Triglav Group

Analyst conference on Solvency II

Ljubljana, 5 July 2016

Everything will be alright.

triglav

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Introduction

Solvency II:

Impact on Balance Sheet, Solvency Capital Requirement

Triglav Group S II position

Capital Management

Introduction

Solvency II preparation process

2009
Directive

Quantitative impact studies (QIS), stress tests

2013
Adjustments of Directive

Jan 2015
Final Delegated Act, Technical standards (EIOPA)

End 2015
Changed Slovenian Insurance Law

1 Jan 2016
SII comes info force

2016
Formal reporting to supervisor (QRT, ORSA)

April 2016
Delegated Act Amended

May 2017
Reporting to supervisor (RSR), public disclosure (SFCR)

Pillars of Solvency II

Single supervisory regime for the whole EU

Pillar I Quantitative requirements	Pillar II Qualitative requirements and supervision	Pillar III Reporting and disclosure
Market consistent valuation of assets and liabilities Capital requirements (SCR, MCR) Own funds	Management system based on 4 key functions: ▪ Risk management function ▪ Actuarial function ▪ Compliance function ▪ Internal audit function Conducting own risk and solvency assessment (ORSA) Supervisory review process (SRP)	Reporting to the national supervisor (RSR, QRT, ORSA) Public disclosure (SFCR)

Main changes compared to previous system (1)

SI regime	SII regime
Fixed formula determining capital requirement based on insurance risks	Economic framework taking into account the entire risk profile
Capital requirement: Life 4% of net gross mathematical provisions + 3‰ of net sum at risk	Pillar 1 – quantitative, standard formula Pillar 2 – risk management, own risk assessment, ORSA
Capital requirement: Non-Life Premium Index = 16/18% of net premiums earned or Claim Index = 23/26% of net claims incurred	Pillar 3 – reporting and market disclosure
Key Conclusions: ▪ Only insurance risk considered ▪ Premiums, reserves and claims are drivers of capital requirement	**Key Conclusions**: Volatility of business to drive capital requirement ▪ Insurance, market, credit risk and operational risks considered ▪ Risk can be reduced by reduction techniques (eg. reinsurance)

Main changes compared to previous system (2)

- **Move away from fixed formula approach determining capital requirements based on insurance risk to based on entity-specific risks**:
  New solvency requirements are more risk-sensitive and more sophisticated, thus enabling a better coverage of the real risks.

- **Risk vs. Economic balance sheet:**
  Solvency requirements on both sides of balance sheet: the asset and liability side.
  Solvency II risk measure is based on Value at Risk (VaR) level of 99.5%, which is equivalent to a 0.5% target default probability in time horizon of one year.

  Increased volatility of balance sheet items expected by any particular insurer. This means increased volatility of economic capital and thus volatility of the solvency ratio.

- **New risk types introduced in capital requirement**:
  - market risk (i.e. fall in the value of insurers' investments),
  - credit risk (e.g. when third parties cannot repay their debts) and
  - operational risk (e.g. risk of systems breaking down or malpractice).

Main changes compared to previous system (3)

- **More focus on risks and their management**:
  Under Solvency II focus on the identification, measurement and proactive management of risks.

- **„Own Risk and Solvency Assessment" (ORSA):**
  While until now solvency requirements were based on largely historical data, the new rules require insurers also to think about how business decisions and other external events will affect risks profile and thus solvency ratio (new business plans, the possibility of catastrophic events etc). ORSA is an integral part of the strategic management process by regularly taking a holistic view on all relevant risks that threaten the achievement of strategic objectives in relation to current and future capital needs.

- **„Supervisory Review Process" (SRP):**
  The purpose of the SRP is to enable supervisors to better and earlier identify insurers which might be heading for difficulties.

Main changes compared to previous system (4)

- **Public disclosure**:
  The new rules require insurers to disclose certain information publicly to a far greater extent than currently. The same requirements are imposed on all EU insurers. This will bring in market discipline. Insurers applying best practice are more likely to be rewarded by lower financing costs, for example.

- **Special role of the group supervisor**:
  Specific responsibilities to be exercised in close cooperation with the solo supervisors of local countries (insurance groups can be better managed as a single economic entity; greater cooperation between insurance supervisors).

- **Group capital requirements and risk identification:**
  - Concentration risk
  - Intragroup transaction risk
  - Risk of contagion
  - Fungibility and transferability of capital
  - ORSA on group level

