and international markets in order to ensure the products and services meet the needs of prospective and existing customers.

Last year, for example, many new types of legal insurance were introduced. ARAG's unemployment protection product protects private customers against financial loss if they become unemployed through no fault of their own as a result of compulsory redundancy. The special employment legal insurance for seniors covers employment that supplements a pension. It also includes legal advice insurance and insurance for people with domestic employees.

A particular highlight of 2016 for self-employed people and small business owners was the addition of Receivables Management Plus to ARAG Aktiv-Rechtsschutz Premium legal insurance for the self-employed. The new feature offers the advantages of business agreement legal insurance combined with online receivables management. In addition, the ARAG JuraCheck® legal advice service has been expanded and is now always included in the premium variants of legal insurance policies for private and small business customers, who receive help from specialist attorneys when having employment contracts and references checked. These attorneys can also answer questions about contracts and check the legal aspects of customers' own websites. ARAG legal insurance is now available for price-conscious private customers and the self-employed in two additional Flex variants with different deductibles, enabling customers to decide on a case-by-case basis whether they want to hire their own attorney or – in return for a lower deductible – call on an attorney from ARAG's network.

The high quality of ARAG's legal insurance products can be seen from the many accolades and ratings. In 2016, for example, these included certification of ARAG Aktiv-Rechtsschutz legal insurance for the self-employed by the TÜV product standards regulator in Saarland – with excellent results: The Premium and Komfort packages were rated 'very good', the Basic variant was rated 'good'. And in a test of legal insurance products carried out by insurance IT specialists Softfair, the Flex variant of ARAG's new premium legal insurance range, launched in 2016, was rated 'excellent' three times – for the Family, the Senior, and the Singles packages.

ARAG SE was also a trailblazer outside Germany in 2016. The Dutch branch, for example, expanded Flexpolis, a bespoke private legal insurance product sold through Noordhollandsche Versicherung. The product, for which customers choose the modules they need, now comes with several additional inclusive benefits. In the Italian market, ARAG Italy launched a new version of its private legal insurance product for families. A modular structure is also the distinctive feature of this product, with a wide range of optional modules and various levels of deductibles available depending on whether the customer chooses to use ARAG's network of attorneys. The Spanish branch has also

brought in various new online services for its customers. These include special web protection (including software) for parents of minors as well as CyberSchutz for problems on the internet that offers customers a deletion service for unwanted online content and provides legal assistance to help stop cyberbullying. New services have also been added specifically for online shopping – including the drafting and verification of sales contracts – and for the preparation of wills. In 2016, ARAG Austria developed a new commercial legal insurance product for start-ups and launched it on the market at the beginning of 2017. ARAG Slovenia introduced legal insurance for property managers that can be taken out in conjunction with fire insurance from a strategic partner.

In the Norwegian market, the ARAG subsidiary HELP Forsikring AS expanded its range of legal insurance products for small and medium-sized enterprises: The product, which was launched in the previous year, is now also available to companies with more than 20 employees through group policies with Norwegian labor unions. The HELP Försäkring branch in Sweden has also added to its portfolio, developing and launching My Safety to provide cover for identity theft. The newly established ARAG Services Corporation, which acts as a broker in the Canadian market, has developed new private and commercial legal insurance products and entered into its first strategic alliances. It also provides its customers with a document center, which is a database containing a variety of legal documents that are available for download.

Employees, employee skills and qualifications ARAG SE relies on a skilled and highly motivated workforce in Germany and in its international markets to ensure that it delivers on its value proposition. At the end of 2016, ARAG SE had a total of 1,096 (December 31, 2015: 1,058) employees in Germany. The international branches employed a further 1,468 (December 31, 2015: 1,335) people. ARAG SE also provides successful training programs, enabling its trainees to gain vocational qualifications in insurance and finance. Alongside vocational training, ARAG attaches huge importance to the skills, qualifications, and professional development of its workforce. ARAG intends to remain one of the best insurers in the market. ARAG operates a web-based skills and qualifications platform known as ARAG IQ enabling all employees to keep their knowledge and capabilities up to date. The continuing professional development (CPD) options include classroom-based seminars, training sessions, and e-learning. The content is wide-ranging and includes executive programs, seminars on personal and social skills, project management training, coaching, and foreign languages. All planned and completed CPD has been centrally recorded in ARAG IQ since 2016.

A further key component in ARAG's strategy for retaining suitably qualified employees in the Group is ARAG myCareer, an in-house talent management program introduced in 2011. This program offers an enhanced set of tools to support recruitment and professional development. It helps employees to plan their development and careers, and at the same time ensures that both specialist and interdisciplinary expertise is retained in the Company.

A fundamental factor in the successful performance of the entire ARAG Group is the targeted internationalization of the business. The growing cross-border integration of corporate units also plays a key role in this development. The ARAG INTandem international professional development program, which was launched in February 2015 with a view to systematically expanding this integration and embedding it in the Group, continued in the reporting year. ARAG's sales academy ensures that continuous, high-quality skills development is provided for ARAG partners in the Field Sales force. This unit offers a broad range of needs-based seminars covering the entire spectrum of knowledge related to sales and the performance of ARAG products.

ARAG Essentials The revision of the ARAG Essentials in 2014 included the development of a multifaceted communications concept for the corporate guidelines of the ARAG Group. This strategy included the new ARAG Essentials online tool at www.ARAG.com and meetings throughout the Group to communicate these guidelines. The ARAG Essentials online tool enables users to explore the world of ARAG Essentials in a virtual environment and find out more about the various ARAG locations. The tool is accessible to both the employees and external users on the Group's website at www.ARAG.com, and is available in twelve different languages. As part of the communication activities for ARAG Essentials 2.0, a values mentoring scheme was set up in March 2015. Since then, the approximately 100 executives in the Group's first level of management have been taking it in turns – in alphabetical order – to carry out mentoring with their team for a one-month period. The scheme will continue until December 2017, and details have been published on the groupwide intranet. Since 2012, the ARAG AWARD has been presented in recognition of exemplary implementation of the ARAG Essentials. Prizes are awarded annually in three categories (Germany, International, and (German) Sales) to team projects proactively initiated by employees that stand out as models of successful implementation of the principles in day-to-day activities. The winning teams receive their awards at the next ARAG Group Management Conference.

Corporate responsibility In the ARAG Group, responsible dealings with employees, customers, and partners are based on a long-term, and therefore sustainable, approach. ARAG positions itself as the internationally successful, innovative quality insurer – independent and family-owned. Starting from this fundamental philosophy, the Company takes its corporate social responsibility very seriously. When Heinrich Faßbender established ARAG more than 80 years ago, he had a clear objective in mind: to enable all citizens to enjoy equality of opportunity before the law. This notion still remains an underlying principle in the ARAG Group – and ensures that a high degree of corporate social responsibility is directly enshrined in the ARAG business model.

Today, ARAG brings together the sustainable management of the business at different levels under the general heading of corporate responsibility: The aim is to ensure that customers and consumers derive the greatest possible benefit from the Company's products and services. ARAG also takes responsibility for its employees and supports suitable social projects. The principles of corporate governance set out firmly established voluntary undertakings, providing the framework for socially responsible activities.

Codes of conduct for sales With effect from July 1, 2013, all the German companies in the ARAG Group signed up to the revised GDV code of conduct for the sale of insurance products. This code represents a clear industry commitment to more consumer protection, better quality of advice, development of skills and qualifications for agents, and transparent, mandatory rules for dealing with customers. It thereby establishes the foundations for strengthening trust and confidence in the entire area of insurance broking. It is mandatory for ARAG companies to impose a requirement on the agents in the Core Sales and Partner Sales operations to comply with the code. A number of basic steps are already covered by the ARAG 'Red Thread' advisory approach in Core Sales; furthermore, the promise that customers will receive high-quality products and services is in any case an essential component of ARAG's positioning as a high-quality insurer. In ARAG Partner Sales, very close attention is paid to ensuring that, in the collaboration with brokers, the fundamental rules laid down by the broker associations also correspond to the provisions in the GDV code of conduct. The GDV code of conduct provides for a mandatory audit to be carried out by an independent auditor every two years. All five ARAG companies successfully underwent the initial appropriateness test in 2015 and published a description of the compliance management system that serves as the basis for the test and the positive audit report from the independent auditor, PricewaterhouseCoopers, on the GDV website. The appropriateness test examines whether internal corporate rules reflect the regulations in the code. This approach ensures a high degree of commitment and self-monitoring. The ARAG companies will undergo the follow-up test in spring 2017. The ARAG companies are thus adhering to the promise of high quality defined in the GDV code of conduct in their product brokerage.

ARAGcare The ARAG Group is widely regarded as a demanding employer that expects high levels of performance from its workforce. In return, the Group invests in a comprehensive range of services for its employees. The key component is ARAGcare, the corporate health management program.

ARAGcare is aimed at supporting the personal health of employees. The tried-and-tested components include health checks, diverse company sports activities, regular preventive medical services, and health courses. One of the main features of these expanded services is a reorganized return-to-work and disability management system, which is now run by an external partner. In the year under review, greater emphasis was also given to the second pillar of ARAGcare: work/life balance. To this end, ARAG underwent a comprehensive third-party audit with the aim of developing and embedding a sustainable HR policy that takes into account family requirements and stage of life. Targets were drawn up and set during the course of this project, and the 'audit berufundfamilie' certification is accompanied by an obligation for the Company to achieve these targets by 2017. Numerous measures are already being implemented. Examples include action in connection with the Part-Time Management project, the expansion of teleworking and working from home, an employee assistance program, a new range of courses, and many other individual measures. In 2016, ARAG again received a Corporate Health Award certificate of excellence in recognition of these extensive activities by ARAGcare.

Targets for the proportion of women in management functions In accordance with the provisions in the German Act on the Equal Participation of Women and Men in Managerial Positions (FührposGleichberG), the Company must set targets for the proportion of women at the two management levels below the Management Board, on the Management Board itself and on the Supervisory Board. The Management Board advocates a rising proportion of women in managerial positions, especially as long as the proportion remains below 30 percent. To this end, numerous supporting measures are being implemented as part of the work/life balance project.

The Management Board has set a target for the proportion of women at the first management level below the Management Board of 11 percent and a target at the second management level of 25 percent, in both cases to be achieved by June 30, 2017. Both targets represent an increase compared with the situation at the time the targets were set. The Supervisory Board has set the following targets for June 30, 2017 in respect of the proportion of women: 11 percent on the Supervisory Board and 0 percent on the Management Board. These two targets are the same as the actual percentages at the time the targets were set.

Corporate social responsibility ARAG is a family enterprise. As a consequence, ARAG attaches a huge amount of importance to the interconnection between corporate and social responsibility. The independence that ARAG enjoys as a family enterprise means that the assumption of responsibility becomes even more significant because it is incumbent on the ARAG Group to use this independence responsibly. Since March 2014, ARAG has therefore been successfully offering its innovative development project known as Conflict Management in Schools.

Supported by the North Rhine-Westphalia Ministry for Education and Schools, this program is offered to all high schools and vocational colleges in the German state of North Rhine-Westphalia. During the three training cycles so far, a total of 233 teachers, specialists in educational social work, and parents from 65 high schools and vocational colleges in different school districts across the state have taken part. The project is currently running at 19 other schools. The project focuses on the introduction of universal quality standards for conflict management structures, preventive measures, and intervention techniques. Teachers, parents, specialists in educational social work, and school pastors are trained as school mediators and go on to train school students as conflict controllers. The project has been certified under the name ARAG Mediators as a 'Commitment to Action' by the Clinton Global Initiative (CGI).

The 2016 ARAG Educational Day, attended by Sylvia Löhrmann, North Rhine-Westphalia's Minister for Education and Schools, was held in June in the ARAG Tower. Participants from schools all over North Rhine-Westphalia took part in ten workshops on intercultural conflict management and mediation.

Another key area of activity is the internet. It is changing and affecting the lives of people around the globe – including to a large degree the lives of children and young people – but is also bringing risks. Suitable prevention is important to avert these risks. ARAG SE has a comprehensive range of prevention experience and believes that important areas of prevention lie in the long-term development of media skills and in the provision of information and education, as well as the raising of awareness, about the consequences of bullying.

The ARAG Digital Risks Survey, an international trend study conducted by ARAG and the Institute for Cyberpsychology and Media Ethics, was presented in Berlin at the end of May 2016. Leading academics in the field of cyberpsychology from the UK, Italy, the Netherlands, Norway, Poland, Spain, and the US investigated the impact of cyberbullying and provided their assessment of this phenomenon and its future development. The findings show that cyberbullying and cyberviolence are evolving from a phenomenon of youth culture into a social problem affecting all age groups. The experts surveyed particularly highlighted the increasing violation of the right of individuals to privacy when online. From 2017, ARAG will therefore focus more intensely on protecting online privacy rights. Corporate social responsibility at ARAG also extends to the provision of support for the German Children and Youth Foundation (DKJS), specifically in the area of digital education. For 20 years, this charity has been operating projects and programs throughout Germany, helping children and young people have the courage to take control of their own lives and play a role in society. This approach is a perfect match for ARAG's definition of corporate responsibility – and also fits in well with its current commitments. Since 2014, ARAG has been supporting the DKJS as a program partner, helping to raise awareness among children and young people about the challenges presented by cyberlife and the risks from cyberbullying.

'ZEIT für die Schule' is a project promoted by Germany's weekly DIE ZEIT newspaper. The project is the largest nationwide school project run by a German newspaper and aims to foster reading skills as well as introduce children from the age of around 14 or 15 to the medium of newspapers. As part of the project, ARAG supported the publication of free worksheets for teachers in the lower and upper stages of secondary education, the delivery of free copies of DIE ZEIT and special publications for schools covering media studies and what to do after the Abitur high-school diploma, and the preparation of newsletters for teachers.

