Risk Management

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- The first year of operation in line with the Solvency II regulations showed a strong capital adequacy and financial stability of Zavarovalnica Triglav and the Triglav Group.
- Both recorded high target performance values in the extreme environment of low interest rates and fierce competition at an acceptable level of risks.
- Individual types of main risks are effectively managed through the established "three lines of defence" system.
- The stress tests and own risk assessment performed in the context of Solvency II showed strong resilience of the Company to external influences.

In 2016, the comprehensive and integrated risk management system was successfully upgraded at the level of the Triglav Group. In accordance with the new Solvency II regulations, the Company calculated and reported on capital adequacy in a timely manner. The Company conducted its own risk assessment, assessed the suitability of the standard formula and evaluated scenario tests. Furthermore, it participated in the stress test excercise, performed by the European Insurance and Occupational Pensions Authority (EIOPA) in 2016, in order to obtain the supervisory assessment of potential vulnerabilities of the sector to market risk. Intensive preparations for drawing up the Solvency and Financial Condition Report (SFCR) were undertaken, as the first such report will have to be submitted for 2016.

Major development activities concerning the risk management system at the Group level in 2016 included:

- upgrading of the risk management system in all insurance subsidiaries of the Group, particularly with respect to currency risks and credit risks related to exposure to banks and banking groups;
- upgrading of the capital adequacy calculation and transfer of know-how to subsidiaries;
- updating of the minimum risk management standards within the Triglav Group;
- organisation of several workshops on risk management in subsidiaries for employees in Zavarovalnica Triglav and the Triglav Group.

Adequate capital and financial strength of the Group was confirmed by the two rating agencies S&P Global Ratings and A.M. Best, which upgraded the long-term credit rating and the financial strength credit rating of the parent company Zavarovalnica Triglav, the Triglav Group and the subsidiary Pozavarovalnica Triglav Re from "A–" to "A" in 2016. Both credit ratings have a stable medium-term outlook.

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 and the Group is clear, transparent and well-documented. 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 presents possible ways of managing individual risks or exposures.

1.1 Powers and responsibilities

Risk management is a corporate governance system, which ensures that the risk profile of the Company and the Group is within the limits set in the Risk Appetite Statement. The risk management system of the Group is based on the "Three Lines of Defence" model.

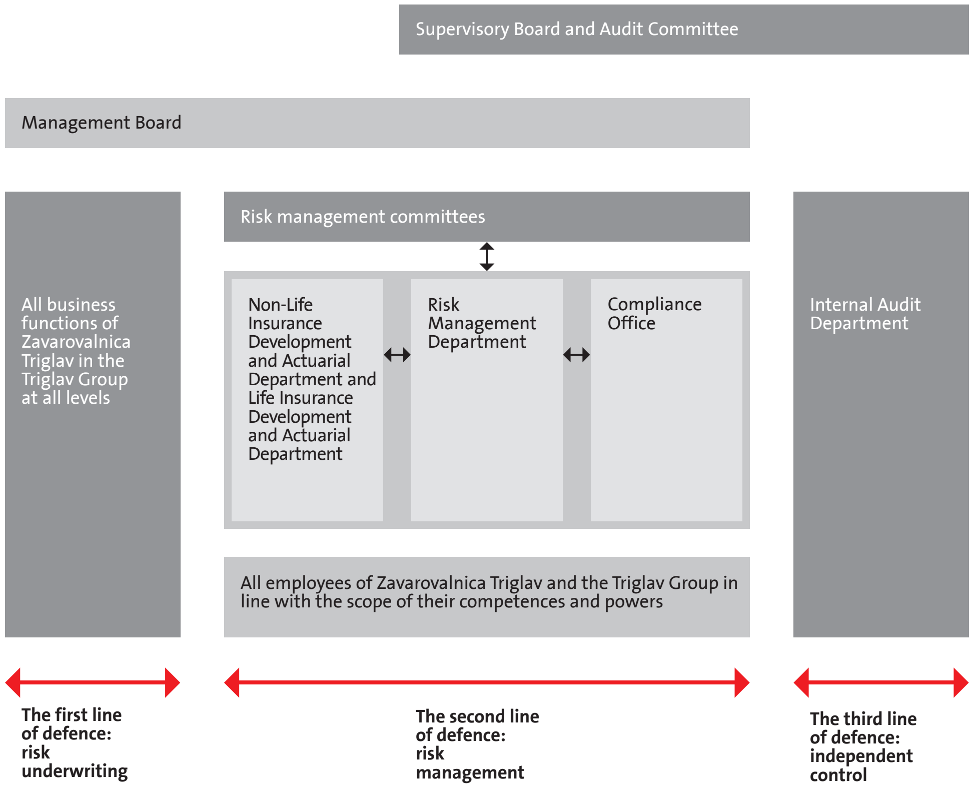
The first line of defence consists of the business functions, which actively manage concrete business risks through their business decisions and are primarily responsible for risk identification and underwriting.