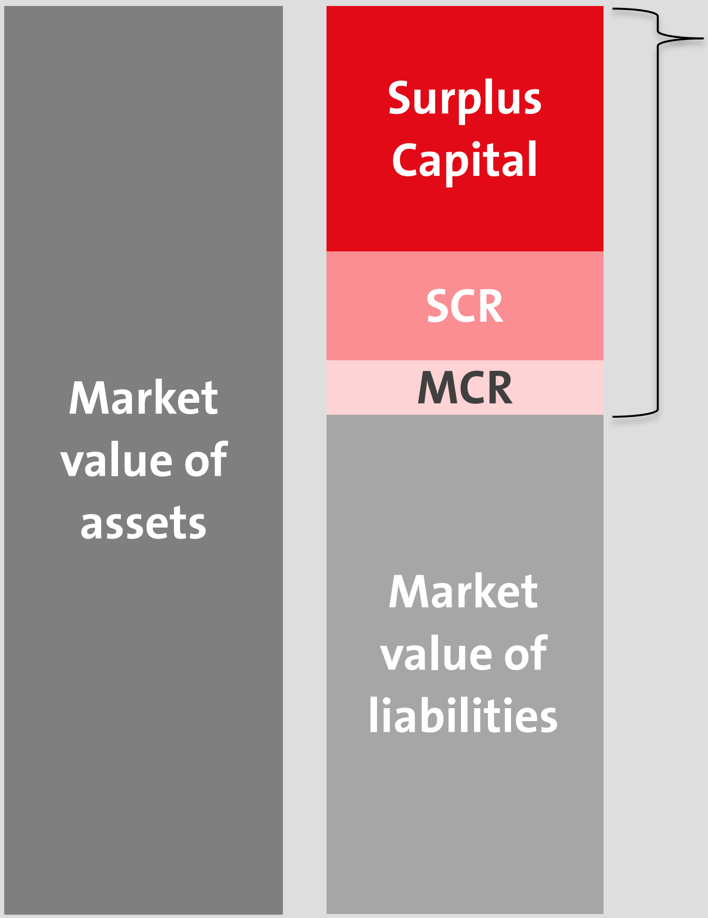
Benefits of Solvency II at a Glance

Benefits/Differences	Solvency I	Solvency II
EU insurance market	Several different supervisory regimes (14 EU Directives)	**Single supervisory regime for the whole EU**
Risk management of EU insurers	No need to closely look at several types of risks	**Better understanding and thus more efficient forward looking mitigation of risks**
Consumers Policyholders	Protection based on mechanic, non-risk related formula	**Robust risk management and governance means better protection of company & policyholders**
Supervisors	No full picture about companies' risk profiles, different approaches	**Enhanced reporting allows identification of upcoming problems and timely reactions**

Solvency II:

Impact on balance sheet, solvency capital requirement

Solvency II Balance Sheet



AFR = market consistent value of net asset value (Own funds or Available Financial Resources)

EOF = eligible own funds to cover SCR

Solvency II ratio $= \frac{EOF}{SCR}$

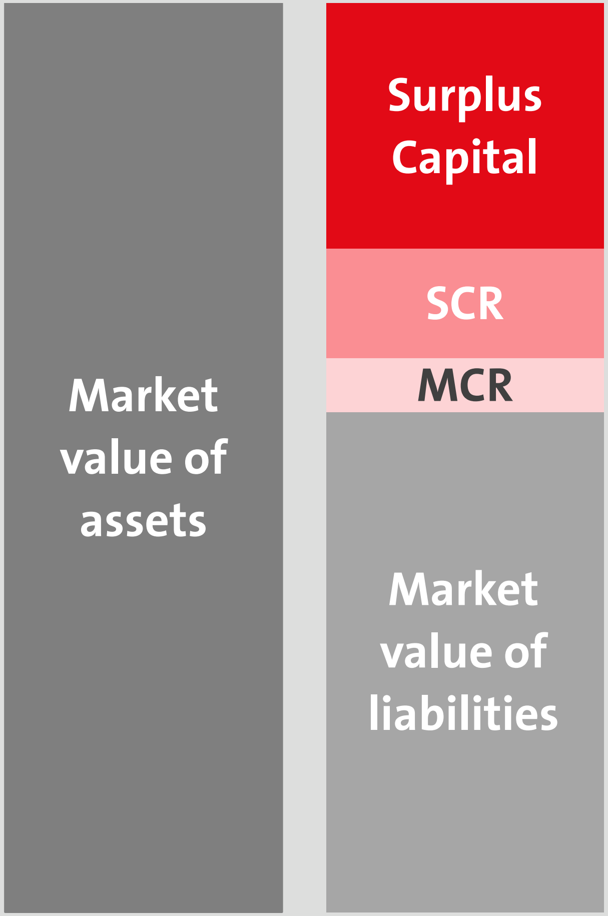
Solvency Capital Requirement (SCR):

- Calculated on a risk estimation basis (= the one-year value at risk of AFR at confidence level of 99.5%)
- Holding own funds below this requirement leads to supervisor‘s intervention

Minimum Capital Requirement (MCR):

- Reflects min level of protection of policyholders
- Leave the market unless MCR is not met again within period of time