Solvency

Under section 89 (1) of the German Insurance Supervision Act (VAG), all insurance companies are obliged to have eligible own funds available at all times that, as a minimum, are sufficient to satisfy the solvency capital requirement. The Solvency II rules came into force on January 1, 2016. In accordance with section 40 of the VAG, a solvency and financial condition report must be published no later than 14 weeks after the end of the financial year. This report must explain the solvency position in a manner that is understandable to the general reader. Insurance groups must also ensure at group level that the solvency margin is covered by eligible own funds and that these funds are appropriately allocated in the group. Evidence of compliance with the solvency requirements is submitted to the German Federal Financial Supervisory Authority (BaFin) on a quarterly basis.

Solvency ratios must be calculated quarterly at the level of the insurance company and at group level.

In the year under review, appropriate coverage of the statutory requirement for the solvency margin in accordance with current solvency regulations was ensured by ARAG SE at all times.

III. Dependent Company Report

ARAG Holding SE, Düsseldorf, indirectly holds a majority interest in ARAG SE. The existence of the majority interest was notified to ARAG Allgemeine Rechtsschutz-Versicherungs-AG (now ARAG SE) on April 28, 2000 by the Management Board of ARAG AG (now ARAG Holding SE) in accordance with section 20 (1) and (4) of the German Stock Corporation Act (AktG).

ARAG SE is therefore a dependent company within the meaning of section 17 (1) AktG in relation to ARAG Holding SE.

The report on relationships with affiliated companies pursuant to section 312 AktG concludes with the following declaration:

“In accordance with the circumstances known to us at the time the legal transactions were undertaken or the activities were carried out or omitted, our Company received an appropriate consideration for each legal transaction. Other than the activities listed, the Company did not carry out or omit any other reportable activities. Our Company did not incur any disadvantage from the activities carried out at the instigation of or in the interests of the controlling entity or its affiliated companies.”

IV. Outlook, Opportunity and Risk Reports

Outlook

The ARAG Group operates in a total of 17 countries: Germany, 14 other European countries, the US and, since 2016, Canada. Given the strong international focus of the Group, economic trends in Europe and North America in particular have an impact on the business performance of ARAG SE, the operational holding company for the ARAG Group.

Future global economic growth is currently subject to many significant risks. As well as ongoing geopolitical issues, these risks also include a crisis-like escalation of political uncertainty in Europe, a renewed flaring up of the European sovereign debt crisis, an unexpected downturn in China's economy, and possible turmoil in international financial markets.

Following a temporary period of weakness in the first half of 2016, the US economy is likely to return to a stronger rate of growth. The recovery in Japan and the eurozone is expected to continue. The pace of growth may falter as monetary policy effects and the positive impact of lower oil prices on real incomes disappear. Reflecting the slight rise in oil prices, inflation will go up again. China's economic output is not predicted to slump, and other emerging markets will probably maintain the process of stabilization that they have begun. Overall, the German Council of Economic Experts anticipates that the moderate rate of global economic growth will continue, forecasting a rise in economic output of around 2.8 percent in 2017.

Political developments in Europe demand particular attention. One major concern is that the future political and economic relationships between the United Kingdom and the European Union have not yet been clarified. So far, the vote for Brexit has not had any substantial adverse effects on the real economy. This indicates a prevailing expectation that a solution will be found that will limit the damage to the economy. If the two sides cannot resolve their political differences, much greater effects are likely to be felt in the UK in terms of investment, trade, and employment. However, Europe's political risks are not restricted to the uncertainty surrounding Brexit. In many member states, parties on the fringes of the political spectrum are enjoying strong popularity. This brings with it the danger of growing political risk. Moreover, a number of member states have unstable governments. At the end of December, for example, Italy held a referendum on constitutional reforms. The lasting political impact of the vote's outcome is not yet clear to see. The eurozone is also heavily affected by the banking sector's unresolved problems, which have mainly been created by low levels of capitalization and the still high volumes of non-performing loans, e.g. in Italy and Portugal. For the eurozone as a whole, the German Council of Economic Experts predicts that economic output will increase by 1.4 percent in 2017.

Germany's upturn is likely to continue this year. Although the growth in real gross domestic product is expected to drop to 1.3 percent, 0.4 percentage points of this slowdown in the pace of growth is due solely to there being fewer working days in 2017. Excluding this one-off effect, the German economy would expand at virtually the same rate as in 2016. It can be assumed that capacity utilization in manufacturing will continue to rise. The expansionary monetary policy of the European Central Bank (ECB) will probably play a significant part in the German economy's upturn. The effect of the ECB's unconventional measures has been to considerably improve the foreign trade environment for German exports since mid-2014, despite muted global demand. Although currently in a good position, the German economy is not immune to the performance of the rest of the euro area. A marked downturn in the other eurozone countries or an unexpected appreciation of the euro could cause the increase in production to slow down significantly.

One of the factors fueling the sustained upturn is the sharp rise in consumer spending and house-building. This is a reflection of the continued robust health of the labor market, as can be seen from the steady growth of employment. The number of people in employment is predicted to increase by more than 400,000 to a total of 44.0 million in 2017. Nevertheless, a major challenge for German economic policy will be to integrate into the job market those who remain unemployed and a rising number of refugees who have been granted asylum. Disposable income is expected to carry on increasing in the forecast period as conditions in the labor market continue to improve. Pension adjustments made in mid-2016 will also push up monetary welfare benefits in 2017. Consumer spending is therefore predicted to go up by 1.3 percent this year. A higher rate of inflation is also likely in 2017, firstly because energy prices will probably increase and secondly because the core inflation rate is slowly rising due to growing capacity utilization in manufacturing. The average rate of inflation is expected to be 1.6 percent.

The insurance industry will not remain unaffected by the above trends. One of the factors taken into account in the latest forecasts of the German Insurance Association (GDV) is that heightened uncertainty caused, for example, by geopolitical risks is one of the major influences on current macroeconomic conditions. Any change in the projected economic growth could therefore also have an impact on business trends in the insurance industry.

Insurers continue to be faced by challenges caused by an unmistakable trend toward fiercer competition.

As in prior years, other action priorities include the increasing differentiation between customer groups and the need to respond to demographic change. In addition, continuous shifts in insurance markets are being brought about by changes in the product landscape, some of which (such as unisex rates or the pluralization of sales structures) are far-reaching.

One transformation that is clearly becoming increasingly important is the digital revolution. The digitalization of the financial sector is increasing the pressure for change in the rather conservative insurance industry. There is a need to open up additional sales, service, and communication channels for consumers. Other technologies such as telematics are beginning – at least in selected European markets – to have an impact on the realignment of product and pricing policy. ‘Either-or’ concepts are not sufficient in this context because the market is not populated exclusively by online-only customers. Whether consumers decide to opt for a digital offering or not depends on the product, the target group, and sentiment. Ultimately, the goal is to offer consumers easy, barrier-free access to insurance benefits. Such an overarching approach is crucial to being able to address the fundamental changes in customer behavior in the digital age. Online business models will therefore soon no longer be aimed at particularly price-sensitive customers but will become an integral component – configured for maximum ease of use – in the range of services provided by each and every insurance company.

The digitalization of legal services is creating new and rapidly increasing challenges, especially for legal insurance providers. One particular example is provided by simpler legal services that are now being offered by dedicated service providers: legal tech companies. It is important to get involved in these trends and take steps to meet new customer requirements, taking account of the special legal requirements in this area, especially in Germany. With the latest technology, it has already been demonstrated that certain legal services can be provided perfectly well via digital platforms. The task is to proactively and systematically seize business opportunities within these parameters.

For property insurers, the main source of risk is the much-discussed climate change that has taken place in past years and decades. Events in early summer 2016 once again showed that natural disasters are an increasingly important issue. In summer 2015, however, politicians had decided against mandatory insurance for natural disasters. Instead, the measures to be taken include national and state-level natural disasters insurance campaigns and the establishment of a country-wide natural disasters portal. The German National Meteorological Service (DWD) and the GDV have launched a new heavy rain project in order to significantly improve the future forecasting of flooding caused by heavy rain so that insurance cover that is more suited to the level of risk can be calculated. The federal government also wants to cut greenhouse gas emissions in Germany to zero by 2050. The insurance industry has contributed its expertise to the development of a strategy, and the sector’s experts are also working on new building regulations for Germany and Europe.

As before, sales activities in the German insurance industry are being made more difficult because the market is very mature. Opportunities for further premium growth and for additional expansion of in-force business are largely limited to customers who are switching between insurers. This trend will continue going forward. Consequently, premium growth will most probably be rather modest in the insurance industry. The GDV forecasts growth of up to 1.0 percent for the German market in 2017. Assuming that there is no unforeseen deterioration in the macroeconomic environment, premiums in the casualty and property insurance segment are expected to be up by around 2.1 percent this year. In the case of legal insurance, the GDV predicts a rise in premiums of 4.5 percent in view of the opportunities to adjust premiums. As in prior years, there is a chance in general accident insurance that the impetus from growth will help to offset the persistent portfolio erosion. The overall result is that premium growth in this insurance segment is likely to be slight at 0.5 percent.

As projected in its 2015 outlook report, ARAG SE continued to increase its premium income in 2016 and, in fact, achieved significant growth. Claims incurred went up in line with prior-year forecasts, but the claims ratio still fell slightly compared with 2015. Absolute costs rose in the reporting year as expected, while the cost ratio reduced slightly year on year. As projected, the underwriting result was in positive territory and in fact exceeded the 2015 profit by a substantial margin.

ARAG SE will continue to pursue its steady, profitable growth trajectory. New digital services are to be added to the portfolio in order to seek out new business opportunities. Starting next year, ARAG SE plans to develop additional insurance-related services and bring them to market maturity. At an international level, the branches will seize opportunities for growth in the field of legal-insurance-related coverage. The corresponding increase in business volume is expected as early as 2017. However, the capital expenditure will initially manifest itself on the costs side.

Under the Solvency II regulatory regime, stricter requirements regarding the type, scope, and periodicity of reports to the insurance supervisor and to the public must be met. ARAG SE has adopted a proactive, forward-looking approach to prepare for this. The use of a partial internal model allows the relatively homogeneous legal insurance business to be taken into consideration on a Company-specific basis when determining the capital requirement. This creates a competitive edge that offers room for additional business opportunities. ARAG SE is open to deliberately tapping into further new international growth markets and to acquiring portfolios.

The positive business performance is expected to continue in the next year and the internationalization of ARAG will be pursued even further. Expectations for premium growth in 2017 envisage a figure of approximately 3 percent. Provided that there are no cumulative claims, the claims ratio is expected to remain the same in relation to premiums earned. As a result of the favorable impact of changes to the discount rate on pension and other post-employment benefit expenses, savings were incurred in the year under review that will not recur in 2017. For this reason and due to the continuing expansion of the business volume, insurance business operating expenses are expected to increase further in absolute terms.

A positive underwriting result is still expected for 2017, although the profit is likely to be smaller than in the year under review.

The current economic and political situation in the EU, the unexpected outcome of the US presidential election, and the ECB's unusual policy on interest rates make it difficult to provide a specific forecast for gains and losses on investments. However, it seems certain that the low interest rates will remain in place for the rest of 2017. As a consequence, the net gain under ordinary gains and losses on investments in 2017 will be lower than in the reporting year. However, further reversals of write-downs and the realization of gains on disposals should offset at least a significant portion, if not all, of this decrease.

In accordance with the amendments to the German Regulation on the Principles Underlying the Calculation of the Actuarial Reserve (DeckRV) of 2011, an additional actuarial reserve will be recognized in the subsidiary ARAG Lebensversicherungs-AG as a supplementary change-in-discount-rate reserve. This reserve has recently grown to €186.3 million. It can be assumed that further significant additions to the supplementary change-in-discount-rate reserve will also be recognized in the next few years. Long-term additions to the supplementary change-in-discount-rate reserve will lead to a substantial additional adverse impact on the ARAG life insurance business. The Management Board of ARAG SE therefore sold its interest in ARAG Lebensversicherungs-AG in the year under review. This sale is subject to the condition precedent of approval by BaFin. If the transaction is approved, the financial strain arising from the life insurance business due to sustained low interest rates will cease.

The sale of the life insurance business is not expected to result in a loss. After taking into account the opportunities and risks, the profit before tax for 2017 is expected to be smaller than that realized in 2016. The net retained profit will come to at least €15.0 million.

Opportunity report

The opportunities and risks in relation to the future development of ARAG SE have already been addressed at various points in the management report. Because of the strong international focus of the business, the Company's positioning in different markets outside Germany is well diversified. This positioning gives rise to opportunities and risks for ARAG SE.

ARAG SE benefits from its international diversification, which is embedded in the overall strategy of the ARAG Group. This structure enables the Company to be more independent from trends in individual national markets.

The cross-border structure of ARAG SE is the logical business consequence of the advanced maturity of the German market and the highly varied economic trends within Europe. The legal insurance markets outside Germany still offer substantial growth potential and the Company will continue to focus considerable efforts on exploiting this potential with a view to achieving further growth. In this regard, ARAG attaches great importance to taking into account the particular features of the market in each country.

Responsibilities are distributed throughout the ARAG Group so that the position enjoyed by the ARAG brand in the German market will be further consolidated and improved by the strengthening of the non-legal-insurance segments. This two-dimensional diversification strategy in the Group is also enabling ARAG SE to move away from its original tightly focused positioning as a niche provider in Germany. A specialist insurer concentrating solely on one line of business is considerably more susceptible to risk. The strategic approach at ARAG is therefore to actively reduce risk and is based on spreading risk evenly across all markets and segments.

