RISK MANAGEMENT

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- Zavarovalnica Triglav established a comprehensive and integrated risk management system at the Group level, which is regularly and continuously upgraded.
- The Triglav Group continues to have a strong capital base and high liquidity.
- The established risk management processes and system ensure controlled taking of risks and safe operations.
- Individual types of material risks are effectively managed and controlled.
- The own risk assessment, which is performed by using the standard formula in the context of Solvency II, showed strong resilience of the Group even in the case of stress situations.

The capital management process enables the Group to ensure adequate safety and profitability of its operations and a high degree of confidence of all stakeholders. The main goal of this process is to make efficient use of the available capital to ensure a long-term and stable return on investment for the shareholders of Zavarovalnica Triglav by paying out dividends based on the predefined criteria in the dividend policy and taking into account the interests of other stakeholders and regulatory restrictions.

The key preconditions for the implementation of these objectives are comprehensive identification, measurement, monitoring and management of assumed and potential risks as well as an ongoing own risk and solvency assessment. Comprehensive risk management enables regular measurement and monitoring of the level, return and use of economic capital. On this basis, the capital structure is optimised and business decisions are made.

The Group monitors capital adequacy, which complies with Solvency II regulatory requirements, based on mark-to-market valuation. Capital adequacy is calculated using the standard formula. To ensure the long-term target capital adequacy, own risk assessment is regularly performed so as to assess the current and future solvency requirements and to define the necessary capital management measures. According to the own risk assessment for 2017, the capital adequacy of the Group remains at a high level despite the adverse situation in the financial markets and an increased number of devastating weather events and thereto related growth of non-life insurance claims.

The Group continues to be well capitalised. Its capital strength is confirmed by its capital structure, which almost entirely consists of the highest-quality capital, composed of share capital and reconciliation reserve. Subordinated liabilities account for a small portion of available capital. Compared to the previous year, the quality of available capital remained mostly unchanged. A slight increase was seen in reconciliation reserve. The market value of subordinated bonds changed and slightly fell as the result of discounting using a higher risk-free interest rate and a shorter maturity in 2017.

After the coordination with the Insurance Supervision Agency, in 2017 Zavarovalnica Triglav amended its methodology for calculating capital requirements, particularly in relation to ring-fenced funds, which include supplemental voluntary pension insurance. In accordance with the new methodology, the additional capital requirement of ring-fenced funds is taken into account in the overall capital requirement; in determining available capital, the amount needed to cover the capital requirement of ring-fenced funds is not deducted. The change in the methodology does not have material impact on the capital adequacy of the Group. See [→ *Section 2.1.*] for further details.

The Group provides for adequate short-term and medium-term liquidity by ensuring adequate liquidity of every subsidiary, particularly Zavarovalnica Triglav, which is an institution with strong liquidity. Exposure to liquidity risk primarily arises from the probability of catastrophic loss events and is adequately managed with an efficient reinsurance programme.

Compared to the 2016 year-end, the risk profile of the Group remained largely unchanged. Changes in exposure mainly arise from underwriting risks, especially due to the increase in the volume of the non-life insurance portfolio and claims experience due to devastating weather events; the latter also caused an increase in the claims ratio. In the context of market risks, exposure to credit spread risk increased. In contrast, exposure to equity risk decreased (see [→ *Section 7.9 of the Business Report*] for more details).

Zavarovalnica Triglav established a comprehensive and integrated risk management system at the Group level, which is regularly and continuously upgraded.

The key development activities at the Group level in 2017:
- The internal rules for the operation of the committees which are part of the risk management system were upgraded by defining their powers and responsibilities even more clearly.
- The upgrading of the risk management system in all insurance subsidiaries of the Group continued. In this context, insurance subsidiaries have been establishing a risk management system as defined in the minimum standards of the Group.
- Effective cooperation with insurance undertakings from the EU continued with respect to the drafting of regular reports on capital adequacy in the context of Solvency II. On the basis of experience and workshops, especially with the insurance subsidiaries of the Triglav INT Group, which do not conduct their business in accordance with the Solvency II requirements, the quality of data and the reporting system were further improved at the Group level.
- With the aim of strengthening the risk management culture, training workshops on risk management were organised both for Zavarovalnica Triglav's employees and for the employees involved in risk management in the subsidiaries.
- Improvement of the established risk measurement and monitoring processes based on the experience gained continued, resulting in an upgraded operational risk system and a redesigned application for reporting loss events.

Adequate capital and financial strength of the Group are reflected in the credit rating of the rating agencies S&P Global Ratings and A.M. Best, which in 2017 again assigned the Triglav Group the long-term credit rating and financial strength rating of "A". Both credit ratings have a stable medium-term outlook (See [→ *Section 6.6. of the Business Report*] for more details).

1. Risk Management System

The comprehensive risk management system is a fundamental part of the governance system in the Triglav Group and ensures the achievement of the Group's strategic objectives. The risk management system of Zavarovalnica Triglav is clear, transparent and well-documented. Through minimum standards, it is effectively transferred to the other Group members, taking into account the principle of proportionality. It ensures timely identification of all material risks and standardised set of procedures, which provides for the understanding of the consequences of realised potential risks. Furthermore, it includes the processes that enable effective management of individual risks or exposures.

The quality of the whole system is closely connected with the **own risk and solvency assessment process**. Its main purpose is to prepare own risk assessments at the Group level, which define the impact on current or future capital requirements, and on the basis of these assessments to make decisions on risk retention or transfer, optimisation of capital management and improved setting of premium rates. All of this is the basis for making other strategic decisions. The risk management system is well incorporated into the operations of the Group. This means that risks are partly managed in the first line of defence, which allows a quality assessment of present and future risks.

1.1 Powers and responsibilities

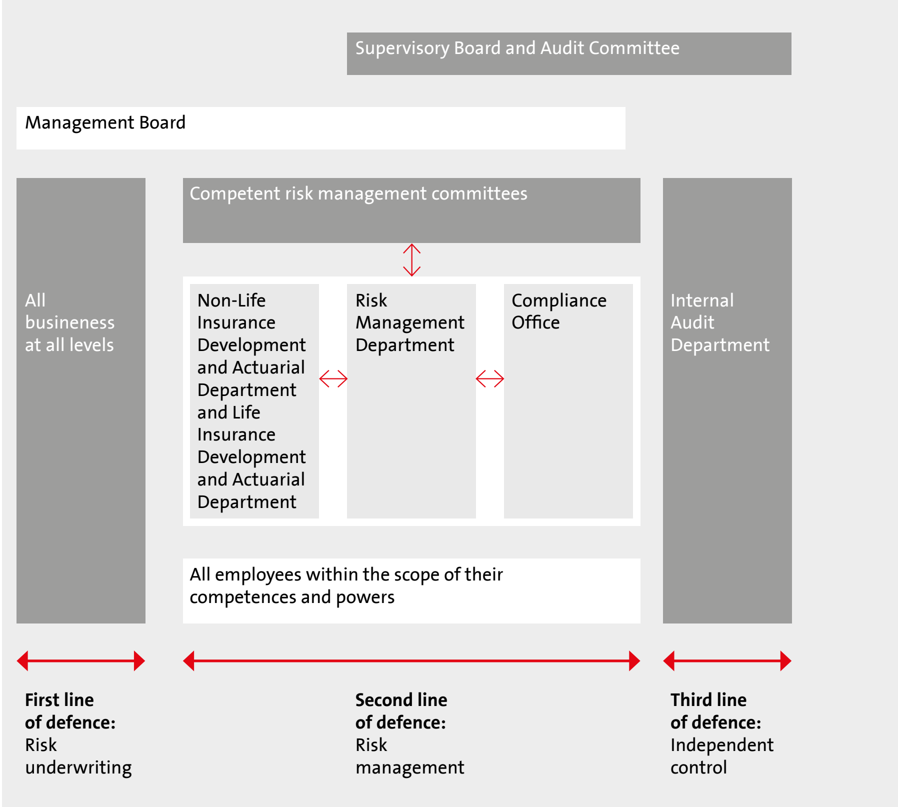
The key element of comprehensive risk management is a corporate governance system, which ensures that the risk profile is within the within the frameworks set in the Risk Appetite Statement.

The risk management system is designed based on the **"Three Lines of Defence"** model.

- **The first line of defence** consists of the business functions, which actively manage concrete business risks through their business decisions and which are primarily responsible for risk identification and underwriting.
- **The second line of defence** is composed of business functions and decision-making bodies, forming the risk management system, which includes exposure identification, measurement and monitoring as well as the exposure limit system.
- **The third line of defence** includes the internal audit function. This function executes regular adequacy and efficiency reviews of the internal control environment and of the risk management system in individual functional areas.

The Management Board and the Supervisory Board are not directly part of the three lines of defence, however they do play a key role in the risk management system. They are the primary stakeholders serviced by the three lines of defence, who are also in charge of the operation of the three lines of defence within the system of risk management and control processes.

The decision-making bodies participating in the integrated corporate risk management process and the three lines of defence



The Supervisory Board of the Company gives consent to the Management Board with respect to the written rules of the risk management system at the highest level. Within the scope of its powers and responsibilities, it takes note of the reports of key functions. At its sessions, the Supervisory Board regularly monitors the risk profile and capital adequacy and the findings of the own risk and solvency assessment. Furthermore, it gives the Management Board its approval to the Solvency and Financial Condition Report in the context of discussing the comprehensive risk report. The Supervisory Board established a working body, which provides expert assistance and support in the formulation of positions on risk management.

The Audit Committee of the Supervisory Board supervises the adequacy and effectiveness of the risk management system and monitors the comprehensive risk profile of the Company.

The Management Board of the Company defines the business objectives and the risk appetite and approves the risk management strategy and policies. It is responsible for ensuring the effectiveness of the risk management system. The Management Board approves policies and plans of individual key functions, it is regularly briefed on capital adequacy and approves the most important reports drafted by the key functions, including the Regular Supervisory Report and the Solvency and Financial Condition Report. Independently or within a committee, the Management Board not only actively participates in and directs the own risk and solvency assessment but also ensures its compliance with and integration into the capital planning and management processes.

The business functions in Zavarovalnica Triglav and individual subsidiaries are responsible for risk underwriting and identification in their respective work area in accordance with the guidelines of the Management Board, as well as for the management of concrete risks within the allowed exposure limits.

The second line of defence includes the key functions of the risk management system: the Risk Management Department, the Non-Life Insurance Development and Actuarial Department, the Life Insurance Development and Actuarial Department, and the Compliance Office. The third line of defence includes the Internal Audit Department as one of the key functions. **The key functions in Zavarovalnica Triglav are organised as independent organisational units**, which carry out their duties and responsibilities independently from one another and from the other organisational units of the Company. All four key functions cooperate with one another and regularly exchange information necessary for their operation. The key function holders meet the fit and proper requirements in line with the applicable internal rules.

The risk management function is responsible for the establishment and coordinated and continuous operation of the integrated risk management system in accordance with the guidelines of the Management Board. Furthermore, it is in charge of monitoring the general risk profile, developing risk measurement methodologies and risk valuation models, performing the underlying risk analyses, reporting on risk exposures, and undertaking capital adequacy valuation using the standard Solvency II formula and other capital models. In accordance with the guidelines of the Management Board, the risk management function also performs own risk and solvency assessment, prepares disclosures on risks and the solvency and financial condition for publication, as well as reports to regulatory bodies.

The compliance function monitors compliance of the Company's operations with the applicable regulations and any other commitments and informs the Management and Supervisory Boards thereof. Furthermore, the compliance function assesses the compliance risks of the Company's operations and the potential impact of any changes in the legal environment on the operations, advises on coordination, as well as assesses the adequacy and effectiveness of the procedures and measures to adapt the Company's operations to changes in the legal environment. The compliance function also plays a major role in ensuring fair and transparent practices.