Solvency II Balance Sheet



OPERATIONAL RISK

- Formula based on volume of premiums & TP’s

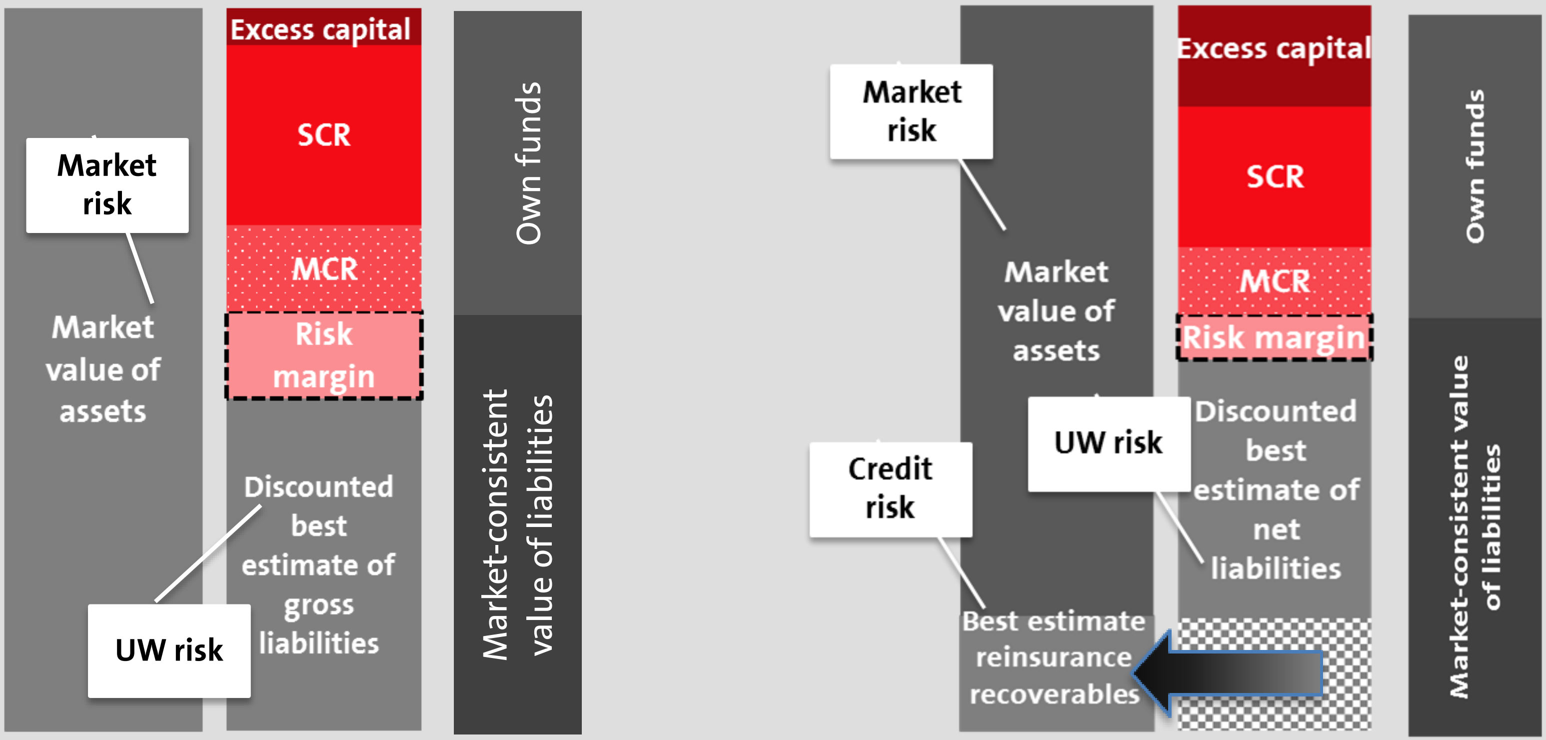
MEASURING RISKS

- Risks have impact on BS and therefore own funds
- Can use Standard formula, undertaking specific parameters, partial internal model, internal model
- SCR should be calibrated at VaR of basic OF at 99.5% over 1 year

Solvency II Balance Sheet (Gross & Net)

Gross situation

Net situation
(reinsurance risk migration)



Difference in BS between IFRS and Solvency II

ASSETS

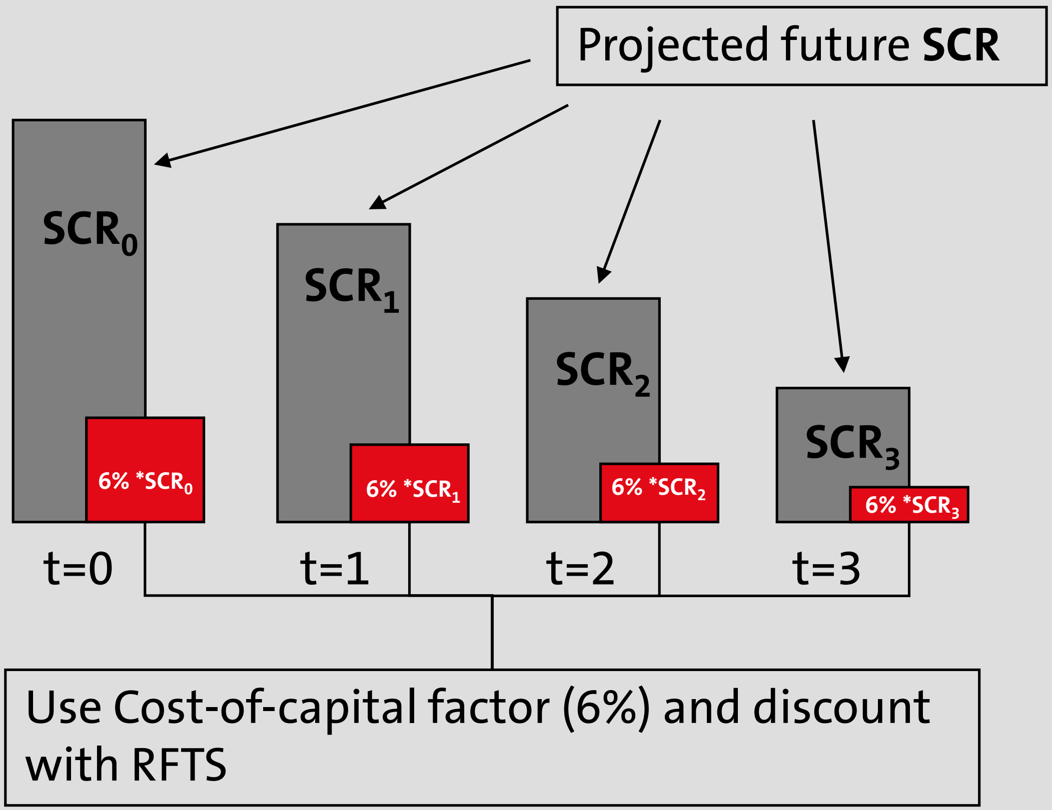
- Goodwill, DAC & intangible assets* valued at 0
- All financial assets valued at market price
- Receivables on policyholders which are not overdue, excluded from asset side and subtracted from the best estimate liabilities
- Deferred tax assets adjustment for economic balance sheet
- Reinsurance recoverables (best estimate on CF basis)