To manage the international structure of ARAG SE, the Management Board is supported by a Group Executive Committee (GEC). This committee comprises the members of the Group Management Board, representatives of the main European branches, and representatives of the other insurance segments in Germany. This committee improves the sharing of information between the branches and the German insurance companies in the ARAG Group. One of the main objectives of the GEC is to ensure that innovations and market changes are converted more quickly into specific business processes, both in Germany and abroad, if the committee believes that these innovations or changes offer clear opportunities for the successful further development of the business.

ARAG SE will work systematically and energetically to meet the challenges presented by the markets. In direct implementation of the Group strategy, ARAG SE will continue the process of international diversification and significantly expand the international share of the business.

Risk report

Risk management system

The assumption of risk is the core business of ARAG as an insurer. This means that its activities aimed at achieving its strategic business objectives naturally involve taking on risks in order to achieve the desired success. To deal with these risks, ARAG has implemented a risk management system of which the operational risk management process forms the core element. Taking a multifaceted approach, including a risk strategy, a limit system, and an own risk and solvency assessment (ORSA), ARAG ensures that its risk management activities to control its business operations remain within the prescribed risk-bearing capacity requirements.

Based on the business strategy, the Management Board specifies the risk strategy and defines the capital adequacy requirements and the required limits for the Company. Risks are therefore managed in the round, ensuring at all times that the overall risk profile is consistent with the risk strategy. The Supervisory Board deliberates on these matters and receives regular reports on the risk situation.

To implement the risk strategy, the Company has implemented a risk management system, which is the responsibility of the risk management function. This function is performed by the Group Risk Management Central Department. Group Risk Management is separate from the operational departments with profit-and-loss responsibility up to Management Board level and therefore performs the role of an independent risk control function. The Chief Risk Officer of ARAG SE is responsible for the implementation of the risk management system in all Group companies. Group Risk Management bears process responsibility for the risk management system and, by means of quarterly risk reports to the Management Board, ensures that there is comprehensive transparency with regard to the risk position and any changes to the risk position. Group Risk Management is also responsible for refining the risk management system and for drawing up proposals for uniform standards to be applied throughout the Group. The remit of the central department also includes developing models for determining risk-bearing capacity, solvency capital requirements, and the allocation of solvency capital.

Decisions about whether or not to pursue opportunities and/or take on risk are made in the operating units. The roles and responsibilities of all the people involved in the process, such as members of the Management Board, managers, local and central risk controllers and managers, are clearly defined and documented in the ARAG Group's risk management guidelines.

The core element of the risk management system is the risk management process, comprising the identification, analysis, measurement, management, and monitoring of risk as well as risk reporting.

Risk identification The aim of risk identification is to identify the emergence of new risks or changes in existing risks at an early stage and to assess them using a standard procedure. For example, risks arising in connection with the development of new markets or the launch of new products are identified, analyzed, assessed, and submitted to the Management Board for decision using an appropriate cross-functional new-product process. Corresponding processes have also been put in place for new investment products and reinsurance instruments. These procedures are also integrated into the existing limit and monitoring processes.

Risk analysis To ensure risks are managed appropriately, the influencing factors determining the relevant exposure on the Solvency II balance sheet are examined. These influencing factors are regularly validated to check that they are appropriate for the measurement of risk.

Risk assessment All identified risks are constantly quantified using suitable methods and on the basis of systematically captured and continuously updated data. This process also includes checks to ensure that the risk profile is within the specified limits.

The key element in this process is the solvency capital requirement calculated for all quantified downside risk (value-at-risk). The purpose is to ensure that unexpected losses are covered. A partial internal model is used to calculate the solvency capital requirement. The model calculates the maximum loss from risk exposures covered in the model within a specific holding period (one year in this model) and with a specified level of probability (99.5 percent in this model). The loss could arise as a result of unfavorable movements affecting investments or as a result of unexpected developments in the insurance business. The methodology is regularly reviewed using backtesting and validation tests. Stress tests are also continuously carried out in respect of the risk exposures.

Risk management The Company's approach is to manage risk where it arises. Operational management of risk is thus carried out by the managers and process owners in those departments where the risks occur. Risk management consists of implementing measures to reduce, mitigate, transfer, and diversify identified and analyzed risks.

Risk monitoring and reporting A key element of risk monitoring is examining changes in the risk profile over time, focusing on risk-bearing capacity and utilization of the limits. The risk-bearing capacity of the Company is determined on the basis of the aggregated solvency capital requirement and the eligible own funds that are available. This takes into account the regulatory and internal requirements regarding minimum cover. The actual utilization of limits is determined by reconciling the individual risks assumed and the aggregated risk with the specified limits.

To calculate the limits, the minimum coverage ratio determined by business policy requirements and the eligible own funds are used to determine the maximum permitted solvency capital requirement for the Company. The Management Board sets an overall limit in accordance with its risk tolerance. This overall limit is then apportioned to the risks.

The results from the risk monitoring process and the associated recommendations for action are reported to the Management Board promptly, without restriction, and on a continuous basis.

Internal control system The internal control system (ICS) refers to all control and monitoring mechanisms as well as other measures that help to support the effectiveness and profitability of business activities and to identify and minimize risk at an early stage. They also ensure compliance with the applicable laws and regulations, all regulatory requirements, and internal rules.

The ICS is based on the principles, functions, processes, measures, and policies implemented by the Management Board and on statutory and regulatory requirements that ensure the decisions of the Management Board are implemented operationally.

ARAG structures its internal control system in accordance with the 'three lines of defense' model.

The first line of defense is formed by all employees and managers in operational roles. They are directly responsible for the risks and processes in their departments.

The second line of defense is the monitoring of the first line of defense by the interdisciplinary functions Group Controlling, Group Risk Management, and Legal/Compliance, and by the Actuarial function. These functions specify standards for the design and monitoring of controls and for the handling of risk.

In the third line of defense, Group Audit conducts internal audits of the functions in the first and second lines of defense within the ARAG Group.

Internal audit The Group Audit function is an instrument of the Management Board, to which it is accountable and to which it reports. Group Audit is bound only by the instructions of the Management Board.

Following the orders issued by the Management Board, Group Audit examines the operational and organizational structure as well as the internal control system for all operating and business processes from a risk perspective, including those that have been outsourced to other companies.

The Management Board makes sure that Group Audit carries out its duties autonomously and independently of the units that it audits, particularly in respect of its audit planning, audit procedures, and evaluation of audit results.

So that it can fulfill its role and responsibilities properly, Group Audit does not get involved in operational processes. Employees in Group Audit are not permitted to be assigned tasks that would conflict with Group Audit's independence within the ARAG Group and are not allowed to carry out non-auditing work or operational activities. Group Audit itself does not have any authority to issue instructions to employees in other departments.

Individual risks

Underwriting risk Underwriting risk is the risk of a loss or adverse change in the value of insurance liabilities arising from inadequate pricing and inadequate provisioning assumptions. These losses result from:

- Premium/reserve risk: fluctuations in the timing, frequency, and severity of insured events and in the duration of claims settlement and the amount involved.
- Catastrophe and accumulation risk: significant uncertainties regarding pricing and assumptions in respect of the recognition of technical provisions for extreme or exceptional events.
- Lapse risk: changes in the level or volatility of the rates of insurance policy lapses and terminations.

These risks are measured with an internal model. Using a simulation, the losses and adverse changes in liabilities that could occur within one year are forecast. The value of the risk equates to the negative simulation result expected only every 200 years (1 in 200 year event). Each risk is measured separately. For premium and reserve risk, specified criteria are used to aggregate historical losses into groups of risks sharing similar characteristics. These are then used for 200,000 simulations of future unexpected claims and/or required additions to reserves. Likewise, catastrophe and accumulation risk is assessed by simulating losses that may arise from cumulative claims in the legal insurance business. Lapse risk is calculated on the basis of exceptional cancellations in the past. The actual underwriting risk arises from the aggregation of the individual risks, taking diversification effects into account.

The consistency of the insurance business and the adequacy of the claims provisions at all times can be seen in the following disclosures on the changes in the claims ratio for the entire direct insurance business over the last ten financial years.

Changes in claims ratio

Financial year	Claims ratio, gross, total		Settlements
	<i>FY ratio</i>	<i>Financial statements</i>	<i>% of initial reserve</i>
2016	57.7	51.2	4.6
2015	61.0	52.5	5.6
2014	61.7	55.8	3.7
2013	63.8	58.6	3.3
2012	60.0	55.4	3.0
2011	68.3	56.1	3.9
2010	68.6	63.6	2.8
2009	71.7	64.8	3.8
2008	66.5	58.3	4.6
2007	66.0	63.0	1.8

At operational level, underwriting risk arising from legal insurance is managed by means of underwriting, premium, and reinsurance policy measures.

Counterparty default risk While counterparty default risk attaching to investments is calculated as part of market risk, counterparty default risk in the insurance business is treated separately. Counterparty default risk is the downside risk arising from the unexpected default or deterioration in the credit standing of counterparties and debtors during the next twelve months.

Counterparty default risk is measured with the standard formula. The risk is an aggregation of the solvency capital requirement for receivables from reinsurers and the solvency capital requirement for receivables from policyholders/insurance brokers. This aggregation takes account of specified correlations.

The risk of default on receivables from reinsurers is modeled on the basis of the information available and proportionality considerations. The reinsurers' individual credit ratings are explicitly used. Receivables from reinsurers relate only to Spanish reinsurers that are not assigned to rating classes.

Default risk in connection with reinsurance contracts is managed in accordance with the reinsurance strategy, which is reviewed at regular intervals.

To measure the risk of default on receivables from policyholders and insurance brokers, a constant factor is applied to the fair value of the relevant exposures on the Solvency II balance sheet. As of the balance sheet date, receivables from policyholders more than 90 days past due amounted to €12.4 million (December 31, 2015: €3.5 million). The average default rate for the German headquarters over the last three years in relation to these receivables as of December 31, 2016 was 25.6 percent. Receivables from policyholders are managed by means of an automated reminder and dunning process.

Market risk Market risk is the risk of loss or of adverse changes to market prices of assets, liabilities, and financial instruments. The risk arises directly or indirectly from the following sub-risks:

- Interest-rate risk: changes in the term structure or volatility of interest rates. An assumed increase or decrease of 1 percent in the general level of interest rates would decrease or increase the fair value of ARAG SE's fixed-income securities by €69.9 million.
- Equity risk: changes in the level or volatility of the market prices of equities. A hypothetical fall in equities markets of 20 percent would cause a loss in fair value of €32.6 million.
- Property risk: changes in the level or volatility of the market prices of real estate.
- Spread risk: changes in the level or volatility of credit spreads over the risk-free interest-rate term structure.
- Migration/default risk: rating level changes or changes in the extent of projected defaults. The breakdown of interest-bearing investments by rating is as follows:

Fixed-income securities by rating class

(Proportion (%) by fair value)

AAA	17.5
AA	17.3
A	29.9
BBB	30.4
BB	3.5
B	1.4
CCC	0.0
CC	0.0
C	0.0
D	0.0
Not rated	0.0

The breakdown of fixed-income securities is as follows (fair values): of the fixed-income securities – including securities held indirectly through institutional funds – approximately 37.3 percent are accounted for by financial services entities, 28.5 percent by public-sector bonds, and 34.2 percent by non-financial services entities.

- Currency risk: changes in the level or volatility of exchange rates.
- Concentration risk: all risk exposures with a loss potential that is large enough to threaten solvency or financial position.

These risks are measured with an internal model. An economic scenario generator is used to simulate capital market scenarios looking at interest rates, share prices, real estate prices, credit spreads, credit ratings/defaults, and exchange rates. These risk factors are used to determine the possible fair values of investments in one year's time. The market risk itself results from the 1 in 200 year event considering all risk factors simultaneously, and from concentration risk, taking diversification effects into account.

The strategic asset allocation is defined in order to manage the risks. This allocation is used to optimize the investment portfolio so that the desired risk/return ratio can be achieved. Portfolio management is based on the prudent person principle and follows the related regulatory requirements. Interest-rate risk is contained separately by means of asset-liability management. In addition, derivatives are used within institutional funds to hedge changes in interest rates, share prices, and exchange rates. Investments in hedge funds, the funding of investments by borrowing, and the sale of shares not owned by ARAG SE (short selling) are not permitted.

Liquidity risk Liquidity risk is the risk that insurance companies are unable to realize investments and other assets in order to settle their financial obligations when they fall due.

Currently, there is no regulatory solvency requirement for the coverage of liquidity risk so it is not measured. Instead, the monthly excess liquidity cover and liquidity shortfall are calculated on a rolling basis.

Each line item on the balance sheet is assigned to a liquidity class so that the liquidity of the non-trading portfolio can be adjusted if necessary. To ensure the Company can always meet its due liabilities, most investments are made in the 'available-for-sale at short notice' liquidity class.

The liquidity planning is updated constantly so that liquidity can be managed. The Company thus has early warning of whether it will require liquidity in the coming months.

Operational risk Operational risk is the risk arising from inadequate or failed internal processes or systems, employee misconduct, or unexpected external events that disrupt or even prevent business operations. Operational risk also encompasses legal risk but does not include reputational risk or risks arising from strategic decisions.

The Company uses the standard formula to determine the solvency capital requirement.

Measurement for operational purposes is derived from the estimated gross and net values of each individual operational risk based on the risk's probability of occurrence and its impact on the income statement. The probability of occurrence describes the likelihood that an operational risk will materialize within a defined period. The scale is calibrated for a period of one year. Both a qualitative and a quantitative estimate of the impact can be prepared. In the case of a quantitative estimate, the risk is classified directly using a risk matrix. With a qualitative estimate, the impact is determined by comparing the risk matrix classification with the class limits. This risk matrix enables the risks to be prioritized. As risks are measured using subjective estimates carried out by experts, the employees responsible have an additional instrument, the loss event database, that helps them to determine the values. This contains data on all loss events that have occurred in the past and their actual impact on the income statement.

Specific measures are agreed upon and carried out in order to manage the identified risks at operational level.