The actuarial function primarily coordinates and calculates the insurance technical provisions:

- to ensure the appropriateness of the methods and models used as well as the assumptions made in the calculation of insurance technical provisions;
- to assess the appropriateness, sufficiency and quality of data required for the calculation of insurance technical provisions;
- to verify the appropriateness of the overall underwriting risk policy.

In addition, it forms an opinion whether the amount of the premium of individual products is sufficient to cover all the liabilities arising from these insurance contracts, as well as checks the adequacy of reinsurance. Furthermore, the actuarial function actively participates in the introduction and implementation of the risk management system, particularly in the development, application and monitoring of the appropriateness of capital requirement calculation models and in conducting own risk and solvency assessment. In the context of the second line of defence, the main task of the actuarial function holders is to regularly monitor the implementation of the actuarial function and to inform the Supervisory Board and the Management Board of any major findings.

The internal audit function performs an ongoing and comprehensive control over the operations of the Company. This is achieved by assessing the adequacy and effectiveness of the Company's governance, risk management and control procedures in an impartial, systematic and methodical manner and by making recommendations for their improvement. Apart from that, the internal audit function provides advice in agreement with the Management Board and the management of functional areas, cooperates with external auditors and other supervisory bodies, monitors the implementation of internal and external auditors' recommendations, participates in the performance of internal audits in other Group members, maintains the quality and provides for continuous development of internal auditing. The internal audit function periodically reports on its activities and findings to the Management Board, the Audit Committee and the Supervisory Board. In their work, internal auditors must be impartial and must avoid any conflict of interest. Furthermore, they are not allowed to perform any development and operational tasks that could cause a conflict of interest and weaken their objectivity, nor do they decide on activities in the areas subject to internal auditing.

All key functions are in charge not only of transferring the know-how and good practices to the Group members but also of ensuring coordinated operations within the Group members.

In the Group members, the risk management system is established based on the principles of the controlling company, which are laid down in the Minimum Standards, taking into account the size, complexity and business profile of a particular subsidiary. Risk management within the Group is primarily performed at the level of individual subsidiaries and secondarily at the Group level. In line with the Minimum Standards, the Risk Management Department of Zavarovalnica Triglav in cooperation with the management bodies of subsidiaries and their appointed responsible persons, the Subsidiary Management Department and Triglav INT are responsible for setting up and ensuring the operation of the risk management system at the level of individual subsidiaries. Particularly important are effective communication and quality exchange of data and information (time availability, methodological consistency, accounting verifiability, integrity).

In terms of risk management, the role of **Triglav INT d.d. holding company** as the direct owner of insurance subsidiaries operating on the markets outside Slovenia is particularly to supervise the implementation of the system, policies and processes so as to ensure the implementation of the strategy and the achievement of the objectives, vision and mission of the Triglav Group abroad.

The second line of defence of the risk management system includes the committees appointed by the Management Board. They have an advisory role or are granted certain decision-making rights by the Management Board. The purpose of the committees is to provide support to the Management Board in regular monitoring, coordination and information about risk management. Over the past year, the powers and responsibilities of the committees were revised in relation to comprehensive monitoring and reporting of all risk categories.

The committees are notified on an as-needed basis. In the event of significant changes in the risk profile, the identified risks are also dealt with by the Risk Management Committee or the Management Board.

Powers and responsibilities of the committees in the risk management system

Risk Management Committee (RMC)

- Specific responsibility for monitoring non-financial and capital risks, main responsibility for ensuring an overview of the whole risk profile
- Support to the Management Board in matters related to risks
- Discussion of policies and approval of risk management methodologies, including approval of limits
- Verification of efficiency of the risk management functions

Assets and Liabilities Committee (ALCO)

- Development of the asset and liability management strategy of the Company
- Prior approval of internal documents for the management of market, credit and underwriting risk of life insurance
- Specific responsibility for monitoring liquidity, market and credit risks in the segment of financial assets portfolio and the life insurance

Project Steering Committee (PSC)

- Monitoring the level of project risks
- Prior approval of internal documents for project risk management
- Specific responsibility for monitoring project risks

Operational Risk Committee (ORC)

- Monitoring the level of operational risks and supervision of the establishment of an integrated operational risk management system
- Prior approval of internal documents for operational risk management
- Specific responsibility for monitoring operational risks, including outsourcing risks

Non-life Insurance Underwriting Committee (UWC)

- Monitoring and optimisation of the level and concentration of assumed non-life insurance underwriting risks
- Prior approval of internal documents for the management of underwriting and credit risks of non-life insurance
- Specific responsibility for monitoring non-life insurance underwriting risks, including credit insurance from reinsurance

Life Insurance Product Forum (PF OZ)

- Development of life insurance products
- Upgrading of life insurance products
- Monitoring and discussing changes in legislation

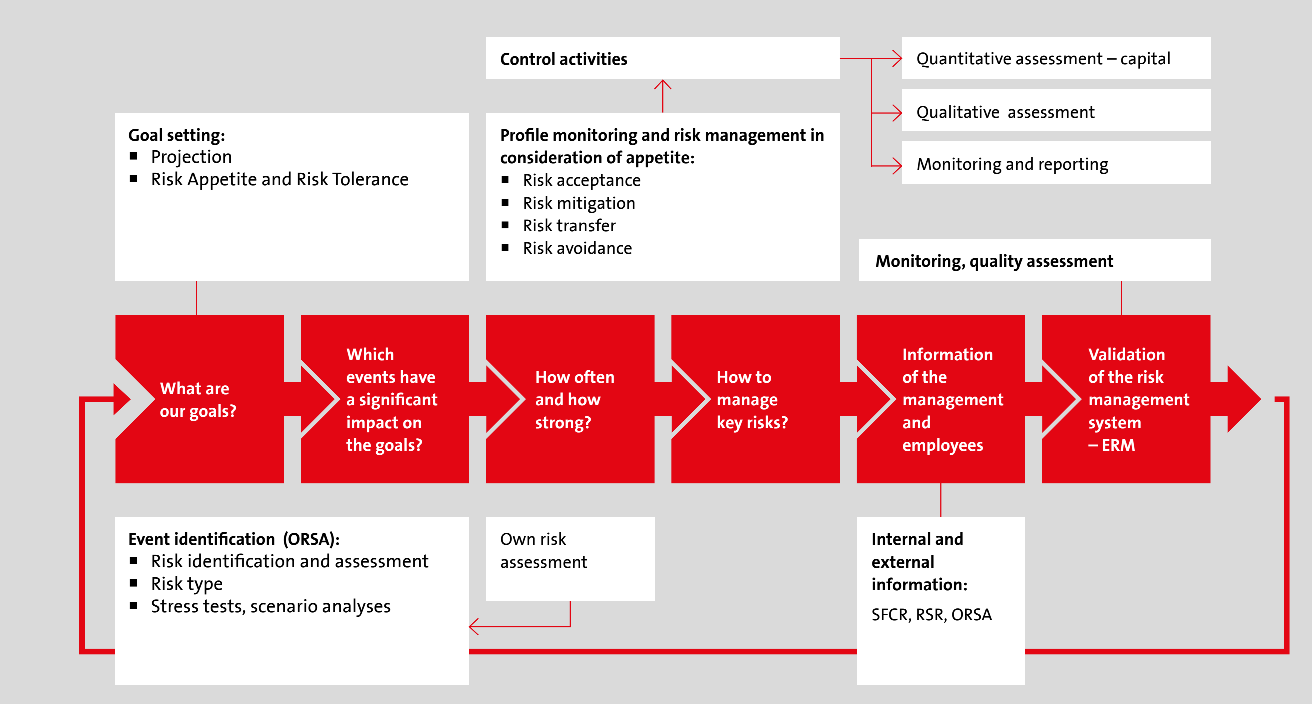
Non-life Insurance Product Forum (PF OZ)

- Development of non-life insurance products
- Upgrading of non-life insurance products
- Monitoring and discussing changes in legislation

1.2 Risk management framework

The risk management system includes all areas, with an emphasis on those that materially affect the operations and the set business objectives. It is very important to build an appropriate culture in the Company, especially in relation to knowledge, cooperation and open communication about risks; the Management Board and the management of individual Group members play the key role in this. The main building blocks of comprehensive risk management in the Company are the Triglav Group Strategy and the Business Plan of Zavarovalnica Triglav. The figure shows the comprehensive risk management process described below.

Risk management process

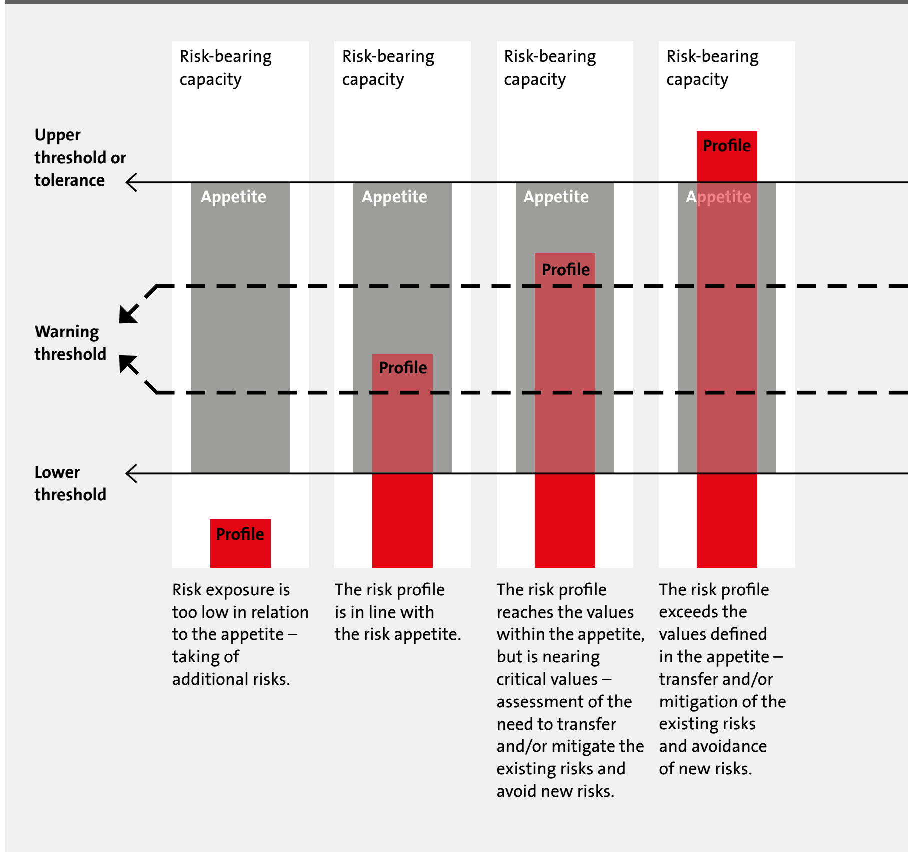


The risk appetite determines the key indicators for each material risk and their target and limit values. The Company has zero tolerance for all types of risks which it does not want to assume in the course of its operations.

The Risk Management Department regularly monitors the matching of the risk profile (actual exposure to risks) and the appetite and briefs the Management Board by drafting periodic risk reports. If it establishes that the values of the indicators are near the figures defined in the risk appetite or that there has been a significant change in the level of exposure, it submits draft measures for limiting the exposure to an acceptable level to the Management Board. Based on the prepared risk analyses, the Management Board decides on a risk management approach, choosing among the following: accept, transfer, mitigate or avoid the risk.

The selection of the approach depends on the ratio between the risk profile and the values laid down in the risk appetite as shown in the figure below.

The basis for deciding on the risk management approach



The risk exposure monitoring mechanisms enable the Company not only to detect and identify any negative trends but also to take appropriate measures. Operationally, risk identification is performed at several levels, i.e. at the level of functional areas and competent committees. Material identified risks are included in the own risk and solvency assessment process.