LIABILITIES

- Technical provisions = Best estimate + Risk margin
- Best estimate = outstanding claim provisions and premium provisions – present value of discounted future CFs
- Risk margin is based on the cost of capital method
- Deferred tax liabilities: adjustment for economic balance sheet

**Intangible assets other than goodwill valued at 0, unless it can be sold separately and can be demonstrated that there is a quoted market prices in active markets for the same or similar assets*

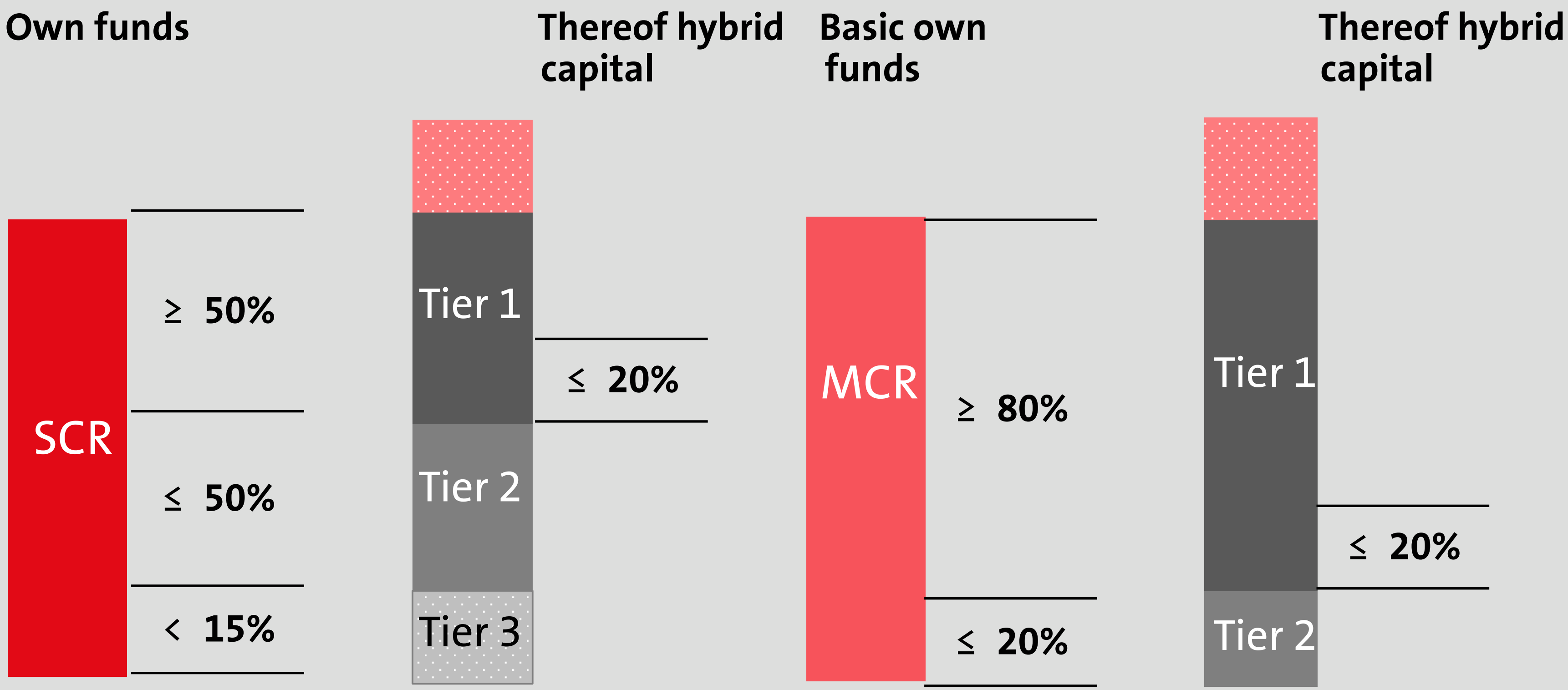
Risk margin



$$CoCM = CoC \cdot \sum_{t \geq 0} SCR_{RU}(t)/(1+r_{(t+1)})^{t+1}$$

- Part of technical provisions which ensures that the value of technical provisions is equivalent to the amount that insurance undertakings would be expected to require in order to meet all insurance obligations.
- Represents the cost of providing an amount of EOF equal to the SCR necessary to support the insurance obligations over the lifetime.