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 in individual functional areas and the risk management system.

The Management Board and the Supervisory Board are not directly part of the three lines of defence, even though they play a crucial 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 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. They are performed at the Company level and provide for the transfer of minimum standards in their respective area to the subsidiaries of the Group. The key function holders meet the fit and proper requirements relating to the risk management process in line with the applicable internal rules.

Within the scope of their powers and responsibilities regarding risk management, **the Supervisory Board** of the Company gives consent to the Management Board with respect to written rules of the risk management system at the highest level. At its sessions, the Supervisory Board is regularly briefed on the risk profile and capital adequacy of the Group and the Company, and gives its approval to the Solvency and Financial Condition Report in the context of a comprehensive discussion of the 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 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 the related policies. It is responsible to set up an effective risk management system, it is regularly briefed on capital adequacy and approves the most important reports, including the Own Risk and Solvency Assessment Report and the Solvency and Financial Condition Report.

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

The second line of defence of the risk management system includes committees and other bodies – the Risk Management Department, the Non-Life Insurance Development and Actuarial Department, the Life Insurance Development and Actuarial Department, and the Compliance Office. The purpose of the committees is to provide support for the Management Board in the performance of regular monitoring, coordination and information activities related to risk management.

The Management Board appoints the committees, which have an advisory role, or grants them certain decision-making rights. The competences and powers of the committees are defined in the respective rules of procedure approved by the Management Board.

The risk management system includes the following committees at the level of Zavarovalnica Triglav and the Triglav Group:

- the Risk Management Committee,
- the Assets and Liabilities Committee,
- the Non-life Insurance Committee,
- the Operational Risk Committee,
- the Life and Non-life Insurance Product Forums,
- the Project Steering Committee.

The Risk Management Committee manages all material risks for the Company or the Group, while also being responsible for strategic or non-financial risks. **The Assets and Liabilities Committee** is responsible for market, life insurance and liquidity risks. **The Non-life Insurance Committee** is in charge of non-life insurance risks and the transfer of risks to reinsurers, including credit risks. Operational risks, including the risks arising from outsourcing (but excluding project-related risks), are addressed by the **Operational Risk Committee**. **The product forums** are responsible for the development of new insurance products. The project-related risks are dealt with by the **Project Steering Committee**, which reports on material project-related risks to other competent committees. Committees are informed 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**.

The risk management function is responsible for the establishment and coordinated and continuous operation of the integrated risk management system in line 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. Apart from that, the risk management function is in charge of the transfer of know-how and good practices and consistent implementation of risk management within the Group.

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 expresses 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. It performs its duties in accordance with the applicable legal provisions, its policy and standards. 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 constant and comprehensive control over the operations of the Company so as to increase the benefits of its operations. 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 in Zavarovalnica Triglav. 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.