Risks are regularly measured and monitored using various methods:

- **Regulatory method:** This method is based on capital adequacy calculation and risk measurement in accordance with the Solvency II standard formula and is used to explain substantial changes in the period.
- **Internal methods:** Through internal risk measurement, own calculations of the defined key risk indicators are regularly performed, thereby assessing the risk level of a particular category. In addition, the limits are defined in order to limit the underwriting of risks. These limits are used in the ordinary course of operations.
- **S&P risk assessment method:** Capital adequacy is also calculated by using the methodology of the S&P rating agency.

At least once a year, in the context of the own risk and solvency assessment process, an analysis is performed to assess the appropriateness of the Solvency II standard formula for the measurement of own risks. The results of the internal risk measurement method are also taken into account in the final assessment of appropriateness. The Company assessed that the standard formula was an appropriate tool for measuring the risk profile in 2017.

Internal reporting enables the Management Board and the Supervisory Board to be regularly briefed on exposure to risks by individual category and the overall exposure at the level of the Company and the Group. The quarterly risk report is a documented result of regular risk measurement and monitoring, as it covers all key risk indicators risks, including trends, limits and recommendations of the Risk Management Department.

The Company regularly documents any deficiencies identified within the risk management system, including proposals for improvements, as well as prepares measures and recommendations for its upgrade.

1.3 Capital management

At any given time, the Triglav Group has sufficient capital, which allows it to assume a specific, measurable quantity of acceptable risks. Capital is the first criterion for assessing the solvency of the Group. The primary goal of capital management is to guarantee the sufficient and suitable capital adequacy level on both a consolidated and an individual basis. In setting the level of acceptable risk, generation of appropriate profit for owners has to be ensured. The goal of capital management is to guarantee the safety and profitability of operations as well as a long-term and stable return on investment for the shareholders by paying out dividends based on the predefined criteria in the dividend policy. In previous years as well as throughout 2017, the Group was adequately capitalised, safe and profitable. It was assessed that the Group had an adequate capital level also as at 31 December 2017.

As required by the applicable legislation, the amount of available capital is regularly measured to make sure it is in line with the regulatory capital requirements, both at the level of individual insurance subsidiaries and at the Group level.

At the Group level, Zavarovalnica Triglav maintains a surplus of available capital in excess of the capital requirements for its core business and covering potential losses. This surplus provides protection against losses due to unforeseen unfavourable events and volatile capital requirements. In addition to current capital adequacy levels, the Company plans and assesses future capital and capital adequacy levels. This allows it to detect any influences from the environment affecting capital adequacy and to ensure optimum capital allocation. Capital adequacy is an essential part of the credit rating. Decisions concerning capital management are supported by the results of the capital models, based on which the credit ratings are assigned. The Group's capital adequacy model is assessed by the credit rating agencies S&P Global Ratings (hereinafter: S&PGR) and A.M. Best. Credit rating is discussed in greater detail in [→ *Section 6.6 of the Business Report*].

In order to ensure a comprehensive and effective approach to capital management, the Group defined the economic capital management criteria.

The capital management criteria are included in the Triglav Group Strategy in accordance with the guidelines set out in the Risk Appetite Statement. The criteria are based on regulatory requirements, internal goals set in the Risk Appetite Statement, the requirements of credit rating agencies, the business and organisational structure, and the specifics of the macroeconomic and political environment. Apart from that, the criteria of the dividend policy and the capital management guidelines were set. These include a range of activities for ensuring the necessary capital strength, which remained unchanged last year.

1.4 Risk types

The main risk types are described below, whereas the risk management methods and exposure to a specific risk type are described in greater detail in [→ *Section 2*].

The basis for defining the risk appetite is identification of the risks to which the Company is exposed in the course of its operations. The risk identification process is ongoing. It involves all functional areas in accordance with their respective powers and responsibilities. Its purpose is to ensure the inclusion of all material risk types in the risk management system, to set up the risk exposure measurement process and to achieve uniform risk management and understanding at all management levels. In its operations, the Company assumes the following risks:

- **Underwriting risk** is the risk of loss or of adverse change in the value of insurance liabilities, due to inadequate pricing and provisioning assumptions taken into account in the calculation of insurance technical provisions. Through risk underwriting, the Company is exposed to premium risk, the risk of insurance technical provisions and catastrophe risk.
- **Market risk** is the risk of loss or of adverse changes in the financial situation, resulting from fluctuations in the level and the volatility of market prices of assets, liabilities and financial instruments. It includes interest rate risk, equity risk, property risk, credit spread risk and market concentration risk.
- **Liquidity risk** is the risk of loss that may occur if the Group is not able to meet all past-due payment obligations or is forced to provide the required funding at costs significantly higher than normal. Liquidity risk is also the risk of limited access to funding needed to meet the payment obligations from insurance and other contracts. Normally, it materialises in the form of the inability to liquidate assets without having to make the sale at a substantial discount based on the current market price.
- **Credit risk** is the risk of loss or of adverse changes in the financial situation, resulting from fluctuations in the credit position of counterparties and potential debtors, to which an insurance undertaking is exposed in the form of counterparty default risk and concentration risk.
- **Operational risk** is the risk of loss arising from inadequate or failed internal processes, personnel or systems, or from external events and their impact. It includes information technology risk, legal risk, compliance risk, conduct risk, model risk, project risk and outsourcing risk.
- The **non-financial risks** include strategic risk, reputational risk, capital risk and the Group risks:
  - *Strategic risks* are the risk of loss due to adverse business decisions, improper implementation of adopted strategic decisions and insufficient responsiveness to changes in the business environment (including legal and regulatory risks).
  - *Reputational risk* is the risk of loss arising from a negative image held regarding the future or existing operations of the Company or the Group by its clients, business partners, employees, shareholders and investors and/or competent or supervisory bodies and the public.
  - *Capital risk* is the risk of loss due to inadequate capital structure with regard to the business volume and method or problems encountered when acquiring fresh capital, especially in the case of unfavourable operating conditions or the need for a rapid capital increase.
  - *The Group risks* arise from the business model of the Company, which is a parent undertaking or a group of related parties. They include the risks that might threaten the achievement of strategic objectives due to an ineffective governance system of the Group and insufficient understanding of the business environment in which its companies operate, e.g. changed circumstances relating to environmental, social, employee, anti-corruption and bribery matters. The Company's risk profile can also be influenced by the transactions between the associated companies and the high complexity of concentration risk management.

2. Disclosures and Risk Management

Presented below is the Group's and Zavarovalnica Triglav's exposure to all material risks.

The quantitative presentation of risk exposure is primarily based on accounting data. Risk exposure from the economic aspect will be presented in greater detail in the Solvency and Financial Condition Report.

The data on capital requirements and capital adequacy are also presented from the economic aspect. Capital requirements represent a regulatory risk assessment, which was assessed as adequate within the own risk and solvency assessment process.

2.1 Capital and capital adequacy management

Capital management enables the Group to optimise its operations, adopt appropriate business decisions and maintain its competitive advantages. Capital management is centralised at the Group level. Through capital concentration in the parent company, active capital management and allocation is ensured in line with the strategic objectives and the interests of a broad range of stakeholders.

The amount of available capital for meeting the regulatory solvency capital requirements at the level of individual subsidiaries and the Group level was regularly calculated in the reporting year. Capital requirements remained the same during the year as there were no significant changes in the risk profile.

In 2017, the level of available capital at the Group level was not only within the set strategic objectives but even considerably exceeded the regulatory capital level required to cover the underwritten risks. Due to the new methodology used, capital adequacy as at 31 December 2016 changed from the reported 246% to 242% at the Group level and from 303% to 295% for Zavarovalnica Triglav. In coordination with the Insurance Supervision Agency, the methodology applied to ring-fenced funds (supplemental voluntary pension insurance) was amended because they are subject to separate capital adequacy and were considered separately in the previous period. The amended methodology affected both the denominator and numerator of the capital adequacy ratio. In accordance with the new methodology, the capital requirement of the Group and the Company increased by the capital requirement of the ring-fenced funds, while the available capital of the Group and the Company increased by the amount required to cover the capital requirements of ring-fenced funds.

	Triglav Group		Zavarovalnica Triglav	
	30 Sept. 2017	31 Dec. 2016	30 Sept. 2017	31 Dec. 2016
Available capital (in million EUR)	907	855	916	854
Capital requirement (in million EUR)	353	354	289	289
Solvency ratio (in %)*	257	242	317	295

* In accordance with the Solvency II methodology, capital requirements are calculated at an annual level. The table shows the unaudited current best estimate of the solvency ratio under the Solvency II Directive requirements as at 30 September 2017. Available capital as at 30 September 2017 includes total market profit generated in Q1–3 excluding dividend payments for 2017.

In view of the forecast EIOPA activities concerning the amendment to the standard formula, especially in relation to the adjustment for the loss-absorbing capacity of deferred taxes (LAC DT), and considering the identified diverse practices of insurance undertakings in its calculation, the Company will adjust its capital adequacy calculation methodology for the Company and the Group for the first time as at the reporting date. By preserving the existing methodology and taking into account the announced amendment to the standard formula, regulatory and subsequently business risks would dramatically increase, as shown by the results of the expert analyses performed in cooperation with external consultants. Thus, the Company will assess the amount of the adjustment for deferred taxes more conservatively, thereby increasing the capital requirement. As a result, the capital adequacy ratio will decrease.

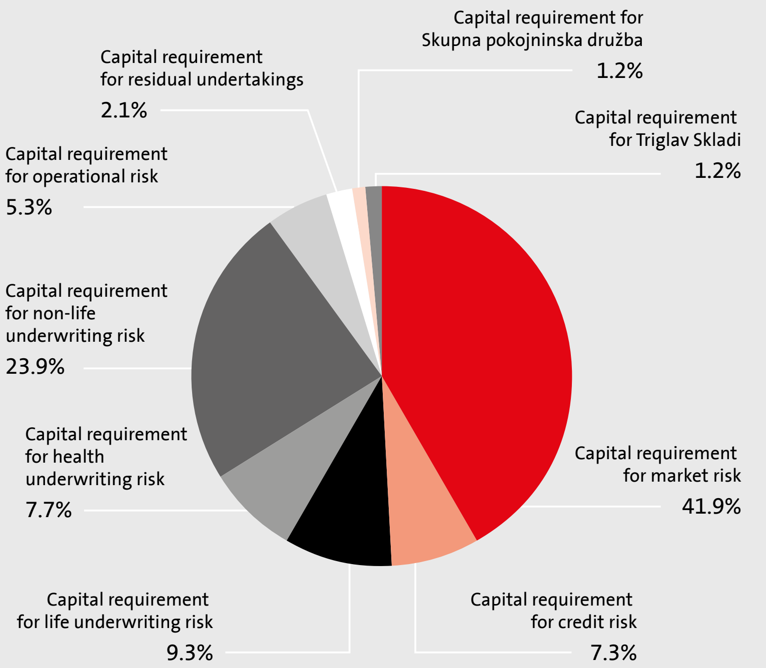
Even after the amendment, both the Company and the Group continue to have a strong capital base, with the objective of maintaining high solvency ratios. The detailed disclosures of individual capital adequacy items in 2017 will be made in the Solvency and Financial Condition Report of the Company and the Group.

2.2 Risk profile

The level of underwritten risks is measured by applying the prescribed regulatory standard formula, which is a suitable tool for measuring the risk profile also based on the results of own risk and solvency assessment.

The level of underwritten risks is in line with the defined risk appetite. The group is most exposed to market and underwriting risks, followed by credit and operational risks. Within the Group, Zavarovalnica Triglav assumes the bulk of the risks.

Capital requirements for the Triglav Group in 2017[106]



2.3 Underwriting risks

The Group assumes the underwriting risks in all insurance companies when performing transactions, which represent its insurance business. Underwriting risk management enables the Group to achieve and maintain the size and quality of the portfolio that provides for stable and safe operations while generating maximum returns.