Overall risk position

Risks to the Company's survival as a going concern There are no internal or external risks that could have a permanent adverse impact on the net assets, financial position, or results of operations of the Company. The overall risk position does not currently point to any trends in 2017 that could jeopardize the continued existence of the Company as a going concern or cause a significant negative impact on net assets, financial position, or results of operations.

Risk position New regulatory requirements for the quantification of the risk position have been in force since January 1, 2016. The regulatory minimum capital requirement pursuant to section 122 VAG is met in full. Moreover, the eligible own funds are significantly higher than the solvency capital requirements calculated in accordance with section 97 VAG. Further details of the coverage situation can be found in the solvency and financial condition report.

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Balance Sheet as of December 31, 2016

Assets

(€)

A. Intangible assets

B. Investments

- I. Land, land rights and buildings, including buildings on third-party land
- II. Investments in affiliated companies and equity investments
 - 1. Shares in affiliated companies
 - 2. Lending to affiliated companies
 - 3. Equity investments
- III. Miscellaneous investments
 - 1. Equities, investment fund shares/units, and other variable-yield securities
 - 2. Bearer bonds and other fixed-income securities
 - 3. Loans secured by mortgages or land charges and fixed-income receivables of which in respect of affiliated companies: € 3,975,000.00 (Dec. 31, 2015: € 4,775,000.00)
 - 4. Miscellaneous lending
 - a) Registered bonds
 - b) Promissory notes and loans
 - c) Sundry lending
 - 5. Bank deposits
 - 6. Other investments
- IV. Deposits with ceding insurers

C. Receivables

- I. Receivables from direct insurance business
 - 1. from policyholders
 - 2. from insurance brokers
 - of which from affiliated companies: € 133,422.85 (Dec. 31, 2015: € 70,942.75)
- II. Receivables from reinsurance business
 - of which from affiliated companies: € 292,265.28 (Dec. 31, 2015: € 272,092.38)
- III. Miscellaneous receivables
 - of which from affiliated companies: € 5,773,217.53 (Dec. 31, 2015: € 13,544,003.52)
 - of which from other long-term investees and investors: € 16,565.62 (Dec. 31, 2015: € 0.00)

D. Miscellaneous assets

- I. Property and equipment and inventories
- II. Current bank balances, checks and cash on hand
- III. Other assets

E. Prepaid expenses and accrued income

- I. Accrued interest and rent
- II. Miscellaneous prepaid expenses and accrued income

F. Deferred tax assets

G. Excess of plan assets over pension liabilities

Total assets

				Dec. 31, 2016	Dec. 31, 2015
				8,329,472.13	9,178,904.51
			97,563,670.52		101,146,850.37
		225,017,698.96			215,619,877.65
		1,655,527.11			2,455,291.73
		16,887,569.37			20,478,979.37
			243,560,795.44		238,554,148.75
		625,493,318.99			614,560,037.24
		301,550,383.27			300,140,063.78
		3,975,000.00			4,775,000.00
	140,511,291.88				149,511,291.88
	243,995,110.85				217,995,110.85
	150,107.42				130,287.44
		384,656,510.15			367,636,690.17
		98,570,813.32			17,711,494.25
		5,331,278.41			5,222,234.20
			1,419,577,304.14		1,310,045,519.64
			44,388,849.23		36,148,718.55
				1,805,090,619.33	1,685,895,237.31
		25,974,932.12			23,962,536.11
		19,854,540.66			19,340,902.18
			45,829,472.78		43,303,438.29
			44,836,329.39		42,887,401.63
			10,461,382.14		17,294,218.23
				101,127,184.31	103,485,058.15
			16,320,490.85		17,105,717.00
			67,912,841.66		85,017,850.17
			38,128,341.36		54,484,152.93
				122,361,673.87	156,607,720.10
			7,260,642.26		8,072,690.94
			2,240,502.16		2,035,074.70
				9,501,144.42	10,107,765.64
				6,080,380.79	29,736,274.83
				0.00	0.00
				2,052,490,474.85	1,995,010,960.54

Balance Sheet as of December 31, 2016

Equity and liabilities

(€)

A. Equity

- I. Subscribed capital
- II. Capital reserve
- III. Revenue reserves
 - 1. Statutory reserves
 - 2. Other revenue reserves
- IV. Net retained profit

B. Subordinated liabilities

C. Technical provisions

- I. Unearned premiums
 - 1. Gross amount
 - 2. less: portion for outward reinsurance business
- II. Provision for outstanding claims
 - 1. Gross amount
 - 2. less: portion for outward reinsurance business

III. Equalization provision and similar provisions

IV. Miscellaneous technical provisions

D. Other provisions

- I. Provisions for pensions and other post-employment benefits
- II. Provisions for taxes
- III. Miscellaneous provisions

E. Deposits received from reinsurers

F. Other liabilities

- I. Liabilities from direct insurance business
 - 1. to policyholders
 - 2. to insurance brokers
 - of which to affiliated companies: €16,281.97 (Dec. 31, 2015: €86,663.19)
 - of which to other long-term investees and investors: €48.65 (Dec. 31, 2015: €37.49)
- II. Liabilities from reinsurance business
 - of which to affiliated companies: €90,160.50 (Dec. 31, 2015: €47,887.66)
- III. Liabilities to banks
- IV. Miscellaneous liabilities
 - of which tax liabilities: €14,419,570.00 (Dec. 31, 2015: €13,371,222.07)
 - of which social security liabilities: €1,759,752.31 (Dec. 31, 2015: €1,962,040.76)
 - of which to affiliated companies: €16,129,957.34 (Dec. 31, 2015: €11,668,375.46)
 - of which to other long-term investees and investors: €0.00 (Dec. 31, 2015: €0.00)

G. Deferred income and accrued expenses

H. Deferred tax liabilities

Total equity and liabilities

			Dec. 31, 2016	Dec. 31, 2015
		100,000,000.00		100,000,000.00
		81,772,569.19		81,772,569.19
	10,000,000.00			10,000,000.00
	198,900,000.00			190,900,000.00
		208,900,000.00		200,900,000.00
		31,701,021.52		23,038,483.15
			422,373,590.71	405,711,052.34
			30,000,000.00	30,000,000.00
	200,249,508.90			194,606,195.08
	1,417,577.35			1,199,110.00
		198,831,931.55		193,407,085.08
	1,062,854,310.12			1,055,511,862.80
	1,784,031.80			1,150,612.61
		1,061,070,278.32		1,054,361,250.19
		13,794,281.00		8,237,880.00
		882,000.00		876,000.00
			1,274,578,490.87	1,256,882,215.27
		164,314,789.76		170,638,993.00
		12,938,359.11		3,754,028.23
		65,207,692.91		52,562,079.71
			242,460,841.78	226,955,100.94
			1,509,590.45	1,215,522.85
	10,593,565.54			9,408,001.37
	24,855,693.40			24,102,857.32
		35,449,258.94		33,510,858.69
		1,878,744.58		2,476,040.21
		0.00		0.00
		44,022,550.43		38,065,501.97
			81,350,553.95	74,052,400.87
			217,407.09	194,668.27
			0.00	0.00
			2,052,490,474.85	1,995,010,960.54

Income Statement for the Period from January 1 to December 31, 2016

(€)

I. Underwriting account

1. Premiums earned for own account
a) Gross premiums written
b) Reinsurance premiums ceded
c) Change in gross unearned premiums
d) Change in reinsurers' share of gross unearned premiums
2. Miscellaneous underwriting income for own account
3. Claims incurred net of reinsurance
a) Payments for claims
aa) Gross amount
bb) Reinsurers' share
b) Change in provision for outstanding claims
aa) Gross amount
bb) Reinsurers' share
4. Change in miscellaneous net technical provisions
5. Own account insurance business operating expenses
a) Gross insurance business operating expenses
b) less: commissions received and profit sharing received from outward reinsurance business
6. Miscellaneous underwriting expenses for own account
7. Subtotal
8. Change in the equalization provision and similar provisions
9. Underwriting result for own account
Carried forward:

			2016	2015
	824,615,978.15			766,127,218.71
	-5,247,633.53			-4,680,121.65
		819,368,344.62		761,447,097.06
	-5,334,530.43			-5,704,141.11
	218,467.35			389,875.71
		-5,116,063.08		-5,314,265.40
			814,252,281.54	756,132,831.66
			1,464,471.83	1,465,953.12
	409,338,599.15			395,477,330.08
	-855,825.29			-749,119.95
		408,482,773.86		394,728,210.13
	-7,543,653.05			-5,177,229.70
	633,419.19			-164,766.21
		-6,910,233.86		-5,341,995.91
			415,393,007.72	400,070,206.04
			-6,000.00	89,000.00
		366,974,892.54		346,480,654.07
		-2,590,163.97		-1,699,254.61
			364,384,728.57	344,781,399.46
			0.00	10,966.80
			35,933,017.08	12,825,212.48
			-5,556,401.00	-1,558,087.00
			30,376,616.08	11,267,125.48
			30,376,616.08	11,267,125.48

Income Statement for the Period from January 1 to December 31, 2016

(€)

Brought forward:

II. Non-underwriting account

1. Income from investments

a) Income from equity investments

of which from affiliated companies: € 11,185,074.66 (2015: € 17,515,921.49)

b) Income from other investments

of which from affiliated companies: € 2,154,166.06 (2015: € 1,860,747.14)

aa) Income from land, land rights and buildings, including buildings
on third-party land

bb) Income from other investments

c) Income from reversals of write-downs

d) Gains on the disposal of investments

e) Income from profit-pooling, profit-transfer and partial profit-transfer agreements

2. Expenses for investments

a) Expenses for the management of investments, interest expense and similar charges and
miscellaneous expenses for investments

b) Depreciation, amortization and write-downs of investments

of which write-downs: € 6,220,062.95 (2015: € 12,501,567.72)

c) Losses on the disposal of investments

3. Other income

4. Other expenses

Non-underwriting result**5. Profit/loss from ordinary activities**

6. Extraordinary income

7. Extraordinary expenses

8. Net extraordinary income/expense

9. Income taxes

10. Miscellaneous taxes

11. Net income for the year

12. Profit brought forward from 2015

13. Appropriation to revenue reserves

a) To statutory reserve

b) To other revenue reserves

14. Net retained profit

				2016	2015
				30,376,616.08	11,267,125.48
		14,546,427.63			20,704,691.47
	6,382,303.57				6,332,989.30
	33,791,899.85				42,924,692.23
		40,174,203.42			49,257,681.53
		8,939,317.40			4,164,650.67
		8,848,945.81			4,004,151.51
		14,019,208.11			15,014,825.58
			86,528,102.37		93,146,000.76
		6,310,460.61			6,688,449.29
		7,250,941.94			13,546,615.07
		288,072.32			1,291,065.02
			13,849,474.87		21,526,129.38
				72,678,627.50	71,619,871.38
			89,919,753.75		93,320,898.86
			124,947,450.69		132,611,998.32
				-35,027,696.94	-39,291,099.46
				37,650,930.56	32,328,771.92
				68,027,546.64	43,595,897.40
			0.00		0.00
			0.00		0.00
				0.00	0.00
			35,156,509.17		19,101,082.13
			1,208,499.10		1,531,360.20
				36,365,008.27	20,632,442.33
				31,662,538.37	22,963,455.07
				38,483.15	75,028.08
				0.00	0.00
				0.00	0.00
				31,701,021.52	23,038,483.15

Notes to the Financial Statements

I. General Disclosures

ARAG SE operates legal insurance and reinsurance business. Outside Germany, the insurance offering also includes cover for a variety of financial losses as well as emergency assistance insurance. The Company holds equity investments in other insurance companies and other companies pursuing a purpose that is related to the business activities of ARAG SE. ARAG SE is entered in the commercial register of the Düsseldorf local court under the number HRB 66846. Its registered office is ARAG Platz 1, 40472 Düsseldorf, Germany. The financial statements have been prepared in accordance with Book Three of the German Commercial Code (HGB), taking into account the supplementary provisions applicable to large corporations in Part Two and the supplementary provisions applicable to insurance companies in subsection 2, as well as the supplementary provisions in the Regulation on the Accounting of Insurance Undertakings (RechVersV). The Company is a large corporation within the meaning of section 267 (3) HGB. Therefore, and pursuant to the obligations under section 341a (1) HGB, the provisions for large corporations have been applied.

II. Disclosures on Accounting Policies

Financial reporting standards

ARAG SE prepared these financial statements for 2016 in accordance with the requirements of the HGB, including but not limited to sections 341 et seq., and the RechVersV dated November 8, 1994.

Accounting policies

The bookkeeping system has been maintained, and the financial statements prepared, in accordance with the accounting policies specified in Book Three of the HGB, taking into account the provisions applicable to large corporations. The specific provisions applicable to insurance companies in sections 341 et seq. HGB have also been observed, as have the additional requirements in the RechVersV of November 8, 1994.

Purchased **intangible assets** are carried at cost and reduced by straight-line amortization according to their estimated useful life. Internally generated intangible assets are not capitalized.

Land and buildings are valued at cost less depreciation. No write-downs were recognized pursuant to section 253 (3) sentence 5 HGB. Reversals of write-downs pursuant to section 253 (5) HGB were not recognized in 2016. The proportions relating to own use are calculated on the basis of the carrying amounts.

Investments in affiliated companies and equity investments are valued at cost, in some cases written down in accordance with section 253 (3) sentence 5 HGB. Write-downs amounting to €4,187,809.40 were recognized in the reporting year. Reversals of write-downs pursuant to section 253 (5) HGB were recognized in an amount of €2,041,100.00 in 2016.