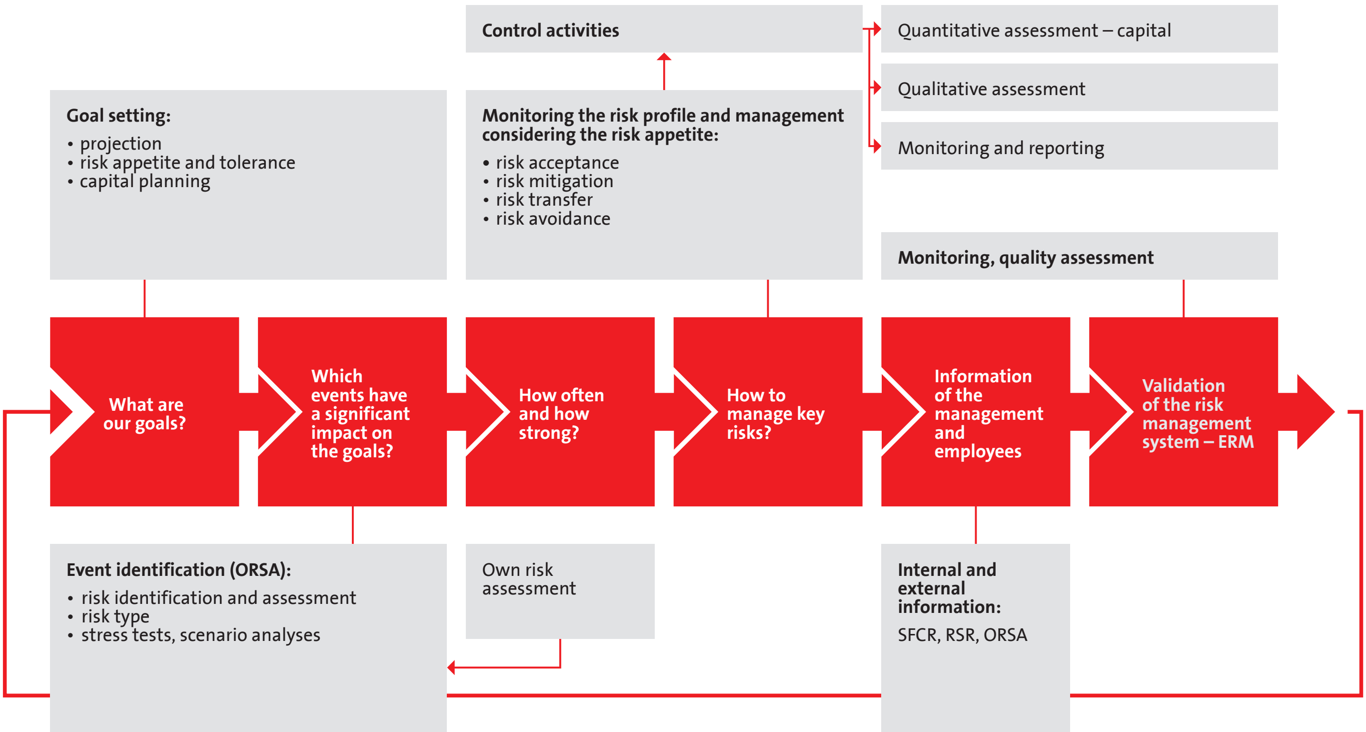
In Group members, the risk management system is established based on the principles of the controlling company, which are laid down in the Minimum Risk Management Standards, taking into account the size, complexity and business profile of a particular subsidiary. Risk management within the Group is primarily performed at the level of individual subsidiaries and secondarily at the Group level. In line with the Minimum Risk Management Standards, the Risk Management Department of Zavarovalnica Triglav in cooperation with the management bodies of subsidiaries, the Subsidiary Management Department and Triglav INT are responsible to set up and ensure 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 formal owner of insurance subsidiaries operating on the foreign markets of the Group 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.

1.2 Risk management framework

The main building blocks of comprehensive risk management in the Company are the Strategy of the Triglav Group and the Business Plan of Zavarovalnica Triglav. The figure shows the comprehensive risk management process described below.

Risk management process of Zavarovalnica Triglav and the Triglav Group



In the process of setting the guidelines and objectives for the strategic period, the Company defines the risks it is consciously willing to take in order to achieve these objectives. In addition, the key indicators are defined, based on which the target (appetite) and maximum (tolerance) exposure values are set and the monitoring of the actual exposure (risk profile) is performed. On the basis of the set **strategic objectives**, material risks are identified at least once a year in the own risk and solvency assessment process. Material risks are those which could have a significant influence on the achievement of objectives in the coming period. These identified risks are first documented and defined in the **Risk Catalogue**, and then appropriately classified, assessed and analysed, particularly in terms of impact and probability of occurrence.