The underwriting risk appetite defines the level of risk or the potential loss that the Group is willing to accept in the course of its operations without jeopardizing the attainment of its business and strategic objectives. The underwriting risks are managed through the relevant procedures and segregation of duties and powers.

Insurance operations are performed via four key processes, through which the assumed and potential underwriting risks are identified, measured, monitored and managed: product development, underwriting, underwriting risk transfer and claim settlement.

The risk appetite limits are considered already in **product development** by setting the underwriting criteria and the premium amount.

The primary responsibility for the active management of **underwriting risk** relating to underwriting lies with the functional areas that are involved in the core business activity. Clearly structured competences and powers include segregation of duties, underwriting limits and an authorisation system. Moreover, a range of actuarial techniques is used in underwriting risk management. The Company also conducts regular performance monitoring, verifies the adequacy of insurance technical provisions and optimises its reinsurance protection. The basic tool for managing underwriting risk is a quality risk assumption process that limits assumed risks to acceptable levels.

Reinsurance is one of the main underwriting risk management tools used in **risk transfer**. The annual planned reinsurance programme includes calculated own shares by individual insurance class and the maximum coverage table prepared on this basis, as well as procedures, bases and criteria for determining the maximum possible loss with regard to individual insurance perils. The choice of reinsurers depends, to a great extent, on their credit rating. By resolving and settling claims, the Group fulfils its obligations to the policyholders. The Group strives for rapid claim settlement and payment so as to provide financial security to the clients who experienced a loss event. At the same time, its aim is to ensure stable operations and control loss events, which includes determining the merits of claims and controlling the amount to be paid out. The Group set up procedures to process the claims and assess the damage in proportion to the amount, nature and complexity, which also includes the assessment of incurred but not yet reported claims. Every type of insurance has its own specific risks, which are duly managed. In the context of direct insurance operations, the Group is predominantly faced with traditional underwriting risks, which are divided into:

- **non-life insurance** underwriting risks (including health insurance) and
- **life insurance** underwriting risks.

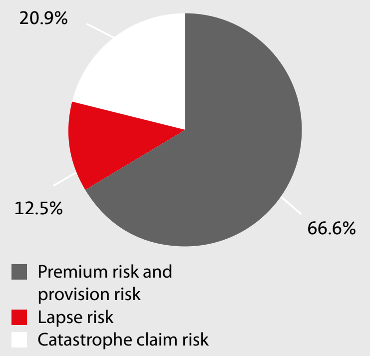
The Triglav Group mainly operates in Slovenia and the countries of the Adria region. The table below summarises the annual consolidated gross written premium in the countries where the insurance companies of the Group operate. The Group's main exposure is in Slovenia, as over 76.8% of the premium income is generated in the Slovene market (2016: 77.4%).

Consolidated gross written premium from insurance and co-insurance contracts of the Triglav Group by the abovementioned segments is presented in [→ *Section 7.5 Gross written premium from insurance and co-insurance contracts*] .

The Group also provides reinsurance and fronting services, ceding most of the business to foreign insurance companies. An adequate reinsurance cover is provided for thereto related risk concentrations.

[106] In accordance with the Solvency II methodology, capital requirements are calculated at an annual level. The information in this and the following figures is based on the current best estimate of capital requirements under the Solvency II requirements as at 31 December 2016, taking into account the change relating to the ring-fenced funds during the year, which had an impact on the solvency ratio.

Capital requirements for the Triglav Group by non-life underwriting risk type including health underwriting risks in 2017



2.3.1 Non-life insurance underwriting risks

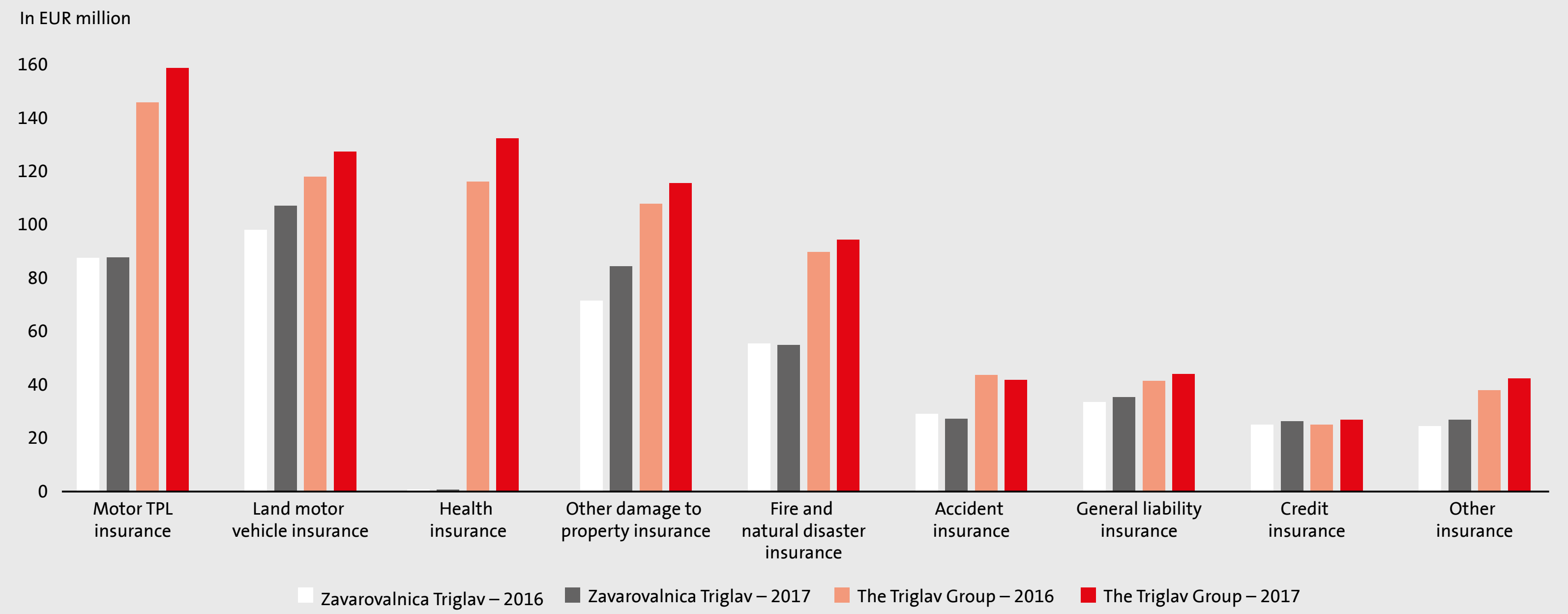
Non-life insurance underwriting risks include: premium risk, provision risk, non-life catastrophe risk, lapse risk and the risks related to the volume of new business, product development risks, underwriting process risks, expense risk, external macroeconomic environment risk and claim settlement risk. As Pozavarovalnica Triglav Re and Triglav, Zdravstvena zavarovalnica are also part of the Triglav Group, non-life insurance underwriting risks also include the risks related to the performance of active reinsurance operations and the risks associated with health insurance.

Non-life underwriting risks account for around a third of all non-diversified risks in the Group. The level of assumed risks in non-life insurance is in line with the defined risk appetite. The Group is most exposed to premium and provision risks, followed by catastrophe claim risk and lapse risk. Within the Group, Zavarovalnica Triglav assumes the bulk of the non-life underwriting risks.

Exposure to non-life underwriting risks is monitored based on the volume of written premium and by assessing the expected range of combined ratios in relation to the past realisation (see Sections 2, 3, 4 and 8 in the Business Report). In 2017, the combined ratio in non-life insurance at the Group level was 93.9% (2016: 92.9%), which reflects sound underwriting risk management. The combined ratios of the Group and Zavarovalnica Triglav for the last three years are presented in [→ *Section 8.1*] and [→ *Section 8.2*] respectively.

Premium risk is the risk that the written premium will be insufficient to meet future obligations arising from concluded insurance policies. It depends on the volume of the portfolio of individual insurance segments and on the range of various insurance segments. In the case of a large quantity of insurance similar in size, the relative deviation from the claims ratio decreases compared to the expected due to the law of large numbers. In the event of a broad range of various insurance covers, the whole portfolio becomes more diversified and less susceptible to externalities, such as price pressure on individual products.

Gross written premium from insurance and co-insurance contracts



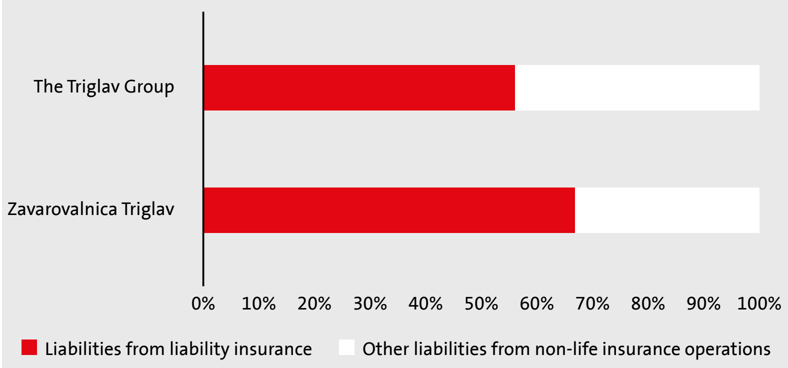
The Triglav Group pursues a balanced diversification of its non-life insurance portfolio in different insurance segments.

Premium rates for non-life insurance were high enough considering reasonable actuarial expectations regarding the movement of the amount of benefits or claims ratios and expenses or expense ratios and the rational behaviour of all market participants. More specifically, premium risk only includes the risks related to the usual claims. In terms of risk and event, the risk of major claims is treated as catastrophe risk, which is presented below.

Provision risk, including claims risk, is the risk that the actual claims arising from insurance will significantly deviate from the foreseen claims included in insurance technical provisions, or that the insurance technical provisions will be higher than they would be if all the relevant information were known in advance. Separately and in more detail, the risks of subrogation, non-life insurance annuity and appraisal costs can be defined. Provision risk is balanced by regularly monitoring the claims experience by individual insurance class, calculating the run-off analysis and promptly adjusting the insurance technical provisions to the new findings of the analyses performed. The described methodological appropriateness of provisions for individual insurance classes (see [→ *Section 2.6 of the Financial Report*]) is verified by regularly performing the liability adequacy test based on the balance as at the last day of the business year and by regularly calculating the best estimate of insurance technical provisions. Special attention in the creation of insurance technical provisions for non-life insurance is paid to incurred but not reported (IBNR) claims. The triangle method is used as the adequacy test of insurance technical provisions for loss events characterised by late claim reporting. The results showed that the level of formed insurance technical provisions was appropriate as at the 2017 year-end (see [→ *Sections 2.6.2 and 3.14 of the Financial Report*]).

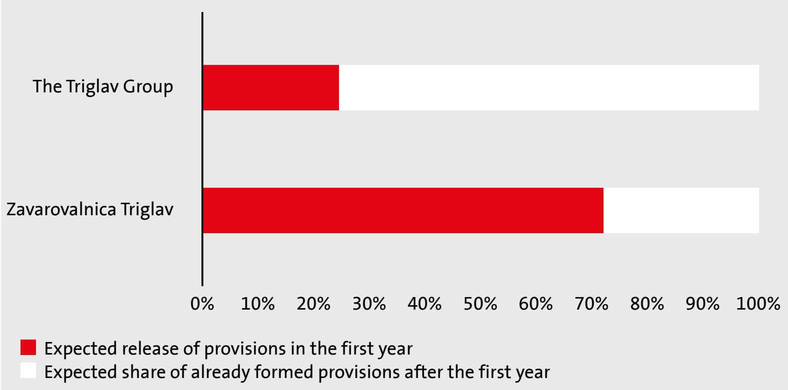
The provision risk can be influenced *inter alia* by the amount of the provisions set aside and the maturity of the liabilities. The latter represents the average duration of claim settlements for which provisions were made. With respect to liability insurance, more than half of the claims are settled after one year, while in other insurance segments more than half of the claims are paid within one year. As a general rule, provisions with long maturity are relatively riskier in the long term than short-term provisions, whereas in the period of one year they are less risky.