The table below shows shares in affiliated companies and equity investments that are intended to serve the Company's own operations by establishing a lasting relationship; the equity and profit/loss of these companies are stated:

Shares in affiliated companies and equity investments

Name and registered office of company	Shareholding (%)	Equity (€)	Profit/loss (€)
1. Affiliated companies			
a) Insurance companies			
ARAG Allgemeine Versicherungs-AG*, Düsseldorf	100.00	55,322,905.72	14,019,208.11
ARAG Lebensversicherungs-AG, Munich	92.00	47,392,227.68	3,650,000.00
ARAG Krankenversicherungs-AG, Munich	25.10	58,752,897.92	6,700,000.00
Help Forsikring AS, Oslo	100.00	24,648,150.00	4,349,414.30
b) Other companies – limited companies			
ARAG International Holding GmbH, Düsseldorf	100.00	46,355,797.14	11,890,573.65
ARAG Liegenschaftsverwaltungs- und Beratungsgesellschaft mbH, Düsseldorf	100.00	935,926.57	-33,540.91
ARAG Service Center GmbH, Düsseldorf	80.00	347,206.00	-12,301.35
ARAG IT GmbH, Düsseldorf	100.00	8,868,996.11	349,457.97
CURA Versicherungsvermittlung GmbH, Düsseldorf	100.00	285,384.11	-1,425,756.38
Solfin GmbH, Düsseldorf	75.10	693,584.01	239,349.71
ALIN 1 Verwaltungs-GmbH, Düsseldorf	100.00	22,082.96	1,785.57
ARAG plc., Bristol	100.00	13,312,857.35	2,196,659.72
ARAG-France S.A.R.L. Assistance et Reglement de Sinistres Automobiles et Generaux, Versailles	100.00	18,988.00	0.00
ARAG Legal Services B.V., Leusden	100.00	93,958.21	-2,409,327.75
Agencia de Seguros ARAG SA, Barcelona***	100.00	178,692.37	108,588.22
ARAG Services Spain & Portugal S.L., Barcelona**	100.00	361,825.63	18,698.82
c) Other companies – partnerships			
ARAG Liegenschaftsverwaltungs- und Beratungs-GmbH & Co. Immobilien KG, Düsseldorf	50.00	6,076,554.58	122,747.10
ALIN 1 GmbH & Co. KG, Düsseldorf	100.00	9,641,386.65	-36,922.60
2. Associates			
AXA ARAG Rechtsschutz AG, Zurich	29.17	46,337,536.96	13,546,746.08

* Profit before profit transfer.

** Figures from financial statements for the year ended December 31, 2015.

*** Figures from financial statements for the year ended December 31, 2014.

Equities, investment fund shares/units, and other fixed-income and variable-yield securities that have not been classified as permanent fixed assets are valued at the lower of cost or quoted market price/market value as of the reporting date in accordance with section 341 b (2) HGB in conjunction with section 253 (1), (4), and (5) HGB. In application of the strict principle of lower of cost or market value, the following write-downs were recognized in 2016: €72,700.74 (2015: €300,534.14) in respect of equities and investment fund shares/units and €1,959,552.81 (2015: €1,915,330.41) in respect of bonds. No write-downs were recognized in respect of investment fund shares/units in application of the discretionary principle of lower of cost or market value (2015: €9,879,234.17). Reversals of write-downs pursuant to section 253 (5) HGB were recognized in the year under review as follows: €5,808,696.26 (2015: €513,833.04) in relation to investment fund shares/units and €998,765.00 (2015: €14,895.00) in relation to bonds. As of the reporting date, undisclosed liabilities of €147,179.85 (December 31, 2015: €2,075,614.42) were not netted as a result of the application of the discretionary principle of lower of cost or market value.

ARAG SE made use of the option to select the discretionary principle of lower of cost or market value in accordance with section 341 b (2) second half-sentence HGB for those institutional investment fund shares/units and bearer bonds that the Management Board intends to use permanently as part of the working capital of the insurance business. Subsequent valuation of the investment fund shares/units classified as fixed assets is based on the long-term market value determined in a fund review. As of December 31, 2016, the long-term market value was assumed to be the quoted market price.

As in 2015, additions to investment fund shares/units, but not additions to bearer bonds, were recognized under fixed assets. Write-downs were not avoided by the classification of these additions as fixed assets.

Registered bonds are accounted for at their nominal or redemption amount. Discounts are deferred using the straight-line method. Premiums are capitalized and recognized in income using the straight-line method over the term to maturity. **Promissory notes, loans and receivables secured by mortgages or land charges, and sundry lending items** are recognized at cost unless permanently impaired. No write-downs to a lower fair value were necessary in the year under review or the previous year.

Bank deposits as well as deposits with and deposits received from ceding insurers are recognized at their nominal amount. Increases and decreases in bank deposits are only netted where the credit balances are held by the same business unit.

Investments are individually assigned to the business units (headquarters and branches). The assignment is documented by recording the investments in the relevant books of the business unit concerned. Income from investments is allocated to each business unit according to the assignment of the investment in question. Assignments are reviewed annually using the modified capital allocation approach determined by the German tax authorities – which has been approved by the Organisation for Economic Co-operation and Development (OECD) – and adjusted by means of compensatory payments.

Receivables are generally recognized at their nominal amount. A general allowance for latent credit risk is deducted from **receivables from policyholders** after specific allowances have been recognized for receivables that are past due by a predefined period of time. Receivables from policyholders past due are valued at the average historical recovery rate. **Receivables from agents** are reduced by specific allowances and a general allowance in the amount of the likely default.

Receivables from reinsurance business comprise amounts derived from both inward and outward reinsurance business. The balance of €44,836,329.39 as of December 31, 2016 arose for the most part from inward reinsurance business at the branches in Spain, Italy, and the Netherlands. The amounts recognized are the outstanding balances. The breakdown by primary insurer or reinsurer was as follows:

Insurance companies

<i>(Balance in €'000)</i>	Dec. 31, 2016	Dec. 31, 2015
UNIPOL Assicurazioni, Italy, BBB- rating	23,791.4	24,438.5
ABN-AMRO Verzekeren, Netherlands, A+ rating	4,495.9	4,592.4
Noordhollandsche van 1816, Netherlands, no rating	3,129.3	2,645.7
REALE, Spain and Italy, BBB+ rating	2,914.4	2,469.0
Italiana Assicurazioni, Italy, BBB+ rating	669.3	990.5
BRIT Syndicate 2987 at Lloyd's, United Kingdom, AA- rating	765.8	632.5
Sundry balances	9,070.2	7,118.8
	44,836.3	42,887.4

In accordance with section 253 (1) sentence 1 HGB, **property and equipment** is recognized at cost and depreciated on a straight-line basis over the standard operating useful life.

Inventories are determined by carrying out physical inventory checks. They are valued at cost and reduced by appropriate write-downs to account for storage risk and impaired marketability.

Other assets are recognized at their nominal amount, which equates to their cost. Long-term tax assets are discounted to present value using a discount rate appropriate to the maturity involved.

Prepaid expenses and accrued income mainly consist of accrued rights to interest not yet due in the income period before the balance sheet date. As of December 31, 2016, this item also included premiums in connection with registered bonds amounting to €43,694.71 (December 31, 2015: €59,373.43).

If differences arise between the carrying amounts in the HGB financial statements and those in the tax base and these differences are expected to reverse in subsequent years, **deferred taxes** are recognized in respect of these differences using separate entity-specific tax rates determined according to the country in which the registered office of the permanent establishment concerned is situated. This also includes differences for which the timing of the reversal is not yet precisely known or depends on action by the entity concerned, and differences that would only reverse in the event of any liquidation. This planning uncertainty is taken into account in the valuation of the deferred taxes depending on the expected timing of the reversal of the differences. A simplified tax planning process on the basis of the strategic planning is used to review recoverability. Deferred tax assets have not been recognized for tax loss carryforwards or reversal effects that solely increase existing loss carryforwards.

The **subscribed capital** has been fully paid up by the shareholders. The **capital reserves** include amounts that shareholders have contributed to the equity of the Company without being granted preferences in accordance with section 272 (2) no. 4 HGB.

Subordinated liabilities have been issued by way of private placement to improve the own funds used to determine the solvency ratio. The registered bond with a value of €30 million has a fixed maturity of ten years and will be redeemed on July 29, 2024. The subordinated registered bond has been recognized at its settlement amount. These bonds were not, and are not, negotiable in Germany on a regulated market within the meaning of section 2 (5) of the German Securities Trading Act (WpHG).

Gross unearned premiums for direct insurance business are calculated pro rata temporis for each individual policy on the basis of the premiums and cancellations posted, less the installment surcharges. The calculated unearned premiums are reduced by the income components intended to cover the acquisition costs. An individually determined proportion (branches) or a flat rate of 85 percent (Group headquarters) of the commissions and other remuneration for agents is recognized as a non-transferable income component. The gross unearned premiums for inward reinsurance business are recognized in accordance with the information provided by the primary insurer. The reinsurers' share of the unearned premiums is determined in accordance with the contractual agreements.

The **provision for outstanding claims** in relation to direct insurance business is recognized separately by event year for claims reported in the financial year concerned and for claims that have occurred up to the balance sheet date but have not yet been reported. A provision for claim settlement expenses is also recognized. These provisions are valued in accordance with prudent business practice, taking into account the ongoing need to satisfy the obligations under insurance contracts. Valuation is based on values as of the balance sheet date. The provisions are not discounted. The results from the group-based and individual valuations are reviewed on a portfolio basis using actuarial methods.

In the reporting year, the settlements in direct business for all classes of insurance amounted to 3.7 percent of the initial reserve (2015: 5.6 percent).

The provision for outstanding claims in the inward reinsurance business is recognized in accordance with the information provided by the primary insurer. The provision for outstanding claims in connection with the inward reinsurance business from the United Kingdom is determined on the basis of past experience and statistics produced by the Group's own claims settlement company. The proportions relating to outward reinsurance business are calculated in accordance with the stipulations in the reinsurance treaties.

The **equalization provision** for the direct and inward reinsurance business is recognized and valued in accordance with section 341h HGB in conjunction with section 29 RechVersV. The calculation is carried out separately for the direct insurance business and for the inward reinsurance business, in each case broken down by class of insurance. The calculated equalization provision is allocated between the Group headquarters and the branches according to gross premiums earned in each class of insurance.

The **cancellation provision** reported under miscellaneous technical provisions to cover the discontinuation or reduction of technical risk is recognized in the amount of the estimated requirement.

In accordance with standard international practice, **the provisions for pensions and other post-employment benefits** are calculated using the projected unit credit (PUC) method and applying section 253 (2) sentence 2 HGB on the basis of the 2005G mortality tables published by Professor Klaus Heubeck. In addition to current circumstances, future trends in salaries, pensions, and staff turnover are taken into account. In accordance with section 253 (2) sentence 2 HGB, the discount rate used is the average interest rate for the past ten years published by Deutsche Bundesbank in accordance with the Regulation on the Discounting of Provisions (RückAbzinsV) for an assumed residual maturity of 15 years. A discount rate of 4.01 percent was applied for the valuation as of December 31, 2016 (December 31, 2015: 3.89 percent). Reflecting the statutory discount rate in force at the time, the average interest rate for the past seven years (3.89 percent) had been used in 2015. As of December 31, 2016, the difference between the application of the ten-year average and the previously used seven-year average (3.24 percent) resulted in a reduction in the provision for pensions and other post-employment benefits of €17,583,468.00.

The following actuarial parameters were used to calculate the obligations: earliest possible age under the German Pension Age Reform Act (RVAGAnpG), annual increase in salaries of 2.5 percent, annual increase in pension benefits of 1.75 percent (for Spain, 2.5 percent). The level of staff turnover taken into account reflects the generally observable age-dependent average for the industry and has only a minor impact on the settlement value.

In accordance with section 246 (2) sentence 2 HGB, assets from reinsurance are offset against the defined benefit obligation. As of December 31, 2016, the fair value of these assets amounted to €1,215,595.00. The settlement value of the offset liabilities amounted to €1,215,595.00. In 2016, an expense of €54,957.92 arising on the increase in the liability was offset in the income statement against interest income of €54,957.92 on the assets. In addition, securities with a fair value of €3,823,438.70 in accordance with section 253 (1) sentence 4 HGB were offset against the present value of the obligation.

The valuation at fair value gave rise to an amount of €403,818.70 that was not allowed to be distributed as a dividend pursuant to section 268 (8) sentence 3 HGB. Neither the option under section 28 (1) of the Introductory Act to the German Commercial Code (EGHGB), which permits provisions for pensions and other post-employment benefits not to be recognized for legacy entitlements, nor the transitional provision under section 67 (1) EGHGB has been exercised.

Provisions for early retirement obligations are recognized for those persons with whom individual contractual agreements have been reached. The provisions are calculated using actuarial principles.

In 2016, a provision in accordance with the **pre-retirement part-time employment agreement** for the private insurance industry dated June 11, 1997 and in accordance with the Accounting Principle issued by the Main Technical Committee of the Institute of Public Auditors in Germany (IDW AcP HFA 3) dated November 18, 1998 was recognized on the basis of a discount rate of 3.24 percent for matching maturities. In the case of deferred beneficiaries with whom a specific agreement has not yet been reached, the probability of their making use of the early retirement arrangements and natural employee attrition were taken into account. Credit balances on employee working hours accounts models are protected against insolvency in accordance with section 8a of the German Pre-Retirement Part-Time Employment Act (AltTZG) by means of a fixed liability guarantee from a German commercial bank.

The **sundry provisions** are recognized in the amount that is necessary according to prudent business practice. A **long-service provision** was recognized in the year under review for long-service awards to be paid to employees. The provision was calculated using the projected unit credit method taking into account death rates in accordance with the 2005G mortality tables published by Professor Klaus Heubeck and applying a discount rate of 3.24 percent. The calculation also included staff turnover at an average rate of 1.5 percent and salary increases at a rate of 2.5 percent. The earliest possible pension age under the RVAGAnpG was selected as the final age.