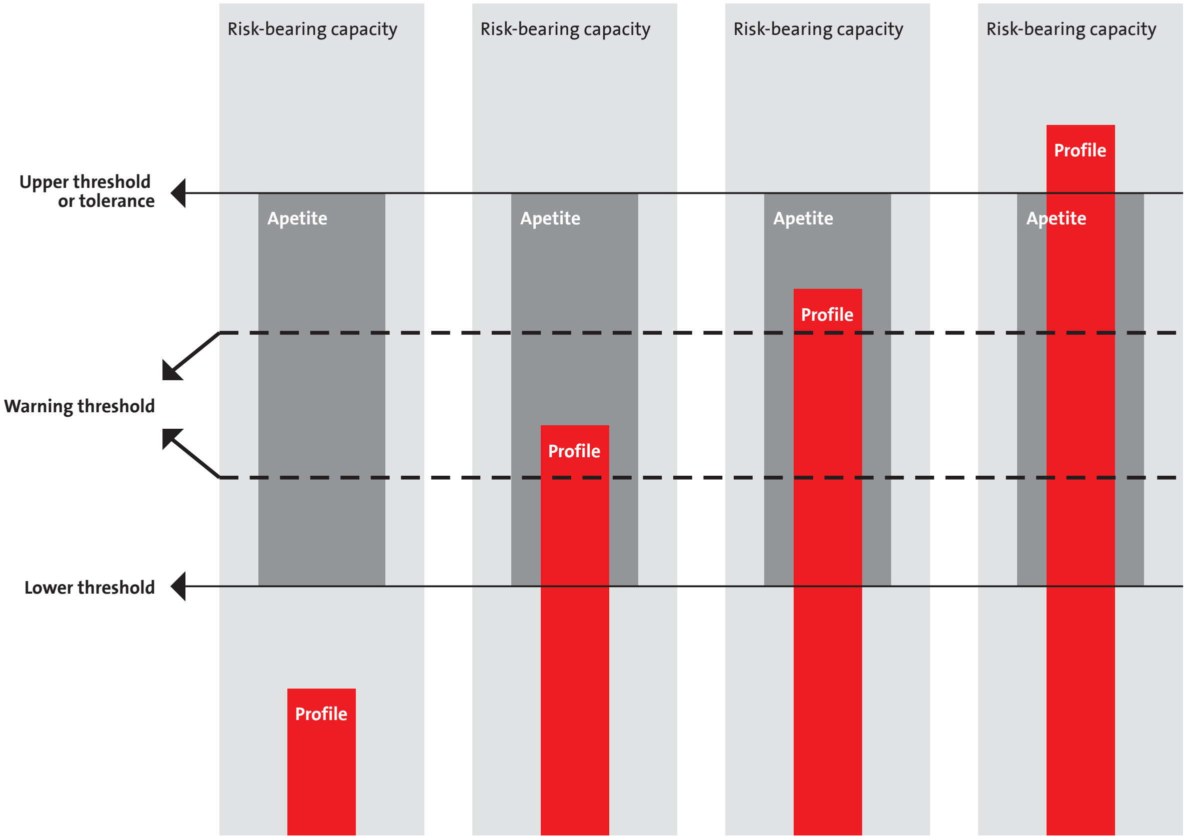
The underlying documents of the risk management system are the **Risk Underwriting and Management Strategy** (hereinafter: the Strategy) and the **Risk Appetite Statement** (hereinafter: the Risk Appetite) of Zavarovalnica Triglav and the Triglav Group. They define the main strategic elements of the system and represent the basis for subordinate risk management documents, policies, methodologies and instructions.

The Strategy defines the comprehensive risk management system within the Triglav Group and the guidelines for underwriting particular risk types, quantified in the Risk Appetite. This strategic document quantitatively defines the level to which the Group is able and willing to expose itself in individual risk segments, taking into account its strategic objectives and capital strength.

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 and the appetite and informs the Management Board by drafting periodic risk reports. If it establishes that the risk appetite has been exceeded or that there has been a significant change in the level of exposure, it will submit draft measures for limiting the exposure to an acceptable level to the Management Board. Based on the analysis, the Management Board decides on the appropriate risk management approach (accept, transfer, mitigate or avoid). The selection of the approach depends on the ratio between the actual exposure (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



Risk exposure is too low in relation to the appetite – taking of additional risks.

The risk profile is in line with the risk appetite.

The risk profile reaches the values within the appetite, but is nearing critical values – assessment of the need to transfer and/or mitigate the existing risks and avoid new risks.

The risk profile exceeds the values defined in the appetite – transfer and/or mitigation of the existing risks and avoidance of new risks.

The risk exposure monitoring mechanisms enable the Company not only to detect and identify any negative trends but also to take appropriate measures. Risk identification at the operational level is performed at several levels, i.e. at the level of functional areas and competent committees.