Ratio between liabilities from insurance with long maturity and short-term insurance in 2017



The share of long-term provisions of the Group is lower, primarily due to the significant impact of short-term insurance of Triglav, Zdravstvena zavarovalnica.

Expected release of provisions after one year



After one year, it is expected that almost a quarter of provisions for long-term liabilities and three quarters of provisions for short-term liabilities relating to non-life insurance will be released. Long-term provisions are released at a slower pace, which is why they are slightly more stable than short-term provisions in a one-year period. By setting aside provisions on a precautionary basis, this effect becomes even stronger.

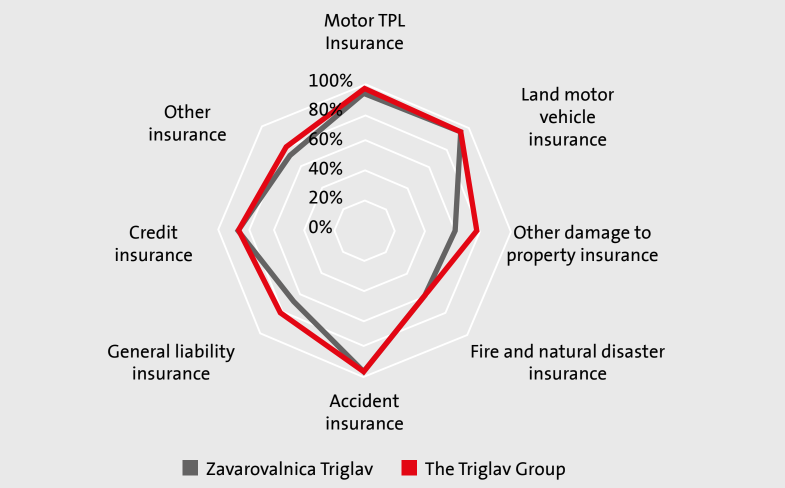
Supplemental voluntary health insurance, regulated by the Health Care and Health Insurance Act, accounts for the bulk of the operations of Triglav, Zdravstvena zavarovalnica. As a result, in addition to the previously mentioned non-life insurance underwriting risks, the Group is exposed to strategic risk, political risk and the risk of changes in legislation, which is related to significant changes in health legislation in Slovenia. With regard to regulating the reinsurance cover in the Triglav Group, Pozavarovalnica Triglav Re plays an important role as it assumes the underwriting risks based on reinsurance agreements concluded with individual subsidiaries of the Group. Pozavarovalnica Triglav Re concludes outward reinsurance agreements (retrocession agreements) for a portion of the risks it reinsures in order to better control its exposure and to protect its own assets, while indirectly protecting the assets of the Group's insurance subsidiaries.

Non-life underwriting risk concentration

Underwriting risk concentration is the consequence of the concentration of an insurance operation in a geographic area, sector or industry, or insurance peril. It may also occur as the result of correlation between individual insurance classes. Underwriting risk concentration is managed with adequate reinsurance schemes, which are based on the tables of maximum net retained lines. Even a single such event in a business segment may have a material impact on the Company's ability to settle its obligations.

The aim of underwriting risk concentration management is to establish appropriate procedures for minimising the probability of loss occurrence and limiting the loss arising from underwriting risk concentration.

Net written premium share in relation to gross written premium in 2017



Larger claim amounts can occur in the case of substantial individual damages, such as a fire in a large building, or a high number of minor damages caused simultaneously, e.g. in the event of an earthquake. Both categories of exposure are managed using the reinsurance cover. The fire and natural disaster insurance portfolio includes the largest number of individual major risks as well as cover for the risk of natural disasters. Reinsurance cover is therefore most needed in this segment. The fire and natural disaster insurance segment has the highest share of reinsurance premium in relation to gross written premium.

With a 25% market share, the Triglav Group is one of three providers of **supplemental health insurance**, and with a 44%[107] share one of the two reinsurance providers. This is why in both insurance peril segments the Group was exposed to supply concentration risk in the insurance and the reinsurance market in 2017. The concentration risk arising from the reinsurance portfolio is managed through the international geographical diversification of risk arising from transactions outside the Group and with adequate retrocession for transactions related to the Group.

Low-frequency and high severity risk

Insurance perils with a low frequency and a high severity risk are managed by the reinsurance cover. The reinsurance scheme includes different types of reinsurance covers by insurance segment, depending on the nature of insurance perils.

The Triglav Group's largest retention amounts to EUR 10 million per insurance peril, with the exception of nuclear perils, and EUR 7.5 million per natural disaster. With regard to nuclear perils with an even lower frequency, the retention of the Group amounts to EUR 13.8 million.

Particular attention is paid to natural disasters such as earthquakes, storms, hail and floods. The results of various models are taken into consideration when assessing the damage potential of catastrophe events and then used to determine the reinsurance cover.

In this segment, the threat of an earthquake in Ljubljana represents the biggest potential risk for the Group. It is covered with quota share reinsurance, while retention is additionally protected with excess-of-loss reinsurance in the event of a catastrophe. The reinsurance cover for retention in the event of a catastrophe is designed as excess of loss reinsurance with four layers and has been activated twice since 2010. The protection against a possible increased occurrence of natural disasters in a particular year is also arranged for the Group. Past events have shown that the reinsurance scheme is suitable.

[107] The data as at 30 September 2017 was used as the basis.

The earthquake damage model with return periods for 2017

	2017	
Return period in years	**Share of total exposure in %**	**Gross claims in EUR**
100	0.33	69,916,976
250	0.71	149,200,016
500	1.35	283,629,366
1000	2.85	598,068,914

* The table is prepared based on the data of Zavarovalnica Triglav. Exposures at the Group level do not deviate significantly.

Another potentially catastrophic loss occurrence could arise from the nuclear peril, which Zavarovalnica Triglav has assumed from the Slovenian Nuclear Pool. Such a loss occurrence is characterised by an extremely low frequency, as no major loss event has been reported in 25 years, and by a low or null correlation with other potential liabilities that would arise in relation to such an event. There were no such significant low frequency and high severity events in 2017.

Assumed capacity of nuclear risk for 2016 and 2017

	Assumed capacity in EUR	
	2017	**2016**
Zavarovalnica Triglav d.d.	10,000,000	7,500,000
Pozavarovalnica Triglav Re d.d.	2.520.000	2.520.000
Triglav Osiguranje d.d., Zagreb	850,000	650,000
TOTAL AFTER THE EVENT	**13,370,000**	**10,670,000**

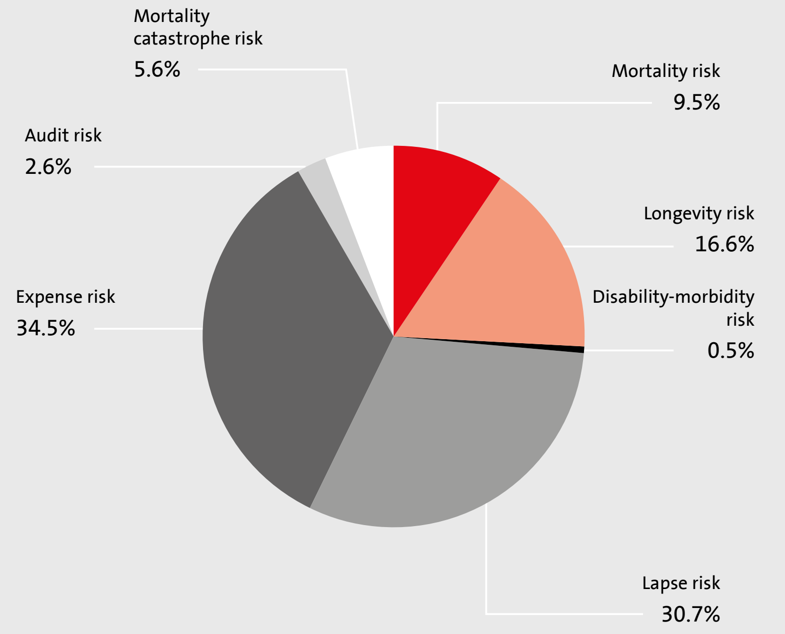
Individual policies of large companies represent great insurance perils. The largest probable gross claim for individual perils amounts to EUR 1.4 billion, while the largest net claim is limited with retention.

2.3.2 Life insurance underwriting risks

The life insurance portfolio includes traditional, unit-linked and pension insurance policies. Supplementary insurance (also known as riders) can be added to unit-linked and traditional insurance policies. **Life insurance underwriting** risks are all underwriting risks arising from life insurance underwriting processes and from maintaining the life insurance portfolio. The Group underwrites mortality risk, longevity risk, morbidity risk and total permanent disability risk. As supplementary insurance cover, the Group underwrites disability risk, accidental death risk, critical illness or injury risk, medical expense risk, daily benefit risk, second medical opinion etc.

Life underwriting risks account for around 10% of total non-diversified risks in the Group. The level of assumed risks is in line with the defined risk appetite. Zavarovalnica Triglav is most exposed to life expense risk and the lapse risk. Within the Group, Zavarovalnica Triglav assumes the bulk of the life underwriting risks.

Capital requirements for the Triglav Group by life underwriting risk type in 2017



Life insurance policies are also associated with the **lapse risk** (requested by the policyholder), i.e. the difference between the future realised and expected surrenders, capitalisation and any other changes to policies. The types of impacts on this risk are similar to those on mortality risk. The lapse risk may arise from changes in the general economic environment, which affect policyholders' behaviour, and in any other sources leading to an incorrect estimate.

Life expense risk is the risk that the future actual life insurance expenses will differ from the expected. In the insurance industry, expense risk is no longer considered an operational risk but a separate risk category within the underwriting risks. This risk is reflected in inadequately calculated premium, insufficient insurance technical provisions and the difference between the actual and expected result. Expense risk may be a consequence of miscalculations and incorrect allocation of actual expenses (the inadequacy of the cost model) and incorrectly estimated level, trend or volatility of expenses.

Mortality risk is the risk that the actual future mortality rate will be different than expected, which affects the adequacy of:

- the amount of calculated premium,
- the level of insurance technical provisions,
- the amount and type of risk transfer (reinsurance, co-insurance) and
- the difference between the actual and the expected result of the Company.

Mortality risk can arise from:

- inappropriate risk assessment in the underwriting process (mainly arising from information asymmetry between the policyholder and the Company);
- incorrectly estimated level, trend or volatility of future mortality rates for a particular homogeneous risk group (e.g. the lack of empirical data);
- catastrophic events that affect mortality (e.g. a pandemic), as well as other sources leading to an incorrect estimate.

Moreover, mortality risk includes **longevity risk**, which is closely monitored primarily in annuity and pension insurance.

As in the case of mortality risk, similar also applies to the other abovementioned underwriting risks covered by life insurance policies.

Adequate risk pooling, which is the basic principle on which the insurance industry functions, is achieved through sufficiently large homogeneous risk groups, which constitute the entire portfolio of the above risks. An important prerequisite for adequate pooling is efficient and correct classification of risks in underwriting, based on which a specific risk is assessed and classified into an appropriate group. Also considered in underwriting are the new findings, know-how and procedures of reinsurers who accept a portion of our risks.

Premium risk and the risk of insufficient insurance technical provisions are managed in the context of the actuarial cycle, where deviations of the realised effects compared to the estimated are periodically checked. In the event any deviations outside the set limits are detected, appropriate action is taken, e.g. adapting the design or parameters of an insurance product, appropriately adjusting the parameters for the calculation of insurance technical provisions, etc.