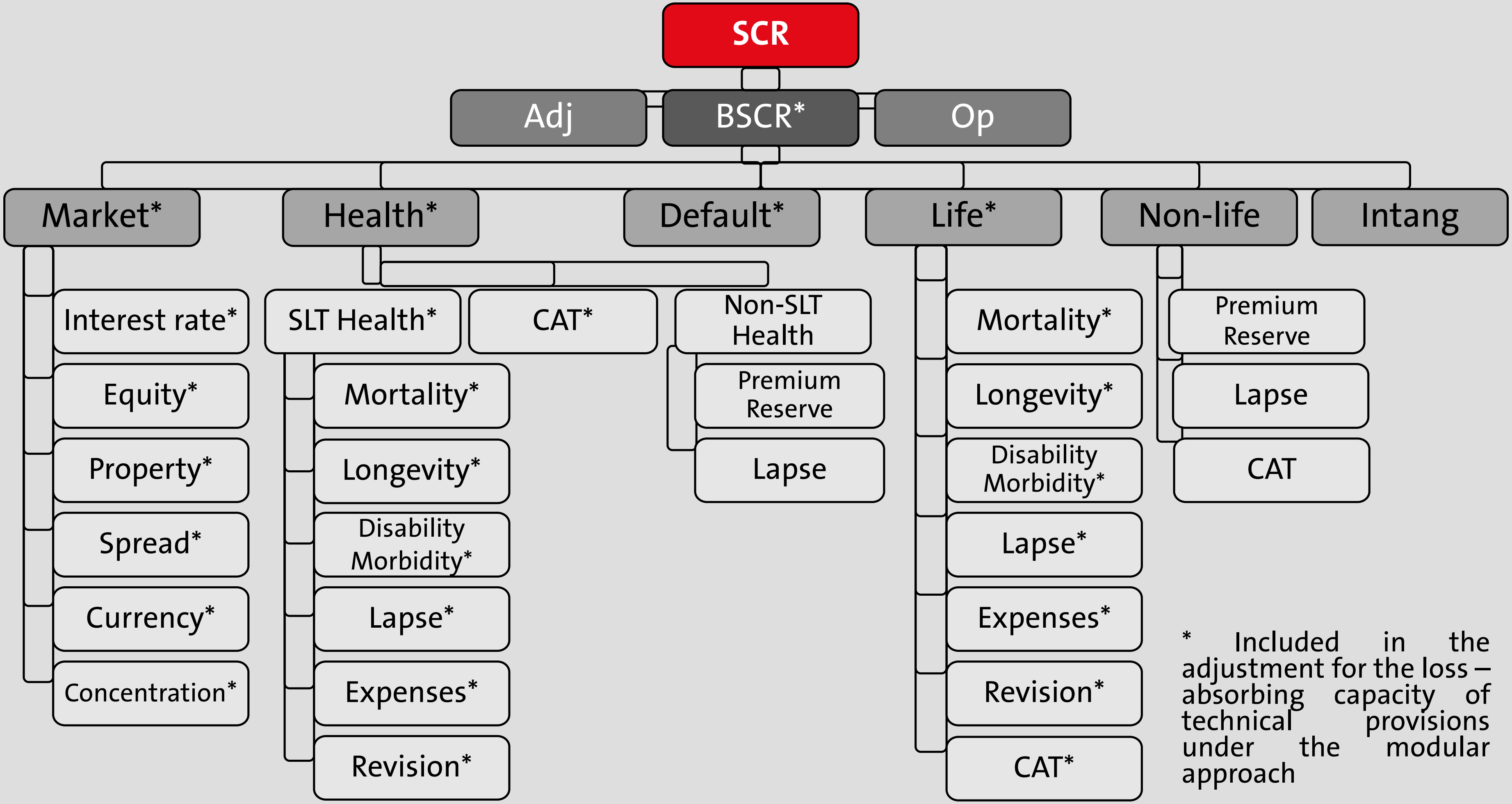
Tiering of own funds



Own funds = Basic own funds + Ancillary own funds
Basic OF = excess of assets over liabilities + subordinated liabilities

Based upon the extent to which they possess the characteristics of permanent availability and subordination.

Solvency capital requirement - standard formula



* Included in the adjustment for the loss – absorbing capacity of technical provisions under the modular approach

Triglav Group
Solvency II position

Solvency II well integrated in Triglav Group

Solvency II framework	Triglav Group
Risk-based supervision	Standard formula used, embedded in risk and business management
Insurers' business models are adequately reflected	Focus on profitable underwriting and liability-driven investments (well diversified risk profile)
Changing capital requirements through final calibration	Capital adequacy appropriately high, Solvency II ratio at 245% (31 Dec 2015), expected to be in the target range
Reporting and public disclosure	Extensive reporting to the supervisor (AZN) in 2015 and 2016, successful 1-day reporting to AZN, first public disclosure (SFCR report) in 2017
Uniform regulatory framework enhances comparability across the industry	Active participation in the implementation of S II in Slovenia, impact on insurance markets in region
Business opportunities for insurers and reinsurers, driver of product innovation	Market leader position in Slovenia in structuring complex and innovative solutions

Major changes of risk management system in 2015/2016

Centralized risk management on Triglav Group level, upgraded by:

- Review of the existing top level risk policies
  - Risk appetite & strategy
  - Risk appetite based on 5 top level indicators (profitability, capital adequacy, risk concentration, liquidity, value of the company brand/operational risks)