Risks are regularly measured and monitored using various methods:

- **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.
- **Regulatory method** – This method is used in the process of calculating capital adequacy at the level of the Company and the Group, to prepare the calculation of risk measurement in accordance with the Solvency II standard formula and to explain substantial changes in the period.
- **S&P risk assessment method** – The Company and the Group calculate capital adequacy also based on the methodology of S&P rating agency.

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 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 and the Group regularly document any deficiencies identified in the risk management system cycle, including proposals for improvements, as well as prepare measures and recommendations for its upgrade.

1.3 Capital management

At any given time, the Triglav Group and Zavarovalnica Triglav have sufficient capital, which allows them to assume a specific, measurable quantity of acceptable risks. Capital is the **first criterion for assessing the solvency** of the Company and the Group. The primary goal of capital management is to guarantee the required and suitable capital adequacy level on both a consolidated and individual basis. In setting the level of acceptable risk, generation of appropriate profit for owners has to be ensured.

In 2016 as well as in previous years, the Company and the Group had an adequate capital level and were safe and profitable financial institutions. It was assessed that they had an adequate capital level also as at 31 December 2016. .

As required by applicable legislation, the amount of available capital is measured regularly 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. The insurance subsidiaries of the Triglav Group maintain a surplus of available capital in excess of the capital requirements for their core business and for covering potential losses, as laid down in local legislation. This surplus provides protection against losses due to unforeseen unfavourable events and capital requirements. In addition to current capital adequacy levels, the Company plans and assesses future capital and capital adequacy levels. In doing so, it monitors the effects of the environment on capital adequacy and provides for optimal capital allocation of Zavarovalnica Triglav, individual Group members and the Triglav Group.

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 Company's and the Group's capital adequacy models are assessed by the credit rating agencies S&P Global Ratings (hereinafter: S&P) 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 criteria are based on regulatory requirements, internal needs, the Risk Appetite

Statement, the requirements of credit rating agencies, the business and organisational structure, and the specifics of the macroeconomic and political environment in which the Group operates. The Group determined the criteria of the dividend policy and the capital management guidelines, including a set of activities aimed at ensuring the necessary capital strength, which remained unchanged in the reporting year. The policy takes into account not only target return on equity, the planned volume of business and the related foreseen capital needs in the Slovene and strategic markets but also the experiences and guidelines of the insurance sector. The capital management strategic objectives and the dividend policy criteria are shown in the figure below.

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

1.4 Risk types

Main risk types of Zavarovalnica Triglav and the Triglav Group are described below. The methods and level of exposures to individual risk types are presented in detail in the second chapter of the report.

The basis for defining the risk appetite is identification of risks assumed by the Company and the Group. The risk identification process is ongoing, involving all functional areas in accordance with their respective powers and responsibilities. Its purpose is to ensure the inclusion of all significant 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 of the Company and the Group.

In their operations, the Company and the Group assume 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 the premium risk, the risk of insurance technical provisions and the catastrophe risk.
- **Market risk** is the risk of loss or of adverse changes in the financial situation of an insurance undertaking or the group, resulting from fluctuations in the level and in the volatility of market prices of assets, liabilities and financial instruments. These include interest risk, equity credit risk, real property risk, credit spread risk and market concentration risk.
- **Liquidity risk** is the risk of loss which may occur if the Company or the Group is not able to meet all past-due payment obligations arising from major claims and/or is forced to provide sufficient funding at costs which are significantly higher than normal. Liquidity risk is also the risk of limited access to financial resources needed to meet the payment obligations from insurance and other contracts.
- **Credit risk** is the risk of loss or of adverse changes in the financial situation of an insurance undertaking, resulting from fluctuations in the credit situation of counterparties and potential debtors to which the Company is exposed through counterparty default risk and concentration risk.
- **Operational risk** is the risk of loss arising from inadequate or failed internal processes (or products), personnel or systems, or from external events and their impact.
- **Non-financial risks** comprise strategic risk and reputational risk.
  - *The strategic risk* is 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 risk).
  - *Reputational risk* is the risk of loss arising from a negative image held regarding the future or existing operations of the insurance undertaking 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 by the Company and the Group 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 risks that might threaten the achievement of strategic objectives due to an inefficient governance system of the Group and insufficient understanding of the business environment in which its companies operate. The Company's risk profile can also be influenced by the transactions between the associated companies and the complexity of concentration risk management.