The adequacy of provisions is regularly tested using the liability adequacy test (LAT) and calculating the "realistic provisions" based on the present value of the best estimate of future expected contractual and other cash flows. The test is performed at least once a year based on the balance as at the last day of the business year (see [→ *Section 2.6 of the Financial Report*]). The test results for 2017 show that an adequate level of insurance technical provisions for life insurance was formed at the level of both the Group and individual subsidiaries, with the exception of an identified shortfall in the cover fund backing pension payouts from accumulated supplementary voluntary pension insurance (SVPI), for which additional other insurance technical provisions were created.

A part of life insurance risk management is the transfer of a corresponding portion of risks to reinsurers under the adopted reinsurance programme, which is also part of regular checks in the context of the actuarial cycle.

Traditional life insurance policies with a savings component and a guaranteed interest rate are exposed to asset-liability mismatch risk, where the assets are insufficient to cover the mentioned liabilities. Similar risks due to a special guarantee for the return arise from the SVPI policies during the saving period. These risks are described in detail among market risks in [→ *Section 2.4.*].

Contractual financial options and guarantees are embedded in a number of policies, therefore the risks related thereto are assessed in the context of regular portfolio valuation. Among them is the guaranteed interest rate risk, which occurs in the products with a savings component. The guaranteed interest rate is set at the time of concluding an insurance policy and remains valid for the entire policy term. The risk arises when the realised rates of investment return, which cover the benefits under such policies, are lower than the guaranteed interest rate. This risk is reduced by achieving the maximum possible matching of assets and liabilities arising from these policies. A secondary measure is to create additional provisions, especially in relation to the liabilities in the older portion of the portfolio.

This risk group also includes the guaranteed annuity conversion rate risk, which arises from the annuity rates set at the time of concluding certain older pension insurance policies, i.e. in the savings phase. The policyholder will be entitled to them at the end of the savings period and the transition to the payout period when they will receive life annuity, which will then be calculated based on the accumulated assets and by applying the aforementioned fixed rates. This guarantee exposes the Company also to longevity risk (in addition to the abovementioned interest rate risk). This risk is not transferred to reinsurers, instead additional provisions are formed if necessary.

The most important type of a contractual financial option is the possibility to lapse the payment of premium and transform the policy into a paid-up policy or to surrender the policy. The fulfilment of this risk depends on the policyholders' actions, and therefore it is more difficult to manage. The Company reduces this risk by designing the products that meet the clients' needs and by carefully managing the existing portfolio.

2.3.3 Concentration of life insurance underwriting risks

The concentration of **life insurance** underwriting risks is assessed as low, because the life insurance risk portfolio is well diversified by all relevant criteria and due to the fact that most policies originate from geographically dispersed retail sale. Any risk concentration in the portfolio is reduced by transferring a portion of the risks to reinsurers based on the reinsurance programme. The risk sum insured in the event of death is less than EUR 60,000 for 82.4% of the whole life insurance portfolio and less than EUR 35,000 for 99.9% for the other life insurance portfolio. For additional accidental death insurance, the sum insured is lower than EUR 50,000 and accounts for 98.3% of the respective portfolio, while for additional disability insurance the sum insured is less than EUR 100,000 for 98.2% of the respective portfolio. Both sums insured represent the stipulated retention in line with the reinsurance contract for most insurance policies.

2.4 Market risks

Asset management is a significant part of operations of the Group. In this way, insurance liabilities and capital requirements are covered while ensuring an appropriate return. The Group is exposed to market risks which are mostly related to exposure to different asset classes.

For the purpose of market risk management, methods and processes with clearly defined powers and responsibilities were established so as to promptly identify, measure, monitor and manage market risks. The market risk management system enables quality analyses and reporting on market risks, as well as preparing, proposing and implementing measures aimed at preventing the reduction of surplus of assets over liabilities due to changes in financial markets, including the real property market.

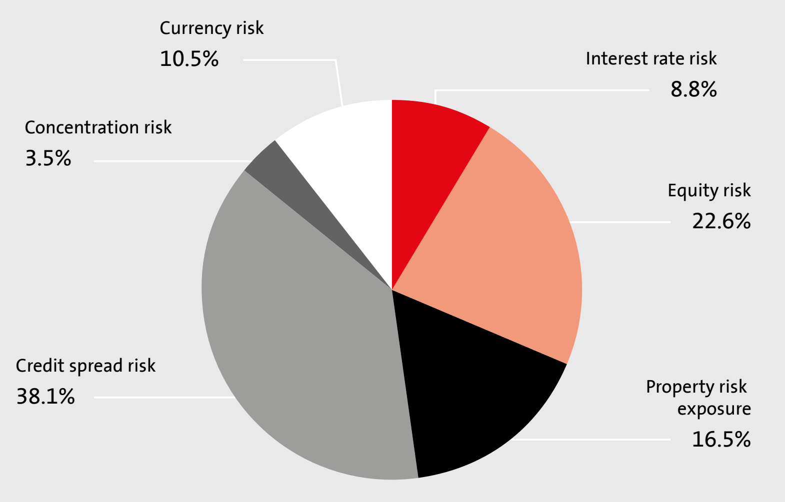
For its market risk appetite, the Group defined the level of unexpected losses, which is still acceptable in relation to its strategic objectives and capital strength. On this basis, the limit system specifies the desired investment portfolio structure and maximum acceptable exposure to counterparties.

Apart from an appropriately diversified investment portfolio, the Group uses derivatives as a risk reduction technique.

The Group is exposed to the following market risk types:
- interest rate risk,
- equity risk,
- property risk,
- credit spread risk,
- currency risk,
- market concentration risk.

Market risks consists of slightly more than 40% of non-diversified risks of the Group. Based on the investment structure (see [→ *Section 7.9 of the Business Report*]), the Group is most exposed to debt securities, followed by equity securities and investment property. The highest exposure of the Group, measured as the non-diversified capital requirement arising from market risk, is credit spread risk, followed by equity risk and property risk. Currency risk, interest rate risk and market concentration risk represent a lower exposure.

Capital requirements for the Triglav Group by market risk type in 2017



2.4.1 Credit spread risk

The value of debt securities, which account for over 71% of the Group's investments, also depends on the level and volatility of credit spreads. Half of these investments is associated with exposure to countries, followed by exposure to the financial sector, accounting for more than a fifth of investments in debt securities.

Credit risk exposure resulting from debt securities is limited by the investment policy aimed at investing in high-quality securities. In its investment portfolio, the Group is exposed to counterparties with high credit quality. Over 43% of investments in debt securities have at least an A credit rating. An overwhelming majority (nearly 80%) of debt securities in the investment portfolio of the Group are investments with an investment grade credit rating of at least BBB.

The structure of debt securities is presented in detail in the Business Report, in [→ *Section 7.9*]. The investment structure in terms of credit rating is shown in greater detail in [→ *Section 2.5 Credit risk*].

2.4.2 Equity risk

Equity securities account for over 19% of the Group's investment portfolio.

The Group manages the equity risk of the securities in its portfolio through exposure limits as well as through geographical and sectoral diversification. In addition, due to different degrees of development of capital markets and local statutory limitations in the strategic markets of the Triglav Group, investment policies adapted to individual markets are pursued.

The major share of equity investments is globally diversified, followed by shares issued by issuers based in the European Union.

	Triglav Group		Zavarovalnica Triglav	
	31 Dec. 2017	31 Dec. 2016	31 Dec. 2017	31 Dec. 2016
Equities in the EU	198,466,682	323,249,208	116,161,531	231,384,899
Equities in the USA	10,800,877	3,755,561	2,985,278	453,264
Equities in Asia**	6,020,532	67,979	5,845,250	67,979
Equities in emerging markets	23,948,525	61,213,205	14,588,535	56,192,389
Global equities*	381,880,388	233,794,996	355,080,954	196,560,088
TOTAL	**621,117,004**	**622,080,949**	**494,661,549**	**484,658,619**

* Equity investments in developed Asian countries (Japan, Hong Kong).
** Globally diversified equity investments

The sensitivity analysis of the change in prices of other equity securities and its impact on comprehensive income or profit or loss of the Group showed that a 10% increase in the market price of equities in the portfolio would have a positive impact on both the equity and profit of the Group in the amount of EUR 17 million and EUR 45.1 million, respectively. In contrast, a 10% drop in market prices of other equity securities would reduce the equity and profit of the Group by EUR 15 million and EUR 47.2 million, respectively. The assessment of the impact on profit or loss presented in the table below would be lower if the impact of changes in liabilities were taken into account in the analysis.

	Triglav Group				Zavarovalnica Triglav			
	31 Dec. 2017		31 Dec. 2016		31 Dec. 2017		31 Dec. 2016	
	10%	-10%	10%	-10%	10%	-10%	10%	-10%
Equities in the EU	19,846,668	-19,846,668	32,324,921	-32,324,921	11,616,153	-11,616,153	23,138,490	-23,138,490
Equities in the USA	1,080,088	-1,080,088	375,556	-375,556	298,528	-298,528	45,326	-45,326
Equities in Asia**	602,053	-60,053	6,798	-6,798	584,525	-584,525	6,798	-6,798
Equities in emerging markets	2,394,853	-2,394,853	6,121,321	-6,121,321	1,458,853	-1,458,853	5,619,239	-5,619,239
Global equities*	38,188,039	-38,188,039	23,379,500	-23,379,500	35,508,095	-35,508,095	19,656,009	-19,656,009
Total	**62,111,700**	**-62,111,700**	**62,208,095**	**-62,208,095**	**49,466,155**	**-49,466,155**	**48,465,862**	**-48,465,862**
Impact on equity	16,999,209	-14,956,900	18,641,767	-18,641,767	12,350,262	-10,307,953	12,720,918	-12,720,918
Impact on profit or loss***	45,112,492	-47,154,801	43,565,754	-43,565,754	37,115,893	-39,158,202	35,744,943	-35,744,943

* Equity investments in developed Asian countries (Japan, Hong Kong).
** Globally diversified equity investments
*** Presented are the impacts of changes in assets that do not include the impacts of liabilities, which occur in the event of changes in the price of equity securities, and that are classified as "available for sale" due to revaluation adjustment.

2.4.3 Property risk

The property risk of the Group arises from the real properties for own use and investment properties owned by the Group. Total exposure amounts to EUR 192.3 million. In the financial investment portfolio, investment properties account for almost a half of the real property portfolio. Real property of the Group is primarily located in Slovenia.

	Triglav Group		Zavarovalnica Triglav	
	31 Dec. 2017	31 Dec. 2016	31 Dec. 2017	31 Dec. 2016
Investment property	94,007,483	95,842,720	48,214,401	49,611,417
Real property for own use*	98,302,376	96,746,971	60,295,362	60,167,549
Total	**192,309,859**	**192,589,691**	**108,509,763**	**109,778,966**

* Investment property is disclosed at cost in the financial statements. The fair value of investment property is shown in the Financial Report in Section 3.2., where the deducted other land and buildings for the direct performance of the insurance activity are included in "property, plant and equipment". Fair value is determined using the valuation techniques. Valuation of real property based on the existing methodology is performed by an authorised valuer.

2.4.4 Currency risk

The Group is exposed to currency risk to a lesser extent, as the currency structure of assets almost fully matches the currency structure of liabilities.

In 2017, the system for measuring and monitoring currency risk exposure at the Group level was upgraded. Open positions are limited and monitored both in absolute amounts and through value-at-risk (VaR) calculations, supplemented by tail value-at-risk (tVar) calculations and stress test analyses.

2.4.5 Interest rate risk

The Group is exposed to interest rate risk in the event of mismatch of asset and liability cash flows. In the financial statements, the interest rate sensitivity of assets is presented, whereas in the Solvency and Financial Condition Report the interest rate sensitivity of assets and liabilities in terms of economic impacts is described in greater detail.