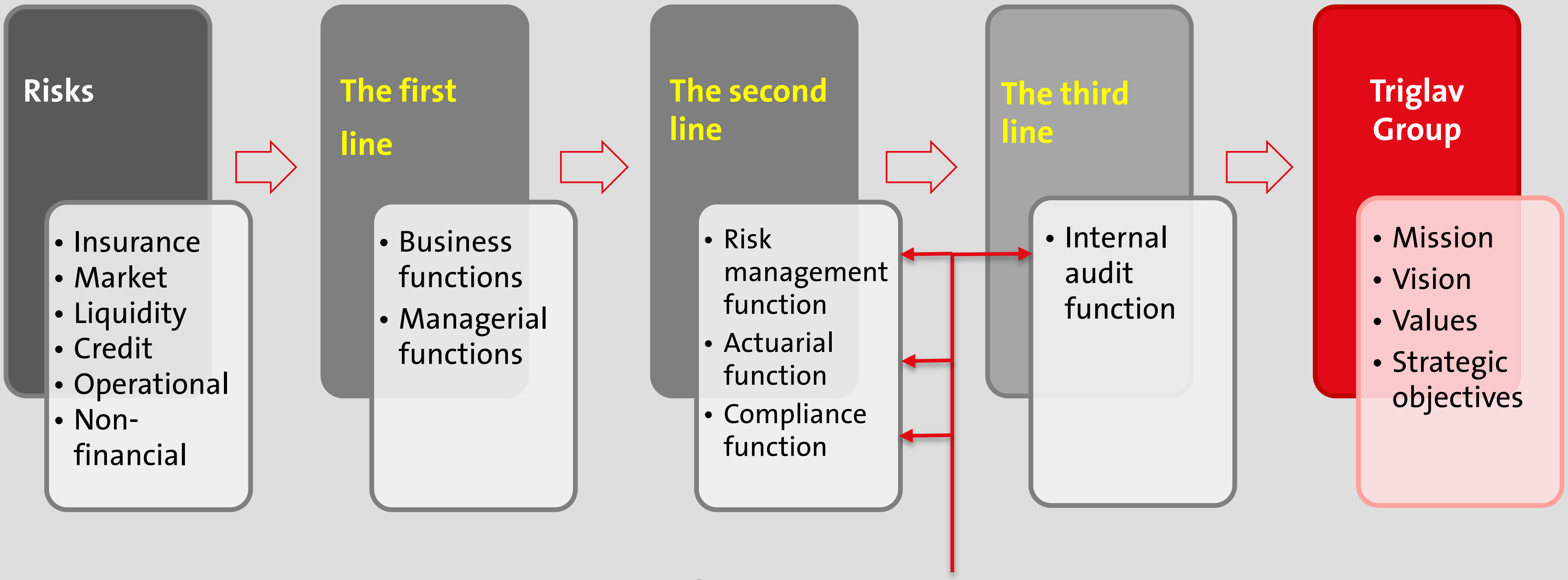
- For each type of risk, separate policies:
  - Capital management policy (new dividend policy)
  - All other risk policies (insurance risk, market risk, liquidity risk, counterparty default risk, operational risk, non financial risk)

- All policies are being implemented by subsidiaries in the group consistently and based on their risk profile taking into account the materiality and local regulation requirements

Risk management integrated into the entire business process

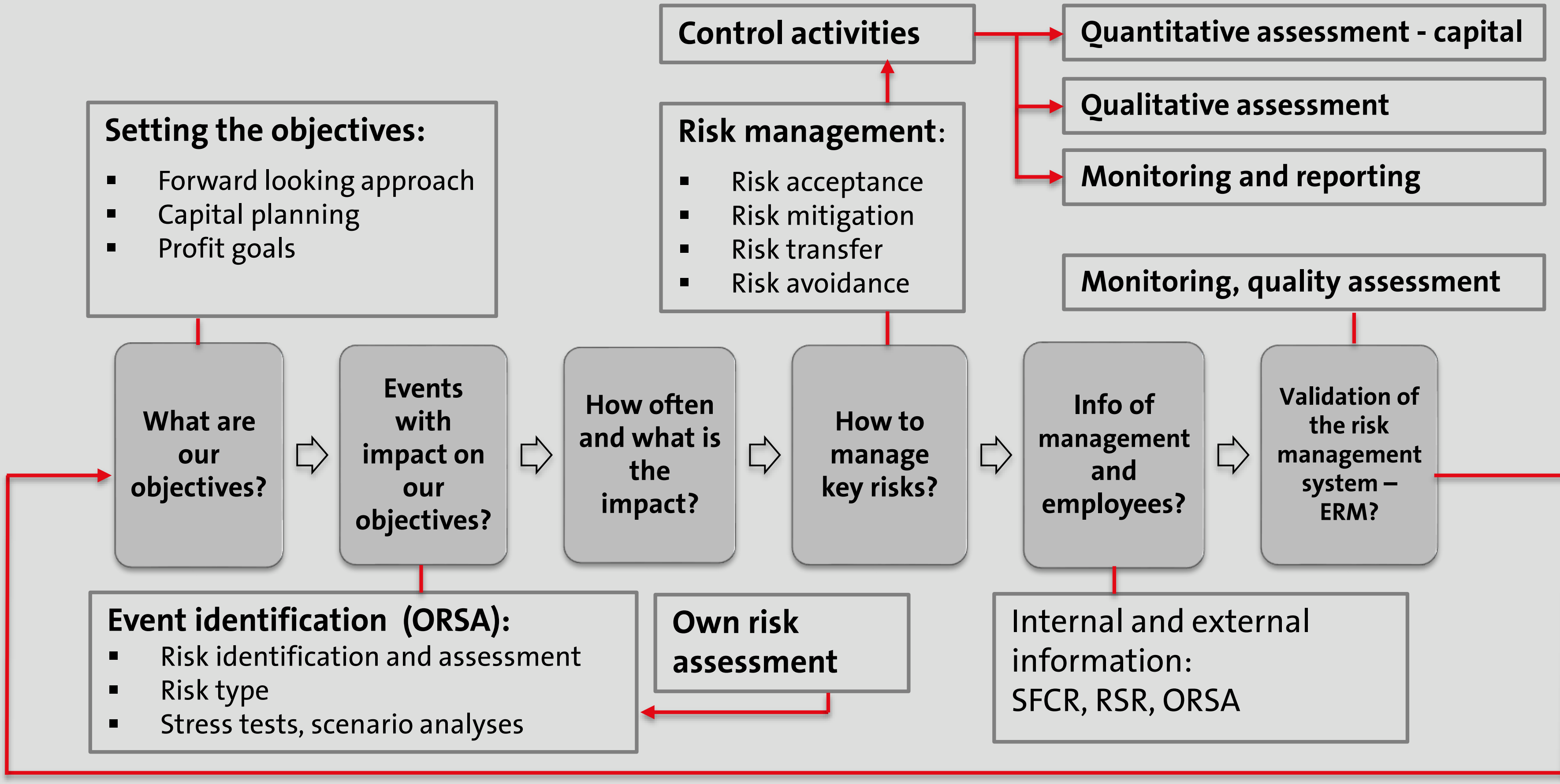
The risk management system of Triglav Group enables a comprehensive overview of concentration of risks within the Group and risks related to intra-group transactions.