Interest income of €14,201.56 (2015: €5,425.00) and interest expenses of €95,303.60 (2015: €180,797.98) arose on the discounting of non-current provisions with a maturity of more than one year. **Deposits received** are accounted for at the nominal value of the collateral received. They have a residual maturity of less than one year, as underlying reinsurance agreements are renewed annually.

Other liabilities are recognized at their settlement value.

The **liabilities from direct insurance business** and **liabilities from reinsurance business** are valued at their nominal amount. All non-interest-bearing **liabilities** are valued at the higher of their nominal amount or settlement value. The residual maturity is less than one year. **Miscellaneous liabilities** are recognized at their settlement value. The residual maturity is less than one year.

The **deferred income and accrued expenses** item includes as yet unbilled ancillary cost advances in connection with leased out real estate. As of December 31, 2016, it also included discounts on registered bonds amounting to €15,675.86 (December 31, 2015: €23,896.57).

Currency translation

The cost of investments is calculated using the exchange rate on the date of acquisition. To determine the quoted market price or market value, foreign shares in affiliated companies and equity investments are valued by using an exchange rate achievable over the medium term; all other assets are valued at the lower of the exchange rate on the date of payment or the exchange rate on the balance sheet date. The sundry assets and liabilities are translated using the exchange rate on the balance sheet date, whereas income and expenses are translated at the exchange rate on the date of the associated cash inflow or outflow. In the year under review, currency translation gave rise to income of €25,190.13 (2015: €89,055.82) and expenses of €138,796.44 (2015: €86,374.91).

Fair value disclosures pursuant to section 54 RechVersV

Fair values of land, land rights and buildings, including buildings on third-party land

Valuation reports have been prepared internally and by third parties to determine these fair values. These reports satisfy the requirements of section 55 (3) RechVersV. Each year, new valuation reports are prepared or the existing reports are revised based on updated underlying data.

Fair values for investments in affiliated companies and equity investments

The shares and equity investments have generally been valued using the income capitalization approach. In the case of companies that predominantly perform services for the ARAG Group and in the case of intermediate holding companies, the pro-rata net asset value has been used as the fair value. Due to the need to expedite year-end closing procedures (Solvency II), figures as of the end of the third quarter of 2016 were used in some instances. For equity investments and shares acquired recently, the carrying amount was used as the fair value.

Fair values of miscellaneous investments

The fair values of line items B. III. 1. and 2. on the balance sheet correspond to their quoted market price or market value as of the balance sheet date. The fair values of securities that are not exchange-traded (registered bonds, promissory notes) are calculated on the basis of the swap curve. This involves determining the discount rate on the swap curve corresponding to the maturity of the security being valued. Any spreads resulting from the structure of the individual security (maturity, collateral, credit rating, etc.) are taken into account as appropriate.

The fair values are shown in the '**Changes in investments in 2016**' table.

III. Insurance Disclosures

(€'000)	Direct insurance business				
	Legal insurance	Emergency assistance insurance	Other (misc. financial losses)	Total 2016	Total 2015
Gross premiums written	583,098	41,666	9,054	633,818	594,451
Gross premiums earned	575,986	41,293	9,196	626,475	591,204
Net premiums earned	-	-	-	-	-
Claims incurred	298,958	21,462	309	320,729	310,114
of which payments for claims	303,996	20,143	1,381	325,520	318,816
Insurance business operating expenses	255,902	20,075	5,367	281,344	269,822
of which front-end fees	79,130	18,074	635	97,839	88,711
of which administrative expenses	176,771	2,001	4,732	183,504	181,111
Change in equalization provision	0	-2,217	-319	-2,536	-72
Miscellaneous underwriting income and expenses	1,459	0	0	1,459	1,544
Underwriting result	22,585	-2,461	3,201	23,325	12,740
Technical provisions:					
Unearned premiums	146,313	2,645	4,673	153,631	146,289
Provision for outstanding claims	876,604	6,246	3,092	885,942	890,733
Equalization provision and similar provisions	0	6,358	2,930	9,288	6,752
Miscellaneous technical provisions	882	0	0	882	876

Number of insurance policies with a term of at least one year

Direct insurance business	2016	2015
(No.)		
German	1,446,227	1,423,702
International	2,692,257	2,339,667
Total	4,138,484	3,763,369

	Inward reinsurance business				Outward reinsurance business		Total insurance business		
	Legal insurance	Emergency assistance insurance	Other (misc. financial losses)	Total 2016	Total 2015	2016	2015	2016	2015
	180,649	9,686	463	190,798	171,676	-	-	824,616	766,127
	184,755	7,836	215	192,806	169,219	-	-	819,281	760,423
	-	-	-	-	-	5,029	4,290	814,252	756,133
	84,610	11,637	-94	96,153	90,541	1,489	585	415,393	400,070
	72,891	10,826	101	83,818	76,661	856	749	408,482	394,728
	84,957	429	245	85,631	76,659	2,590	1,699	364,385	344,782
	714	331	7	1,052	3,883	-	-	-	-
	84,243	98	238	84,579	72,776	-	-	-	-
	-2,875	0	-145	-3,020	-1,486	0	0	-5,556	-1,558
	0	0	0	0	0	0	0	1,459	1,544
	12,313	-4,230	-81	8,002	533	950	2,006	30,377	11,267
	41,445	5,013	160	46,618	48,317	1,417	1,199	198,832	193,407
	174,754	1,831	327	176,912	164,780	1,784	1,151	1,061,070	1,054,362
	4,361	0	145	4,506	1,486	0	0	13,794	8,238
	0	0	0	0	0	0	0	882	876

Source of insurance business by premiums written

Country/source (€'000)	Direct insurance business			Inward reinsurance business			Total business
	Legal insurance	Emergency assistance insurance	Other (misc. financial losses)	Legal insurance	Emergency assistance insurance	Other (misc. financial losses)	
Germany	329,272	0	0	0	0	0	329,272
Spain	47,306	41,478	4,628	21,274	9,686	132	124,506
Netherlands	91,294	0	0	48,847	0	0	140,141
Italy	26,321	0	4,426	87,341	0	331	118,418
Belgium	23,180	0	0	471	0	0	23,650
Austria	58,091	0	0	0	0	0	58,091
Slovenia	2,183	0	0	0	0	0	2,183
Greece	5,003	0	0	42	0	0	5,045
USA	0	0	0	292	0	0	292
UK	0	0	0	22,199	0	0	22,199
Portugal	448	188	0	182	0	0	819
Total	583,098	41,666	9,054	180,649	9,686	463	824,616

IV. Non-Insurance Disclosures

Changes in investments in 2016:

Changes in asset items A., B. I. to IV. from January 1 to December 31, 2016

Type of investment	Balance Jan. 1, 2016	Currency differences	Additions	Disposals
(€)				
A. Intangible assets				
1. Miscellaneous intangible assets	9,178,904.51	0.00	2,693,878.70	45,807.21
Total	9,178,904.51	0.00	2,693,878.70	45,807.21
B. I. Land, land rights and buildings, including buildings on third-party land	101,146,850.37	0.00	83,838.91	2,636,139.77
B. II. Investments in affiliated companies and equity investments				
1. Shares in affiliated companies	215,619,877.65	0.00	53,667,130.71	42,122,600.00
2. Lending to affiliated companies	2,455,291.73	0.00	0.00	799,764.62
3. Equity investments	20,478,979.37	0.00	0.00	3,682,166.14
Total investments in affiliated companies and equity investments	238,554,148.75	0.00	53,667,130.71	46,604,530.76
B. III. Miscellaneous investments				
1. Equities, investment fund shares/units, and other variable-yield securities	614,560,037.24	0.00	17,906,368.57	12,709,082.34
2. Bearer bonds and other fixed-income securities	300,140,063.78	0.00	46,051,200.00	43,680,092.70
3. Loans secured by mortgages or land charges and fixed-income receivables	4,775,000.00	0.00	0.00	800,000.00
4. Miscellaneous lending				
a) Registered bonds	149,511,291.88	0.00	6,000,000.00	15,000,000.00
b) Promissory notes and loans	217,995,110.85	0.00	31,000,000.00	5,000,000.00
c) Sundry lending	130,287.44	0.00	56,564.74	36,744.76
5. Bank deposits	17,711,494.25	0.00	91,016,232.35	10,156,913.28
6. Other investments	5,222,234.20	0.00	435,987.47	326,943.26
Total miscellaneous investments	1,310,045,519.64	0.00	192,466,353.13	87,709,776.34
B. IV. Deposits with ceding insurers	36,148,718.55	0.00	11,546,614.48	3,306,483.80
Total investments	1,685,895,237.31	0.00	257,763,937.23	140,256,930.67
Total including intangible assets	1,695,074,141.82	0.00	260,457,815.93	140,302,737.88

Land, land rights and buildings, including buildings on third-party land, with a carrying amount of €31,582,286.26 (December 31, 2015: €32,477,635.42) are used for the Company's own business operations.

Reversals of write-downs	Depreciation/amortization	Write-downs	Balance Dec. 31, 2016	Cost/nominal amount	Fair value as of Dec. 31, 2016	Hidden reserves
0.00	3,497,503.87	0.00	8,329,472.13	39,633,171.82	8,329,472.13	0.00
0.00	3,497,503.87	0.00	8,329,472.13	39,633,171.82	8,329,472.13	0.00
0.00	1,030,878.99	0.00	97,563,670.52	102,410,166.62	150,683,432.78	53,119,762.26
2,041,100.00	0.00	4,187,809.40	225,017,698.96	327,393,158.27	541,096,101.21	316,078,402.25
0.00	0.00	0.00	1,655,527.11	1,655,527.11	1,655,527.11	0.00
90,756.14	0.00	0.00	16,887,569.37	26,161,255.48	42,275,000.00	25,387,430.63
2,131,856.14	0.00	4,187,809.40	243,560,795.44	355,209,940.86	585,026,628.32	341,465,832.88
5,808,696.26	0.00	72,700.74	625,493,318.99	639,698,575.22	645,429,929.32	19,936,610.33
998,765.00	0.00	1,959,552.81	301,550,383.27	304,074,980.97	324,694,929.46	23,144,546.19
0.00	0.00	0.00	3,975,000.00	3,975,000.00	3,975,000.00	0.00
0.00	0.00	0.00	140,511,291.88	140,511,291.88	147,964,243.33	7,452,951.45
0.00	0.00	0.00	243,995,110.85	243,995,066.32	262,595,491.63	18,600,380.78
0.00	0.00	0.00	150,107.42	150,107.42	150,107.42	0.00
0.00	0.00	0.00	98,570,813.32	98,570,813.32	98,570,813.32	0.00
0.00	0.00	0.00	5,331,278.41	5,331,278.41	7,486,318.72	2,155,040.31
6,807,461.26	0.00	2,032,253.55	1,419,577,304.14	1,436,307,113.54	1,490,866,833.20	71,289,529.06
0.00	0.00	0.00	44,388,849.23	44,388,849.23	44,388,849.23	0.00
8,939,317.40	1,030,878.99	6,220,062.95	1,805,090,619.33	1,938,316,070.25	2,270,965,743.53	465,875,124.20
8,939,317.40	4,528,382.86	6,220,062.95	1,813,420,091.46	1,977,949,242.07	2,279,295,215.66	465,875,124.20

In addition, there is an equity investment in a property-managing entity in the form of a partnership under the German Civil Code (GbR). The sole purpose of this entity is to operate an administrative building. The equity investment is reported under land and buildings. As of December 31, 2016, the carrying amount of the equity investment was €41,000,564.40 (December 31, 2015: €42,398,336.35). Some 97.9 percent of the property managed by the entity (headquarters of the ARAG Group in Düsseldorf) is used for the Company's own business operations. The remaining proportion (2.1 percent) is used by affiliated companies for their operations.

Investment fund disclosures

The portfolio of investments contains the following investment funds of which more than 10 percent is held by the Company:

Institutional funds

Institutional fund	Type of fund	Investment objective	Carrying amount as of Dec. 31, 2016	Market value as of Dec. 31, 2016	Difference	Dividend in 2016	Redemption
			(€)	(€)	(€)	(€)	
ADRENT	Fixed-income fund	Increased income	74,819,280.17	78,600,781.78	3,781,501.61	1,491,437.30	At any time
ATRI	Fixed-income fund	Increased income	149,919,473.82	149,772,293.97	-147,179.85	3,667,674.60	At any time
ARRE	Mixed fund	Increased income	247,061,291.12	257,235,310.16	10,174,019.04	6,517,812.07	At any time
ARI 1	Fixed-income fund	Increased income	66,282,494.06	66,282,494.06	0.00	3,212,086.68	At any time
AAF	Equity fund	Increased income	21,290,116.03	22,683,705.95	1,393,589.92	517,581.86	At any time
EMA	Equity fund	Increased income	25,050,691.36	25,172,653.76	121,962.40	975,475.20	At any time
SIVE Fonds							
INKA	Equity fund	Increased income	21,414,670.02	23,765,855.75	2,351,185.73	786,017.89	At any time
			605,838,016.58	623,513,095.43	17,675,078.85	17,168,085.60	

The investment objectives of the funds – which can be traded on any stock market trading day – are based on the relevant benchmarks derived from the strategic investment structure.