In accounting terms, the Group is exposed to interest rate risk on the assets side, specifically debt securities classified as "measured at fair value through profit or loss" and "available-for-sale financial assets" categories and derivatives. The change in the market interest rate has an impact on the level of insurance technical provisions only in relation to the impact of revaluation adjustment of debt securities classified as "available-for-sale".

The share of debt securities in the total portfolio is shown in [→ *Section 3.6 of the Financial Report*]. The carrying amounts of debt securities as the most important interest rate-sensitive financial investments by sectoral breakdown for the Triglav Group and Zavarovalnica Triglav are presented in [→ *Section 7.9 of the Business Report*].

	Triglav Group				Zavarovalnica Triglav			
	31 Dec. 2017		31 Dec. 2016		31 Dec. 2017		31 Dec. 2016	
	+100 bp	–100 bp	+100 bp	–100 bp	+100 bp	–100 bp	+100 bp	–100 bp
Debt securities issued by countries	-37,481,679	39,914,410	-39,339,300	42,114,784	-25,229,170	27,030,116	-28,919,156	31,116,692
Debt securities issued by financial institutions	-18,096,971	19,284,015	-19,103,053	20,507,883	-15,950,721	17,027,274	-16,813,023	18,086,978
Debt securities issued by companies	-24,941,285	26,527,927	-23,058,962	24,443,159	-20,878,156	22,378,895	-19,091,774	20.394.715
Compound securities	-1,404,774	1,479,613	-588,162	1,064,514	-1,404,774	1,479,613	-584,398	1,060,675
Other	9,632,028	-10,643,994	9,707,396	-10,726,699	9,632,028	-10,643,994	9,707,396	-10,726,699
Total	**-72,292,681**	**76,561,971**	**-72,382,081**	**77,403,641**	**-53,830,793**	**57,271,905**	**-55,700,955**	**59,932,361**
Impact on comprehensive income	-65,660,303	70,376,918	-69,840,458	74,996,286	-54,651,033	58,555,833	-57,895,272	62,261,040
Impact on profit or loss*	-6,144,822	5,681,233	-2,541,623	2,407,355	820,240	-1,283,928	2,194,317	-2,328,679

* Presented are the impacts of changes in assets that do not include the impacts of liabilities, which result from an increase in the price of debt securities, and that are classified as "available for sale" due to revaluation adjustment.

The asset sensitivity analysis of the change in interest rate and its impact on comprehensive income or profit or loss of the Group showed that a decrease of 100 basis points would have a positive impact on both the equity and profit of the Group in the amount of EUR 70.4 million and EUR 5.7 million, respectively. In contrast, if the interest rate were 100 basis points higher, the equity and profit of the Group would be lower by EUR 65.7 million and EUR 6.1 million, respectively. The positive and negative changes in interest rates have the strongest impact on the securities issued by countries, accounting for the bulk of the Group's and the Company's investment portfolio.

The actual net impact of changes is lower due to changes in liabilities which are not included in the analysis.

2.5 Credit risk

The Triglav Group assumes credit risk in the following cases:

- management of investments at which the risk of downgrade or insolvency of issuers of securities and counterparties exists; furthermore, the Group monitors any exposure to debtor, country or sector that is large enough to pose a threat to the solvency or financial position of the Group;
- conclusion of agreements with reinsurers as there is the risk of inability to pay out claims in the case of deteriorated credit position of a reinsurer or in the case of a loss event;
- insurance transactions with clients who are in different financial positions at the time of existence of the obligation to pay the premium.

The investment portfolio credit risk is managed by performing an expert analysis of counterparties' credit quality and through a sufficient degree of portfolio diversification. The credit ratings of external institutions are regularly monitored and the exposure to non-rated counterparties is limited.

The maximum permissible exposure to individual counterparties or a group of related parties as well as limits to similar groups of counterparties are set.

The credit quality of the Group's investment portfolio is high, as almost 80% of financial investments are accounted for by investments in investment grade securities. One tenth of all investments has the highest rating of AAA.

The share of exposures to investments by issuer credit rating

	31 Dec. 2107	31 Dec. 2106
AAA	10.0%	9.9%
AA to BBB	68.1%	67.6%
Below BBB	17.2%	18.4%
NR	4.6%	4.1%

* Presented are only own exposures excluding investments on behalf and for the account of policyholders.

The credit risk of securities issuer default is managed in the context of the market risk management system, specifically in the context of credit spread risk management. See [→ *Section 2.4.1.*] for more details.

In the framework of managing credit risk arising from reinsurance transactions, prudential consideration of the eligibility of business partners for reinsurance (in terms of credit quality and diversification) and regular monitoring of their eligibility are of key importance. Exposure to reinsurers is measured by the reinsurers' share of insurance technical provisions.

The Group is exposed to reinsurers with a high credit quality, as over 91% of exposures have the credit rating equal to or higher than A–.

The share of exposures arising from reinsurance transactions

	31 Dec. 2107	31 Dec. 2106
AA+ to A–	91.9%	90.9%
Below A–	3.5%	1.0%
NR	4.6%	8.1%

* Presented are the data based on the Group's exposures ceded via Zavarovalnica Triglav and Pozavarovalnica Triglav Re.

Receivables of the Group from insurance transactions with clients are presented in [→ *Section 3.8 of the Accounting Report*].

2.6 Liquidity risk

Liquidity is an important element of the risk appetite. The Group pursues the goal of being able to meet, at any given moment, all of its matured liabilities. For this purpose, the Group maintains a surplus of liquid assets, allowing it to settle its obligations in stress situations.

The liquidity management framework provides a comprehensive overview of liquidity. It takes into account the sources of liquidity (cash flows from investments and premiums) and liquidity needs (e.g. payments of claims) and allows for the analysis of potential impacts of exceptional circumstances on both the sources of liquidity and liabilities.

The Group ensures that individual subsidiaries maintain an appropriate structure of assets in terms of their nature, duration and liquidity. An adequate liquidity position is ensured by planning actual and potential net cash outflows, having an appropriate level and structure of liquid investments, and monitoring the structure of liabilities and financial assets. The liquidity position is regularly monitored at various time intervals, under assumed normal and stress situations and by establishing a limit system that adequately limits exposure to liquidity risk.

The guidelines set the liquidity management framework at the Group level. Every subsidiary ensures compliance with both general liquidity requirements and the liquidity requirements set by local regulators.

The Group has sufficient liquidity thanks to regular inflows from premium payments. In order to achieve sufficient liquidity in stress situations, additional safety mechanisms were set up and actions to be taken were planned (credit lines, repurchase agreements, etc.).

Financial assets and liabilities of the Triglav Group[108] by remaining maturity

in EUR

Triglav Group as at 31 Dec. 2017	NOT DEFINED	UNDER 1 YEAR	FROM 1 TO 5 YEARS	FROM 5 TO 10 YEARS	OVER 10 YEARS	TOTAL
FINANCIAL ASSETS						
Financial investments	**640,017,238**	**193,345,537**	**1,175,999,872**	**877,126,274**	**151,597,820**	**3,038,086,741**
Debt securities	245,149	153,037,652	1,124,588,368	875,995,337	149,980,697	2,303,847,203
Held to maturity	0	28,777,936	69,657,035	82,736,846	40,218,760	221,390,577
At fair value through profit and loss	0	31,300,673	220,735,576	145,128,286	19,313,217	416,477,752
Available for sale	5,905	85,793,484	829,224,555	648,130,205	82,417,932	1,645,572,081
Loans and receivables	239,244	7,165,559	4,971,202	0	8,030,788	20,406,793
Equity securities	620,468,540	0	603,050	45,414	0	621,117,004
At fair value through profit and loss	452,706,246	0	0	0	0	452,706,246
Available for sale	167,762,294	0	603,050	45,414	0	168,410,758
Derivatives	26,261	0	2,574,396	0	0	2,600,657
Loans and receivables	19,277,288	40,307,885	48,234,058	1,085,523	1,617,123	110,521,877
Reinsurers' share of insurance technical provisions	3,374,690	41,153,547	18,219,465	14,189,134	6,878,740	83,815,576
Operating receivables	14,766,819	143,858,996	5,050,674	201,865	0	163,878,354
Cash and cash equivalents	55,934,307	22,483,540	0	0	0	78,417,847
Total	**714,093,054**	**400,841,620**	**1,199,270,011**	**891,517,273**	**158,476,560**	**3,364,198,518**
FINANCIAL LIABILITIES						
Insurance technical provisions	421,041,341	704,107,796	478,300,110	495,127,657	633,668,687	2,732,245,591
Other financial liabilities	1	5,081,769	489,881	17,724	13	5,589,388
Total	**421,041,342**	**709,189,565**	**478,789,991**	**495,145,381**	**633,668,700**	**2,737,834,979**

in EUR

Triglav Group as at 31 Dec. 2016	NOT DEFINED	UNDER 1 YEAR	FROM 1 TO 5 YEARS	FROM 5 TO 10 YEARS	OVER 10 YEARS	TOTAL
FINANCIAL ASSETS						
Financial investments	624,766,323	198,012,598	1,057,744,705	884,978,459	208,801,192	2,974,303,277
Debt securities	0	156,763,206	1,017,990,862	855,806,745	197,763,104	2,228,323,917
Held to maturity	0	8,937,340	85,739,157	67,182,497	69,483,398	231,342,392
At fair value through profit and loss	0	56,828,734	220,072,642	82,141,293	59,476,355	418,519,024
Available for sale	0	78,846,301	698,207,492	693,661,323	68,803,351	1,539,518,467
Loans and receivables	0	12,150,831	13,971,571	12,821,632	0	38,944,034
Equity securities	612,660,255	0	0	0	9,420,694	622,080,949
At fair value through profit and loss	425,034,903	0	0	0	0	425,034,903
Available for sale	187,625,352	0	0	0	9,420,694	197,046,046
Derivatives	19,042	1,357,920	1,885,594	0	0	3,262,556
Loans and receivables	12,087,026	39,891,472	37,868,249	29,171,714	1,617,394	120,635,855
Reinsurers' share of insurance technical provisions	4,225,777	37,347,708	19,225,435	9,797,756	6,488,107	77,084,783
Operating receivables	19,399,170	124,447,771	8,828,513	254,636	0	152,930,090
Cash and cash equivalents	52,146,238	13,568,236	0	0	0	65,714,474
Total	700,537,508	373,376,313	1,085,798,653	895,030,851	215,289,299	3,270,032,624
FINANCIAL LIABILITIES						
Insurance technical provisions	436,463,310	679,305,837	422,723,632	457,603,329	664,692,207	2,660,788,315
Other financial liabilities	17,728	4,392,437	742,323	99,629	36,576	5,288,693
Total	436,481,038	683,698,274	423,465,955	457,702,958	664,728,783	2,666,077,008

Total financial assets exceed total financial liabilities of the Triglav Group. As at the 2017 year-end, the Group had a significantly higher surplus of financial assets over financial liabilities in the maturity buckets of 1–5 years and 5–10 years, whereas in other buckets the value of assets was below the value of liabilities. Considering the fact that the table above shows the contractual maturity of assets and liabilities and that the vast majority of the Group's assets is invested in highly liquid investments, the deficits in individual maturity buckets do not represent a liquidity risk. Liquidity of the Group is appropriate.

[108] The mismatch of cash flows in the table above results from the properties of insurance liabilities and the investment policy of the Group as well as the availability of investments of appropriate maturity with respect to the structure of liabilities. Liquidity is ensured not only with short-term investments with the maturity of less than 1 year but also with other highly liquid assets in other maturity buckets (e.g. government bonds of EEA countries and the OECD, shares in ETF funds, etc.).