“Three Lines of Defense” model of Triglav Group



4 Key functions organized as independent organizational units (with responsibility on Group level)

Risk management process of Triglav Group



Triglav Group risk classification

Underwriting risks

- Risk arising from the underwriting process, changes in claim experience, product development and pricing in life and non-life segment
- Risk of reserving
- Risk of changed policyholder behavior and general changes in the external economic environment

Operational risk

- Risk of loss arising from:
  - Internal Fraud
  - External Fraud
  - System Failures
  - Damage to physical assets
  - Improper employment practices
  - Non compliance with regulations, improper business or market practices
  - Inadequate processes, control environment

Financial risks

- Market risks:
  - Interest rate risk
  - Equity risk
  - Credit spread risk
  - FX risk
  - Concentration risk
  - Real estate risk
- Liquidity risk
- Credit risk

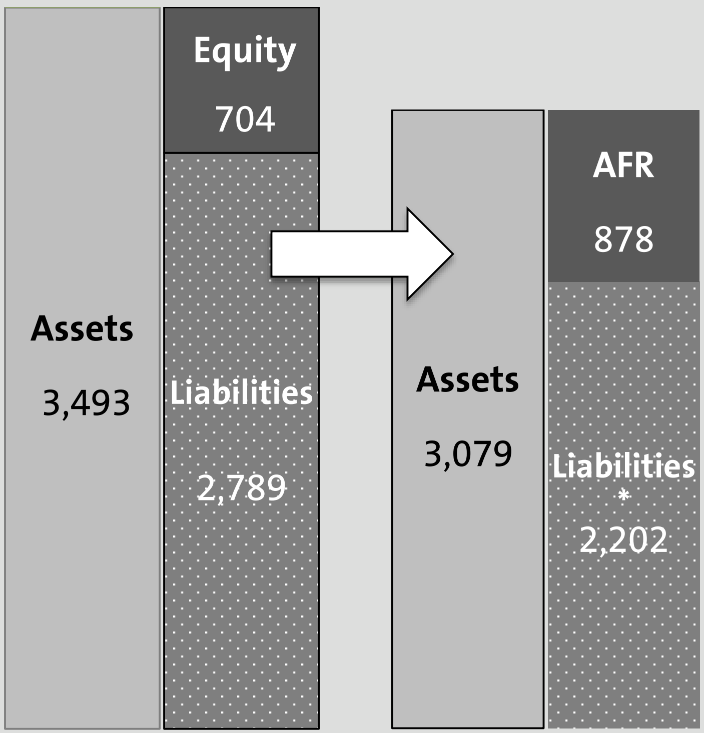
Non-financial risks

- Strategic risks (risks arising from achieving strategic objectives, from external environment)
- Frictional / capital risks
- Reputation risk
- Legal risks

Solvency II - market consistent framework Triglav Group

(data on 31 Dec 2015, in EUR million)

IFRS Balance Sheet | **Solvency II market consistent Balance sheet**



Eligible own funds (EOF)
800

- **Share capital** 74
- **Reconciliation reserves** 703
- **Subordinated liabilities** 23

Surplus
474

SCR
326

Future forseeable dividends, EOF for RFF capital requirements, other adjustments 78

$$\text{S II ratio of Triglav Group} = \frac{EOF}{SCR} = \frac{800}{326} = 245\%$$

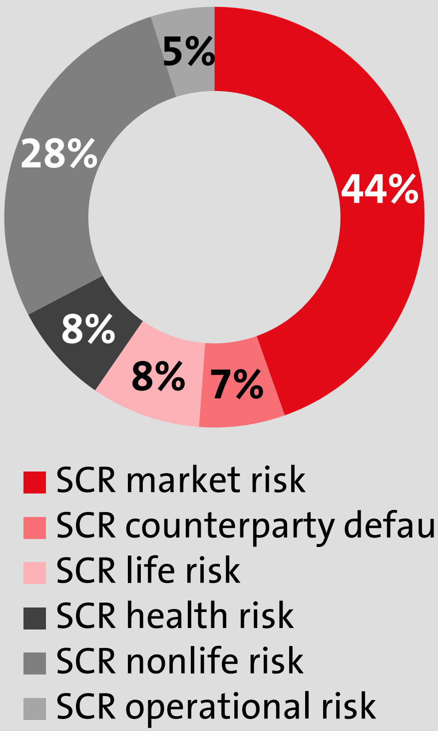
- No optional LTG measures considered (transitional rules, matching adjustment, volatility adjustment)
- High quality capital - more than 97% of EOF is Tier 1