The breakdown of the **other assets** is as follows:

Other assets

(€)	Dec. 31, 2016	Dec. 31, 2015
Claim under section 37 (5) of the German Corporation Tax Act (KStG)	4,608,798.81	9,019,132.60
Income tax refund claim under current income tax assessment and on the basis of tax audit findings	27,765,955.71	40,648,463.14
Italian income tax refund claim	371,656.84	1,159,036.28
Italian insurance tax refund claim	2,020,847.63	2,011,604.75
Spanish income tax refund claim	420,420.73	1,144,467.20
Claims for interest not yet due on tax refunds	2,940,661.64	296,304.00
Sundry items	0.00	205,144.96
Total	38,128,341.36	54,484,152.93

Deferred taxes disclosures

The deferred taxes arise from the following differences between the HGB financial statements and the tax base:

Change in deferred taxes

Balance sheet item (€'000)	Jan. 1, 2016	Change in 2016	Dec. 31, 2016
Intangible assets	830	519	1,349
Investments	- 3,563	3,934	371
Receivables	6,143	760	6,903
Miscellaneous assets	2,666	- 732	1,934
Prepaid expenses and accrued income	0	0	0
Technical provisions	55,693	- 1,443	54,250
Other provisions	45,585	- 716	44,869
Other liabilities	- 239	185	- 54
Deferred income and accrued expenses	0	0	0
Off-balance-sheet additions	- 5,897	4,200	- 1,697
Assessment basis from tax group members (see below)			
- ARAG Allgemeine Versicherungs-AG	62,780	- 5,542	57,238
- Interlloyd Versicherungs-AG	4,539	- 266	4,273
Assessment basis for deferred taxes	168,537	989	169,526
Deferred taxes	51,071	- 1,193	49,878
Reduction in accordance with impact analysis on the basis of the simplified tax planning process (Germany) and individual markdowns (international branches and companies)	- 21,335	- 22,463	- 43,798
Recognized deferred tax assets	29,736	- 23,656	6,080

Assessment basis from tax group members

(€'000)	Jan. 1, 2016	Change in 2016	Dec. 31, 2016
Investments	2,619	486	3,105
Miscellaneous assets	319	3	322
Technical provisions	55,861	- 5,796	50,065
Other provisions	8,520	- 411	8,109
Assessment basis for deferred taxes	67,319	- 5,718	61,601

Deferred taxes are calculated using the current income tax rate of the country that will have the right to levy tax on the assessment basis concerned at the time that the differences reverse in accordance with the relevant double taxation convention. For financial reporting purposes, the effects of the reversal of the differences between the HGB financial statements and the tax base are reviewed in terms of their impact on the basis of tax assessment. Differences that would not be accompanied by sufficient taxable income at the time of reversal or would not be offset by countervailing effects in deferred taxes are not recognized in the event of a resulting net asset. A simplified tax planning process on the basis of the multi-year planning is used for the evaluation. Loss carryforwards are not included when determining deferred taxes. Deferred tax asset balances from international branches are subject to an individual markdown to factor in the uncertainty regarding the impact on current taxes when the differences reverse.

Disclosures on amounts prohibited from being distributed as a dividend

The netting of deferred tax assets and deferred tax liabilities resulted in the recognition of a net asset.

Overall, the following amounts are not allowed to be paid out as a dividend pursuant to section 268 (8) HGB:

Amounts prohibited from being distributed

(€)	Dec. 31, 2016	Dec. 31, 2015
Net asset balance of deferred tax assets and deferred tax liabilities	6,080,380.79	29,736,274.83
Amount by which the carrying amount of assets exceeds the cost (plan assets – valued at fair value – covering personnel liabilities)	403,818.70	284,852.00
Difference pursuant to section 253 (6) sentence 1 HGB (provision for pensions and other post-employment benefits)	17,583,468.00	0.00
Total amount prohibited from being distributed	24,067,667.49	30,021,126.83

The amount is covered in full by freely available equity components.

Equity

(€)	Dec. 31, 2016
Total	422,373,590.71
I. Subscribed capital	
The share capital amounts to	100,000,000.00
<p>The share capital is divided into 62,500 no-par-value registered shares. All the shares are fully paid up. AFI Verwaltungs-Gesellschaft mbH, Düsseldorf, and ARAG Holding SE, Düsseldorf, each own more than one quarter of the shares in the Company. ARAG Holding SE indirectly owns the majority of the shares in the Company.</p>	
II. Capital reserves in accordance with section 272 (2) no. 4 HGB	
Brought forward as of January 1, 2016	81,772,569.19
Changes in the reporting year	0.00
Balance as of December 31, 2016	81,772,569.19
III. Revenue reserves	
1. Statutory reserves	
Brought forward as of January 1, 2016	10,000,000.00
Appropriation from profit	0.00
Balance as of December 31, 2016	10,000,000.00
<p>The full amount of the reserve has been recognized pursuant to section 150 (2) of the German Stock Corporation Act (AktG).</p>	
2. Other revenue reserves	
Brought forward as of January 1, 2016	190,900,000.00
Additions approved by the Annual General Meeting	8,000,000.00
Appropriation from profit	0.00
Balance as of December 31, 2016	198,900,000.00
	208,900,000.00
IV. Net retained profit	
Net retained profit as of December 31, 2015	23,038,483.15
Appropriation of profits: dividend	-15,000,000.00
Appropriation of profits: appropriation to other revenue reserves	-8,000,000.00
Net income for 2016	31,662,538.37
Appropriation to statutory reserves (section 150 (2) AktG)	0.00
Appropriation to other revenue reserves	0.00
Net retained profit as of December 31, 2016	31,701,021.52

Provisions for pensions and other post-employment benefits

Since 2010, this item has also included the offsetting of pension benefit entitlements under reinsurance in accordance with section 246 (2) sentence 2 HGB. The breakdown of the item as of December 31, 2016 was therefore as follows:

Defined benefit obligations

(€)	Dec. 31, 2016	Dec. 31, 2015
Amount required to settle the vested entitlements	169,353,823	174,660,673
of which offsetable against pension insurance assets	- 1,215,595	- 1,268,798
of which offsetable against securities	- 3,823,439	- 2,752,882
Remaining amount	164,314,789	170,638,993

The transitional provision under section 67 (1) EGHGB and the option under 28 (1) EGHGB have not been exercised. The defined benefit obligations have been recognized in full.

Miscellaneous provisions

(€)	Dec. 31, 2016	Dec. 31, 2015
Outstanding employee remuneration	15,057,251.24	12,381,332.82
Outstanding commission payments	12,406,603.06	10,528,978.06
Provision for outstanding invoices	12,255,347.55	8,109,337.46
Subsequent performance obligations related to services	1,672,064.00	2,747,634.23
Long-service provision	3,265,485.21	3,069,402.00
Interest on taxes pursuant to section 233 a of the German Tax Code (AO)	3,068,358.00	0.00
Compensation claims for agents leaving the Company	2,533,660.36	2,466,947.86
Early retirement and pre-retirement part-time working obligations	3,326,544.25	2,146,189.03
Severance payments (Austria and Slovenia)	2,641,980.73	2,549,105.81
Costs for financial statements and tax audit	1,482,773.59	1,272,071.00
Performance-related and business-plan remuneration for agents	1,406,000.00	1,377,000.00
Current litigation costs	955,590.38	898,173.72
Sales competition awards	888,400.00	799,468.00
Supervisory Board and Advisory Council remuneration	589,406.50	604,219.00
Severance payments	128,700.00	0.00
Vacancy costs/outstanding ancillary cost bills	0.00	97,000.00
Redundancy scheme and restructuring obligations	34,720.78	45,272.61
Sundry other provisions	3,494,807.26	3,469,948.11
Total	65,207,692.91	52,562,079.71

Prepaid expenses and accrued income, deferred income and accrued expenses

Prepaid expenses and accrued income includes premiums of €43,694.71 (December 31, 2015: €59,373.43), and deferred income and accrued expenses discounts of €15,675.86 (December 31, 2015: €23,896.57) pursuant to section 341c (2) HGB. These amounts are reclassified to income over the maturity of the investments concerned.

Net extraordinary income/expense

No extraordinary income or expenses arose in the year under review.

Tax expense

The breakdown of income taxes in the income statement is as follows:

Income taxes

(€)	2016	2015
Profit before tax (HGB financial statements)	68,027,546.64	43,595,897.40
less: profit attributable to international branches	-45,737,426.72	-48,989,364.44
Profit/loss subject to German tax	22,290,119.92	-5,393,467.04
Expected income tax expense based on tax rate	31.2 % 6,960,090.00	31.2 % -1,684,110.00
Reconciliation		
Different foreign tax expense	1,310.00	0.00
Proportion of tax relating to:		
Tax-exempt income	-12,803,300.00	-13,673,310.00
Expenses not deductible for tax purposes	1,351,620.00	1,540,220.00
Changes in temporary differences and losses	24,671,366.00	4,572,531.00
Temporary differences and losses for which no deferred taxes have been recognized	2,874,870.00	4,219,100.00
Tax credits	0.00	0.00
Current taxes related to prior periods	-832,752.12	6,162,961.57
Effects from tax rate changes	0.00	0.00
Miscellaneous tax effects	1,616,420.00	9,598,110.00
Rounding effects	-10.00	-10.00
Reported German income tax expense	23,839,613.88	10,735,492.57
Income taxes related to the international branches	11,316,895.29	8,365,589.56
Total income tax expense	35,156,509.17	19,101,082.13
Effective tax rate	51.7 %	43.8 %
Miscellaneous taxes	1,208,499.10	1,531,360.20
Tax expense reported in the income statement	36,365,008.27	20,632,442.33

V. Report on Post-Balance Sheet Events

There were no events of particular significance after December 31, 2016.

VI. Other Disclosures

Commissions and other remuneration for insurance agents, staff costs

(€)	2016	2015
1. Commissions of all types for insurance agents within the meaning of section 92 HGB for direct insurance business	171,423,221.79	156,746,636.46
2. Other remuneration for insurance agents within the meaning of section 92 HGB	13,233,404.15	13,950,377.06
3. Wages and salaries	148,481,534.81	139,947,245.67
4. Social security and other employee benefit expenses	26,138,716.31	24,570,447.98
5. Pension and other post-employment benefit expenses	5,395,715.58	22,070,535.13
6. Total expenses	364,672,592.64	357,285,242.30

Contingent liabilities and miscellaneous financial commitments (section 251 and section 285 HGB)

There were no known **miscellaneous financial obligations** arising outside the insurance business that were significant to the assessment of the Company's financial position.

ARAG SE is a partner in ARAG 2000 Grundstücksgesellschaft bürgerlichen Rechts and is jointly and severally liable for the obligations of this partnership without limitation on the basis of its entire assets.

There are **unpaid contributions** in respect of the following entities:

Unpaid contributions/obligations to pay in capital

(€)	
ARAG IT GmbH, Düsseldorf	1,495,000.00
ARAG Legal Services B.V., Leusden, Netherlands	6,977,311.00
Foyer-ARAG S.A., Leudelange, Luxembourg	24,788.00
RREEF Pan-European Infrastructure Feeder GmbH & Co. KG	232,906.26
ACF V Growth Buy-out Europe GmbH & Co. KG	509,000.00
AXA LBO Fund V Core	57,904.00
AXA LBO Fund V Supplementary	9,240.00

None of the unpaid contributions have been called up. It would be reasonable to expect contributions to be called up by RREEF Pan-European Infrastructure Feeder GmbH & Co. KG, ACF V Growth Buy-out Europe GmbH & Co. KG, and AXA LBO Fund V in the near future. The sundry unpaid contributions will not be called up for the time being.

Investment agreements with a total volume of €31,894,276.23 have been concluded through the affiliated company ALIN 1 GmbH & Co. KG with various private equity funds. Calls from the funds result in cash being paid into ALIN 1 GmbH & Co. KG shortly before payment is due in order to provide the required liquidity. Taking account of the liquidity remaining in the company, calls at short notice of €22,439,305.23 are expected on the basis of open-ended investment agreements.

In addition, purchase agreements exist that are contingent on the occurrence of certain conditions in the future. Future payment obligations arising from these agreements amount to €48.491 million. It is expected that these obligations will be incurred by September 30, 2017.

Auditor's fees

The Company's Supervisory Board agreed fees of €622,006.00 (2015: €470,000.00) with the auditors for the audit of the 2016 annual financial statements, including the first audit of the Solvency II balance sheet as of December 31, 2016. In 2016, VAT was added to these amounts and the totals recognized as an expense. The income statement also included fees for tax consultancy services amounting to €132,339.94 (2015: €32,582.82). Fees amounting to €482,726.12 (2015: €258,088.92) were incurred for other services. The usual amounts of out-of-pocket expenses were reimbursed. As there was no entitlement to offset input VAT, the VAT was included in the recognized expense.

Employees

ARAG SE employed an average of 2,494 (2015: 2,354) people in 2016. As of December 31, 2016, the Company had 2,564 (December 31, 2015: 2,393) employees.

Workforce breakdown

Unit	As of December 31, 2016	As of December 31, 2015
Central Group Functions	80	78
Accounting, Asset Management, Taxes, Central Services	184	187
Sales	229	195
Customer and Claims Service, IT Steering	406	396
Product Development/Innovation	75	80
Risk Management/Controlling	44	44
Group Development, Business Organization	19	18
Netherlands Branch	594	561
Belgium Branch	76	70
Italy Branch	141	137
Spain Branch	422	355
Portugal Branch	7	5
Austria Branch	99	103
Slovenia Branch	11	9
Greece Branch	23	23
Non-active employees (works council, parental leave, pre-retirement part-time employment)	154	132
Total	2,564	2,393
Plus: trainees	5	0
Plus: interns and volunteers	1	0

Supervisory Board, Advisory Council, and Management Board remuneration pursuant to section 285 no. 9 a HGB

The total expense for Supervisory Board remuneration amounted to €502,837.50 and for the Advisory Council €86,569.00. The Management Board's remuneration came to €6,180,900.20, with that for the former members of the Management Board and their surviving dependants totaling €2,001,130.33. A provision of €28,230,279.00 was recognized for current pensions and vested pension entitlements of former members of the Management Board and their surviving dependants.

The members of the Supervisory Board, Advisory Council, and Management Board are listed on pages 78 to 80 of this report.