Financial assets and liabilities of Zavarovalnica Triglav by remaining contractual maturity

in EUR

Zavarovalnica Triglav as at 31 Dec. 2017	NOT DEFINED	UNDER 1 YEAR	FROM 1 TO 5 YEARS	FROM 5 TO 10 YEARS	OVER 10 YEARS	TOTAL
FINANCIAL ASSETS						
Financial investments	**512.846.045**	**96.459.883**	**829.242.356**	**706.393.895**	**133.663.936**	**2.278.606.114**
Debt securities	0	85,957,365	768,371,011	706,391,533	132,065,082	1,692,784,992
Held to maturity	0	11,846,503	40,599,376	74,329,168	40,218,760	166,993,807
At fair value through profit and loss	0	18,557,321	127,522,154	76,255,405	19,313,217	241,648,097
Available for sale	0	54,550,557	600,249,481	555,806,961	66,543,370	1,277,150,369
Loans and receivables	0	1,002,984	0	0	5,989,735	6,992,719
Equity securities	494,661,549	0	0	0	0	494,661,549
At fair value through profit and loss	371,158,929	0	0	0	0	371,158,929
Available for sale	123,502,619	0	0	0	0	123,502,619
Derivatives	0	0	2,574,396	0	0	2,574,396
Loans and receivables	18,184,496	10,502,518	58,296,949	2,361	1,598,854	88,585,178
Reinsurers' share of insurance technical provisions	0	47,372,263	26,631,283	8,184,860	3,139,239	85,327,645
Operating receivables	0	87,209,951	0	0	0	87,209,951
Cash and cash equivalents	35,514,745	0	0	0	0	35,514,745
Total	**548,360,790**	**231,042,097**	**855,873,639**	**714,578,755**	**136,803,175**	**2,486,658,455**
FINANCIAL LIABILITIES						
Insurance technical provisions	416,250,767	427,082,723	397,431,494	415,987,854	446,607,195	2,103,360,033
Other financial liabilities	0	1,845,188	0	0	0	1,845,188
Total	**416,250,767**	**428,927,911**	**397,431,494**	**415,987,854**	**446,607,195**	**2,105,205,221**

in EUR

Zavarovalnica Triglav as at 31 Dec. 2016	NOT DEFINED	UNDER 1 YEAR	FROM 1 TO 5 YEARS	FROM 5 TO 10 YEARS	OVER 10 YEARS	TOTAL
FINANCIAL ASSETS						
Financial investments	495,577,425	104,330,576	705,720,150	728,874,355	192,709,427	2,227,211,932
Debt securities	0	94,844,225	679,033,654	700,604,727	191,110,302	1,665,592,909
Held to maturity	0	0	42,068,581	57,431,727	69,483,398	168,983,706
At fair value through profit and loss	0	43,539,499	118,937,211	47,111,463	59,476,355	269,064,528
Available for sale	0	51,304,726	518,027,863	596,061,537	62,150,550	1,227,544,675
Loans and receivables	0	0	0	0	0	0
Equity securities	484,658,619	0	0	0	0	484,658,619
At fair value through profit and loss	348,635,283	0	0	0	0	348,635,283
Available for sale	136,023,336	0	0	0	0	136,023,336
Derivatives	0	1,357,920	1,885,594	0	0	3,243,514
Loans and receivables	10,918,806	8,128,430	24,800,902	28,269,628	1,599,125	73,716,890
Reinsurers' share of insurance technical provisions	0	2,834,169	3,835,906	1,686,119	2,485,463	10,841,657
Operating receivables	42,228	69,408,794	2,549,299	31,959	0	72,032,280
Cash and cash equivalents	27,653,646	0	0	0	0	27,653,646
Total	523,273,299	176,573,538	712,105,355	730,592,433	195,194,890	2,337,739,515
FINANCIAL LIABILITIES						
Insurance technical provisions	431,125,308	419,247,953	350,633,462	388,091,281	487,262,659	2,076,360,662
Other financial liabilities	0	1,288,665	427,844	99,630	36,576	1,852,714
Total	431,125,308	420,536,617	351,061,306	388,190,911	487,299,234	2,078,213,376

2.7 Operational risk

The aim of effective operational risk management is mainly to effectively eliminate the consequences of realised operational loss events, mitigate and prevent future losses and thereto related additional costs, and to conduct business in a professional, diligent and ethical manner. To achieve this goal, processes with clearly defined competences and responsibilities and own methodology of operational risk management were established. In the Company's own methodology, all seven main operational risk groups are taken into account (internal fraud or unauthorised activity of employees; external fraud or unauthorised activity of third parties; system failure and the related business disruption; damage to physical assets; inadequate management of human resources and the safety of the work environment; non-compliance with the applicable regulations, improper business or market practice as well as clients and products; inadequate implementation and management of processes and the control environment, including suppliers and business partners).

The methodology is based on three key sets:
- identification and assessment of potential operational risks;
- the database of realised operational loss events;
- key operational risk indicators, which include early warning signals.

The established system enables the Company quality and prompt operational risk identification, measurement, assessment, monitoring and management. The system is upgraded on a regular basis. It is incorporated into subsidiaries in accordance with the principles of proportionality and materiality.

The Company established the processes register and internal control register, where the responsible persons (owners and managers) are appointed for each process and control. They are both regularly updated, taking into account any changes in the Company and the business environment. Apart from that, a data quality management (DQM) process was established, a part of which is a list of the data and key controls from the input to the end-use.

In operational risk management, the primary focus is on the critical business processes or segments of operational risk. In 2017, a comprehensive operational risk identification and assessment was performed, which also included the identification of internal controls as one of the key methods of operational risk management. The internal control system mainly focuses on:
- effectiveness and reliability of business process implementation;
- ensuring compliance of the Company's operations with the internal documents and legal regulations;
- accuracy and reliability of financial and accounting reporting;
- protection of property.

In 2017, the Company upgraded its reporting system for realised operational loss events with the reporting application, which allows the employees to report these events also anonymously. Operational loss events are collected in one place which, in addition to monitoring key operational risk indicators and their comparison with the operational risk appetite, enables the Company to take action fast and effectively should the risk appetite be exceeded (the level of risks or potential losses which the Company is ready to accept).

In the reporting year, the Group identified regulatory risk and external fraud risk, especially cyber risk, as the key operational risk types.

Due to the ever-increasing reporting requirements in accordance with the existing regulatory requirements (Solvency II) as well as extensive changes and novelties in the regulatory environment, regulatory risk is gaining importance. In 2018, the General Data Protection Regulation (GDPR) and the Insurance Distribution Directive (IDD) will be fully effective. The Company began intensive preparations for compliance with the said EU legislation at the end of 2016, which included allocation of appropriate resources, preparation of an implementation plan, and adjustment or establishment of the required processes and internal controls. Apart from that, preparations for the implementation of IFRS 17 requirements are underway, which also includes new financial reporting standards for insurance contracts.

The new legislative framework increases the disclosure requirements of information to clients, thereby increasing conduct risk, to which adequate attention is paid by the Company. Even though the Group is mostly exposed to insurance fraud, its fraud prevention, detection and investigation policy encompasses all business areas. As an important external fraud risk, cyber risk is increasing with computerisation, digitisation and more sophisticated cyber attacks. Bearing this in mind, in the context of own risk and solvency assessment (ORSA) in 2017, scenarios were developed for the Group, which represent maximum vulnerability and are linked to the events that may adversely affect the processes and data security. In order to ensure adequate cyber risk management, the Group accelerated the existing activities and the implementation of the new security functionality.

2.7.1 Ensuring business continuity and functioning of systems material for smooth business process implementation

The appropriate functioning of information technology, particularly key applications, is important for the operations of the Group. Consequently, special attention is devoted to IT risk management, information security, business disruptions and failures. Based on the already identified risks arising from the use and development of IT applications, appropriate measures for their reduction were and will continue to be taken. The main activities include process adjustment, especially the entire change development and management process, introduction of complete and more appropriate testing, as well as information and application infrastructure optimisation.

To ensure continuity of key business processes, the business continuity management system was set up. In addition to business continuity plans for critical business processes and disaster recovery plans, it also provides for:

- a crisis management team, who is activated in the case of stress situation which cause the interruption or failure of business processes;
- a disaster recovery team for IT extraordinary events that cause major disruption to IT services;
- a recovery team for commercial buildings, who is activated in the event of disruption of the operation of the Company's headquarters and regional units.

2.8 Non-financial risks

The material non-financial risks are strategic risks, reputational risk and the Group risk. These risks can materialise in the form of major or minor deviations from the business and financial plans due to losses incurred or lost business opportunities.

The internal culture, the governance system and business practices of the Group are set up to avoid these risks and minimise their negative effects.

2.8.1 Strategic risk

As the attainment of strategic objectives is significantly affected by external factors, strategic risks are defined as material. A high degree of political uncertainty worldwide and the developments in the financial markets are important factors that may affect the operations of the Group. In addition, changes in the insurance industry brought about by technological development, risks associated with the digitisation of operations as well as the increasing regulatory and supervisory requirements are also taken into account. An appropriate response to these circumstances is one of the key elements of the Group's business strategy.

Strategic decisions are made by the management of the Group, who is also responsible for strategic risk management. The strategic risk management system is based on a well-established strategic planning process and related elements, which enable in-depth discussions by the relevant decision-making committees, a regular review of strategic priorities and monitoring of their implementation. The powers and responsibilities of the bodies involved in strategic risk management are clearly defined. Furthermore, the implementation of the strategy is supervised with adequate internal controls and the achievement of the Group's strategic objectives is monitored on a regular basis. The business strategies of individual Group members are aligned with one another and with the strategy of the Group.

2.8.2 Reputational risk

The basic element of the reputational risk management system is a strong corporate governance system, supported by adequate and well-documented business processes.

An important element of effective reputational risk management is also an efficient internal information flow and communication system, which ensures proper knowledge and sufficient understanding of the strategy, business operations, plans and current circumstances by all employees. Also important is to provide balanced, consistent and up-to-date information to the general public on the business operations and activities of the Triglav Group, which ensures a long-term relationship with all external stakeholders based on trust. The system also includes monitoring and analysing the presence of the Group in the public.

2.9 Stress tests

The Group regularly conducts stress tests for all material types of risks as well as monitors and assesses the potential impact of a stress situation on its risk profile.

Stress testing and scenario analysis are part of the Group's own risk and solvency assessment process. Stress tests are used to determine the effect of a simultaneous change in several parameters, e.g. simultaneous change in different risk categories that influence an insurance transaction and investment values. The analysis of potential effects and exposures takes into account the actual or planned exposure to:

- adverse circumstances that can last for long periods of time;
- sudden and major events;
- combinations of circumstances and events from the first and second indents.

The established stress testing framework enables that the stress tests are prepared on the basis of workshops held with functional areas, at which the scenarios relevant for the current and future operations are assessed.

In 2017, stress testing was performed in the context of own risk and solvency assessment. The conducted analyses confirm that sufficient capital is available to the Group to offset the effect of the stress scenarios used.

2.10 Summary and focus of risk management in the future

Throughout the year, the Company and the Group regularly assessed risk exposure and compared it to the defined risk appetite. It is estimated that both the risk profile and the risk management system are adequate.

To a large extent, the business performance of the Group depends on a number of more or less foreseeable circumstances. The aim of the Group's strategy is to achieve sustainable growth and an adequate return by monitoring, analysing and finding appropriate responses to the present and future challenges.

High risk management standards significantly contribute to the achievement of strategic objectives. The Triglav Group is committed not only to continuous upgrading of the risk management system but also to enhancing its use both in the strategic planning process and when making current business decisions.

In the coming years, the risk management culture will be further enhanced at the Group level. The Group will face important challenges in the areas where major changes or increased risks are expected, particularly in relation to cyber risks and the upgrading of the internal control environment, which will be necessary due to regulatory changes.