*Market value of subord.liabilities not included 23.2, is part of AFR

Solvency Capital Requirement of Triglav Group split by risk

SCR of Triglav Group split by risk (31 Dec 2015)

Only gross undiversified market, insurance, credit and operational risk considered



Triglav Group	Gross capital requirement (in EUR million)
Total market risk	234.3
Total counterparty default risk	34.7
Total capital requirement for life underwriting risk	44.3
Total health underwriting risk	40.6
Total non-life underwriting risk	146.0
Diversification	-154.1
Basic SCR	**345.8**
Total capital requirement for operational risk	25.7
Loss-absorbing capacity of technical provisions	-0.4
Loss-absorbing capacity of deferred taxes	-58.8
SCR	**312.3**
Capital requirement for companies with sectoral rules	14.0
Total SCR *	**326.3**

**Without capital requirement for ring-fenced funds.*

Solvency II Standard formula stresses

		Stress	
Market risk	Interest rate	▪ 1yr: +70% / -75% ▪ 5yr: +55% / -46% ▪ 10yr: 42% / -31% ▪ 15yr: 33 % / -27 %	
	Equity	▪ Listed EEA/ OECD: -36.8% ▪ Other -46.8% ▪ Strategic participation: -22%	
	Property	▪ -25%	
	Credit spread risk	▪ Government bonds EEA countries: 0% ▪ Non-government bonds & other credit instruments: various % based on type of instrument, duration and credit rating	
	Currency	▪ +/-25%	
Insurance non life risk	**LoB**	**Standard deviation for premium risk** (based on net earned premium)	**Standard deviation for reserve risk** (based on net claim reserves)
	Motor vehicle liability	10.00%	9.00%
	Motor, other classes	8.00%	8.00%
	Fire and other property damage	8.00%	10.00%

Capital Management

Capital management policy and dividend policy

> 300%	**Excess capital adequacy**	▪ The possibility of increased risk appetite ▪ The possibility of more aggressive growth in the volume of operations and consideration of possible changes to the business strategy ▪ **The possibility of increasing the share of dividend payments** ▪ The possibility of excess capital payout (capital reduction)
250 – 300%	**Target capital adequacy**	▪ The payment of dividends within the target range of 30 – 50% of consolidated net profit of the Triglav (**payout ratio of 30-50%**) ▪ Maintenance of the applicable risk appetite ▪ Room for growth in the volume of operations in line with the applicable business strategy
200 - 250%	**Suboptimal capital adequacy**	▪ Analysis of available measures for capital adequacy improvements ▪ Assessment of possible selective reduction in the volume of operations ▪ Changes to the plans for expanding operations ▪ The possibility of reducing the share of dividend payments (**lower payout ratio**)
150 – 200%	**Warning capital adequacy**	▪ The preparation of the plan and the implementation of measures aimed at improving capital adequacy ▪ The implementation of measures for selective reduction in the volume of operations ▪ Strict limitation of the expansion of operations ▪ **Reduction in the share of dividend payments**
< 150%	**Insufficient Capital adequacy**	▪ Assessment of the possibility of issuing subordinated capital instruments ▪ Implementation of the restructuring plan ▪ Consideration of the possibility to increase capital ▪ **No dividend payments**

Capital management guidelines and criteria

- **Capital management objectives:**
  - Safety and profitability at Zavarovalnica Triglav and Triglav Group level
  - High level of confidence of all stakeholders
  - Full compliance with regulatory requirements
  - Adequate capital adequacy as outcome of ORSA process and
  - Compliance with criteria of external credit rating agencies to maintain a credit rating of at least A
- **Risk appetite statement as platform defining key capital management criteria, aligned with business strategy:**
  - Average target ROE throughout the economic cycle period higher than 10%
  - Targeted long term regulatory SII SCR ratio on level 250-300% and minimum 150%
  - Minimum ORSA SCR ratio at 130%
  - Capital adequacy ratio based on S & P model should be at least AA as a condition for stand-alone rating of A
- **Transparent system of responsibilities defined**
- **Capital allocation and profitability assessment methodology in pipeline**

Key takeaways from the day

- **IN GENERAL:** SII step in the direction of better governance of insurance company, transition of insurance industry into risk based mindset and increased reporting requirements.

- **COMPLEXITY of SII:** Focus on proactive management of wide range of risks, some of them being additionally incorporated. New solvency requirements are more risk-sensitive, sophisticated and based on size of impact on economic balance sheet by a rare event (0.5% probability in one year) for each type of risk.

- **MARKET PRACTICE:** Market practice on capital requirement/adequacy calculation not yet established. Higher volatility of the balance sheet value and thus SCR ratio is expected.

- **TRIGLAV GROUP:**
  - Integrated risk management system adapted, compliance with capital requirements in accordance with new legislation provided.
  - Low level of liquidity in local capital markets and unstable political and economic environment on strategic markets demand higher capital buffer on Triglav Group level.
  - Risk management system adequately involved in corporate governance structure, capital management objectives achievable now and in the future to provide stable and reliable long-term business performances of Triglav Group.

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