Group affiliation

The Company and its subsidiaries were included in the consolidated financial statements of ARAG Holding SE for the period ended December 31, 2016. The consolidated financial statements of ARAG Holding SE are published in the electronic Federal Gazette and in the company register of the German Federal Ministry of Justice and Consumer Protection. The Company does not prepare its own consolidated financial statements, as the consolidated financial statements of ARAG Holding SE have an exempting effect pursuant to section 291 HGB.

VII. Proposed Appropriation of Profit

The breakdown of net retained profit is as follows:

Net retained profit

(€)	
Net income for the year	31,662,538.37
Appropriation to other revenue reserves	0.00
Profit brought forward from 2015	38,483.15
Net retained profit	31,701,021.52

It is proposed that this net retained profit be used to pay a dividend of €15,000,000.00 to the shareholders. An amount of €16,700,000.00 is to be added to other revenue reserves. The remaining sum of €1,021.52 is carried forward to the next period.

Düsseldorf, March 21, 2017

The Management Board

Dr. Dr. h. c. Paul-Otto Faßbender

Dr. Renko Dirksen

Dr. Johannes Kathan

Dr. Matthias Maslaton

Werner Nicoll

Hanno Petersen

Dr. Joerg Schwarze

Auditor's Report*

We have audited the financial statements, comprising the balance sheet, the income statement, and the notes to the financial statements, together with the bookkeeping system and the management report of ARAG SE, Düsseldorf, for the financial year from January 1, 2016 to December 31, 2016. The maintenance of the books and records and the preparation of the financial statements and management report in accordance with German commercial law and the supplementary provisions of the Company's articles of incorporation are the responsibility of the Company's Management Board. Our responsibility is to express an opinion on the financial statements, together with the bookkeeping system, and the management report based on our audit.

We conducted our audit of the financial statements in accordance with section 317 of the German Commercial Code (HGB) and German generally accepted auditing standards promulgated by the Institute of Public Auditors in Germany (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 financial statements in accordance with German accepted accounting principles 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 financial statements, and 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 Management Board, as well as evaluating the overall presentation of the 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, based on the findings of our audit, the financial statements comply with the legal requirements and supplementary provisions of the articles of incorporation and give a true and fair view of the net assets, financial position, and results of operations of the Company in accordance with German accepted accounting principles. The management report is consistent with the annual financial statements, complies with the legal requirements, and as a whole provides a suitable view of the Company's position and suitably presents the opportunities and risks of future development.

Düsseldorf, March 24, 2017

PricewaterhouseCoopers GmbH
Wirtschaftsprüfungsgesellschaft

Ludger Koslowski
Wirtschaftsprüfer (German Public Auditor)

Sven Capousek
Wirtschaftsprüfer (German Public Auditor)

* Voluntary translation. It should be noted that only the German Auditor's Report, which is based on the audit of the German version of the Company's single-entity financial statements, is authoritative.

Report of the Supervisory Board

In the year under review, the Supervisory Board carried out the tasks required of it by law, the articles of incorporation, and rules of procedure and continually monitored and advised the Management Board with regard to its running of the Company. The Supervisory Board was directly involved in all decisions of fundamental importance to the Company. The Management Board provided the Supervisory Board with regular, timely, and comprehensive written and oral reports on the economic situation and the performance of the Company and its subsidiaries, planned business policy, corporate planning, the risk situation, risk management, and significant individual transactions. The Management Board explained variances between the actual course of business and plans and targets individually, and these were noted by the Supervisory Board. Where management action required the approval of the Supervisory Board by law or other regulations, the Supervisory Board received detailed written information on the matter from the Management Board. The Supervisory Board discussed these reports extensively at its meetings, deliberated on them with the Management Board, and made the necessary decisions.

Last year, the full Supervisory Board held nine meetings, including six ordinary meetings, at which it was able to satisfy itself that the Management Board was running the Company properly and appropriately. Outside the meetings, the chairman of the Supervisory Board was also in regular contact with the Management Board and was kept informed about the current business situation and major business transactions.

The challenges arising from the sustained period of low interest rates for the investee company ARAG Lebensversicherungs-AG and, in particular, the ensuing deliberations regarding the sale of the company formed the key subject for debate at the Supervisory Board meetings in 2016. The Group's implementation of legislative changes introduced by the amended version of the German Insurance Supervision Act (VAG), which took effect on January 1, 2016, continued to be an important agenda item. The Supervisory Board members attended a joint conference on this topic in order to deepen their knowledge of the relevant regulatory changes and requirements. The Supervisory Board also discussed the Company's international expansion in Canada, the quarterly results under HGB and Solvency II, and the projections for 2016. In addition, it received reports on the business performance of the Company and its affiliated companies. The Group risk strategy, the risk and controlling report, and the strategic planning for the next three years formed part of these reports.

The full Supervisory Board proposed a successor for a deceased Supervisory Board member at the Annual General Meeting (AGM). The AGM supported this proposal. A successor was also elected for the Human Resources Committee. Following preparation by the Human Resources Committee, the full Supervisory Board adopted the necessary resolutions regarding the appointment of Management Board members. It also discussed the appropriateness of the Management Board's remuneration together with the remuneration system used by the Company for its employees and adopted the necessary resolutions. In addition, the full Supervisory Board resolved that a joint general commercial power of representation (Gesamtprokura) be granted and that the Management Board's rules of procedure be amended with regard to investment volumes requiring approval. The full Supervisory Board also discussed the new strategic cornerstones of the business –

focusing particularly on non-insurance customers – and the changes required against a backdrop of advancing digitalization. By means of a written procedure, the full Supervisory Board approved the mandating of ARAG SE's legal representation in a lawsuit.

The Supervisory Board has created three committees.

The Finance Committee held a total of seven meetings in 2016, including four ordinary meetings. Key agenda items at the ordinary meetings included adjustments to ratios and mandates in the field of private equity, several investments and the necessary capital expenditure on IT, the regular real estate report, and consultancy assignments. The Finance Committee also obtained explanations concerning the business plan for planned legal services for non-insurance customers in other European countries and concerning the performance of the Company's investments, and deliberated on these topics. At its extraordinary meetings, the Finance Committee furthermore approved proposals of the Management Board regarding disposals of real estate, the engagement of consultants, and investment decisions. Within the scope of its responsibilities, the Finance Committee also adopted written resolutions to approve the launch of the business model for the expansion of non-insurance business in the Group, the conclusion of a contract of assignment between the Company and ARAG Lebensversicherungs-AG, a capital transfer from a branch, and an HR decision.

The Audit Committee met on four occasions in the year under review. Besides the quarterly financial statements under HGB and Solvency II and forecasts for the 2016 annual financial statements, the committee discussed the strategic planning for the years 2017 to 2019 and recommended the plans to the Supervisory Board for approval. In addition, the Audit Committee worked on the audit planning for 2016 and reviewed the statutory changes that took effect on June 17, 2016 as a result of the EU's reform of audit legislation. In accordance with its responsibilities, it approved a cost allocation agreement with the international companies. The Audit Committee also approved certain auditing services in a written procedure.

The Human Resources Committee met six times in 2016, including two extraordinary meetings. Three resolutions were also adopted using a written procedure. Topics discussed in the meetings included the preparation of the resolution to reappoint two members of the Management Board, as well as target agreements, the pension scheme and provision for surviving dependants, and the appropriateness of the Management Board's remuneration. In addition, the Human Resources Committee addressed necessary adjustments to the remuneration system, especially in the light of new statutory requirements. Another key area of debate was ensuring compliance with the 'fit and proper' requirements under VAG and possible implications of a revocation by BaFin. Matters decided by means of a written procedure included the consents pursuant to section 114 AktG, responsibility for which is assigned to the Human Resources Committee in the rules of procedure.

Detailed reports on the committees' meetings and work were delivered at the Supervisory Board meetings. The financial statements, which were prepared by the Management Board in accordance with the commercial-law accounting regulations for insurance companies, and the management report for 2016 were, together with the bookkeeping system, audited by PwC PricewaterhouseCoopers GmbH, Wirtschaftsprüfungsgesellschaft, Düsseldorf, which had been selected and engaged by the Supervisory Board on May 10, 2016 to carry out the audit and which issued an unqualified opinion.

All the members of the Audit Committee of the Supervisory Board received the aforementioned documents, the annual report, the proposal for the appropriation of profit, and the auditor's report in good time before the Supervisory Board meeting on April 28, 2017. At the meeting, the Management Board also provided additional oral explanations of the documents. The auditors who had signed the auditor's report participated in the discussion of the documents by the Supervisory Board and the Audit Committee, reported on the key findings of the audit, and were available to provide additional information.

The Audit Committee had discussed these documents in detail prior to the meeting of the Supervisory Board and had recommended to the Supervisory Board that the financial statements and the management report be approved.

The Supervisory Board reviewed the financial statements, management report, and proposal for the appropriation of profit. There were no objections to be raised on the basis of the concluding findings of its review. Having carried out its own review and having taken into account the report of the Audit Committee, the Supervisory Board agreed with the findings of the audit of the financial statements and management report by the auditors. The Supervisory Board approved the financial statements and management report and thereby adopted them. It also agreed with the Management Board's proposed appropriation of profit. The Supervisory Board proposes to the AGM that it formally approve the acts of the Management Board members.

The report to be submitted by the Management Board pursuant to section 312 AktG concerning relationships with affiliated companies was also reviewed. The review encompassed the completeness and accuracy of the details in the report on the basis of the right to inspect the books and papers of the Company and on the basis of the reports and information submitted by the Management Board. The review did not give rise to any objections.

The independent auditors also audited the report submitted by the Management Board pursuant to section 312 AktG and issued the following audit opinion:

"Following our audit and evaluation exercising all due care and diligence, we confirm that:

1. The factual disclosures in the report are accurate,
2. The consideration paid by the Company for the transactions listed in the report was not inappropriately high or disadvantages were compensated,
3. As regards the activities listed in the report, there are no circumstances that would support an assessment materially different from that arrived at by the Management Board."

The Supervisory Board agrees with this opinion. Following the concluding findings of its review, the Supervisory Board has not expressed any reservations regarding the concluding statement by the Management Board in the report on relationships with affiliated companies.

The Supervisory Board would like to express its thanks and appreciation for the work of the Management Board and all employees in 2016.

Düsseldorf, April 28, 2017

The chairman of the Supervisory Board

Gerd Peskes

Governing Bodies of the Company

Supervisory Board

The employees have a right of codetermination pursuant to section 1 (1) of the German One-Third Participation Act (DrittelbG), under which one third of the members of the Supervisory Board must be employee representatives.

Supervisory Board Shareholder representatives:

Gerd Peskes Wirtschaftsprüfer (German Public Auditor), Essen,
Chairman

Professor Dr. Walter Ackermann University professor,
St. Gallen, Switzerland

Dr. Tobias Bürgers Attorney,
Munich

Dr. Michael Pielorz Attorney,
Düsseldorf

Dr. Karl-Heinz Strohe Attorney,
Cologne (until July 31, 2016)

Professor Dr. Fred Wagner University professor,
Leipzig

Dr. Sven Wolf Jurist,
Krefeld (since September 29, 2016)

Employee representatives:

Margit Schuler Chair of the Works Council of ARAG SE,
Mettmann,
Deputy Chairwoman

Marco Hoogendam Staff attorney,
Amersfoort, Netherlands

Richard Wenhart Employee in Production Management/
IT System Monitoring,
Buch a. Erlbach

Advisory Council	Christoph Buchbender	Member of the Management Board of Rheinland Holding AG, Neuss, Chairman
	Rainer Gebhart	Member of the Management Board of WWK Lebensversicherung a. G., Rosenheim, Deputy Chairman
	Burkhard Balz	Member of the European Parliament, Stadthagen
	Professor Dr. Dres. h. c. Rolf Dubs	University professor, St. Gallen, Switzerland
	Werner Gremmelmaier	Member of the Management Board of uniVersa Lebensversicherung a. G., Neukeferloh
	Dr. Volker Himmelseher	Graduate in Business Administration, Pulheim
	Dr. Dr. h. c. Burkhard Hirsch	Attorney, Düsseldorf
	Dr. h. c. Horst Klosterkemper	Graduate in Engineering/ Graduate in Engineering Management, Düsseldorf (until May 10, 2016)
	Friedrich-Wilhelm Metzeler	Attorney/ Graduate in Business Administration, Düsseldorf
	Volker Steck	Chief Executive Officer of Helvetia Versicherungen/ Directorate for Germany, Frankfurt (since May 10, 2016)
	Hans Schwarz	Chief Executive Officer of Stadtparkasse Düsseldorf (ret.), Düsseldorf
	André Wüstner	Federal Chairman of the German Army Association (DBwV), Montabaur

Management Board	Dr. Dr. h. c. Paul-Otto Faßbender	Düsseldorf, Chief Executive Officer
	Dr. Renko Dirksen	Düsseldorf
	Dr. Johannes Kathan	Düsseldorf
	Dr. Matthias Maslaton	Moers
	Werner Nicoll	Herzogenrath
	Hanno Petersen	Ratingen
	Dr. Joerg Schwarze	Düsseldorf

Information

ARAG provides you with a broad range of information in many publications and on the internet about the Group and its insurance products and services. And as legal insurance is a core competency of ARAG, it also offers selected tips and advice on legal matters. If you have any questions, require an insurance quote, or are simply looking for some basic information, please get in touch or visit our website.

You can obtain up-to-date **information about the Group** using the following contact details:

ARAG
Corporate Communications/Marketing
ARAG Platz 1
40472 Düsseldorf
Germany

Tel: +49 (0)211 963 3488
Fax: +49 (0)211 963 2025
+49 (0)211 963 2220
Email: medien@ARAG.de

If you would like an individual quote, you can contact us at any time by telephone, fax, or email:

Tel: +49 (0)211 98 700 700
Fax: +49 (0)211 963 2850
Email: service@ARAG.de

You can find the latest **information about the Group and our products** on our website:

www.ARAG.com

Credits

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