Overview of main risks

- **Underwriting risks**
  - Non-life underwriting risk (including health underwriting risk)
    - Premium and reserve risks
    - Lapse risk
  - Life underwriting risk
    - Mortality risk
    - Longevity risk
    - Disability and morbidity risks
    - Lapse risk
    - Expenses
    - Audit
  - Concentration
- **Market risks**
  - Interest rate risk
  - Equity risk
  - Property risk
  - Credit spread risk
  - Currency risk
  - Market concentration
- **Credit risks**
  - Counterparty default risk
  - Concentration risk
- **Liquidity risk**
- **Operational risks**
  - Internal fraud or unauthorised activity of internal persons
  - External fraud or unauthorised activity of third parties
  - System failure and related business interruptions
  - Damage to physical assets
  - Inadequate human resource and work environment safety management
  - Non-compliance with the applicable regulations, inadequate business or market practices, clients and products
  - Inadequate implementation and management of processes and the control environment, suppliers and business partners
- **Non-financial risks**
  - Strategic risk
  - Reputational risk
  - Capital risk
  - Group risks

2 Disclosures and Risk Management

Risk management is a very important part of the corporate governance of the Triglav Group, all business processes and the awareness and work guidelines of employees.

As an integral part of the entire business process of the Group, risk management is in conformity with the Strategy of the Triglav Group and enables the Group to achieve its strategic objectives. The integrated risk management system ensures that the typical existing and recurring risks are identified, adequately measured, managed, controlled and monitored on an on-going basis.

The Management Board is responsible not only for efficiently managing all types of material risks but also for establishing an adequate organisational, management and staffing structure, in addition to ensuring suitable professional qualifications of the employees. The Management Board delegated some of its powers to the committees as the highest-level bodies making decisions on various risk segments. Risk management in subsidiaries is the responsibility of the management of individual companies. A reporting system is set up at the Group level, which allows efficient management of its risks.

The risk appetite for all types of material risks is defined in the Strategy and the Risk Appetite Statement by using indicators. Within each risk type, the concentration of exposures is also monitored. The monitoring of risk appetite indicator values by individual risk in the form of regular reports is performed by the Risk Management Department.

2.1 Capital and capital adequacy management

Capital management in the Company and the Group is a continuous process, which enables the adoption of business decisions that not only ensure competitive advantages but also maintain the successful business model and market position in the long term. Capital management is centralised at the Group level by ensuring optimal and cost-effective capital allocation through capital concentration in the parent company.

In line with the applicable legislation, the amount of available capital for meeting the statutory solvency capital requirements at the level of individual insurance subsidiaries of the Group was regularly calculated in the reporting year. Capital requirements in the Company and the Group remained the same during the year as there were no major changes in the risk profile.

In 2016, the capital level remained within the set strategic objectives and exceeded the level of underwritten risks, both at the Group and the Company level. The level of underwritten risks is measured by applying the statutory standard formula allowing the Company to duly reflect and assess its risk profile following the own assessment obtained in the ORSA process. As in previous years, Zavarovalnica Triglav and the Triglav Group complied with the regulatory capital adequacy requirements throughout 2016.

The table below shows the unaudited current best estimate of the solvency ratio under the Solvency II Directive requirements as at 30 September 2016.

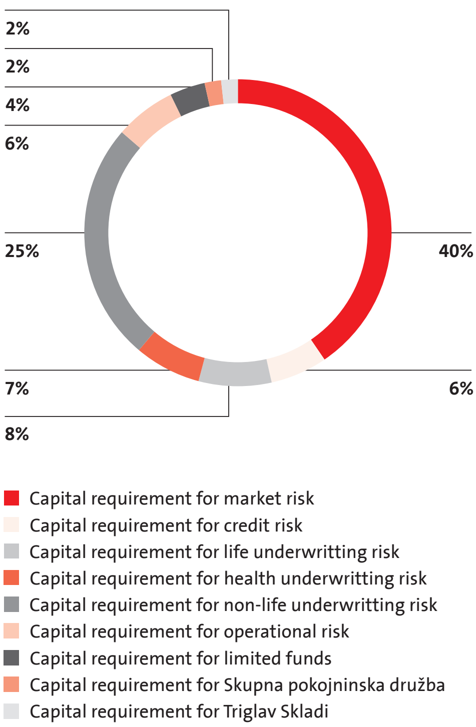
	The Triglav Group		Zavarovalnica Triglav	
	30 September 2016	31 December 2015	30 September 2016	31 December 2015
Solvency ratio (in %)*	276	245	336	307

* The table is unaudited.

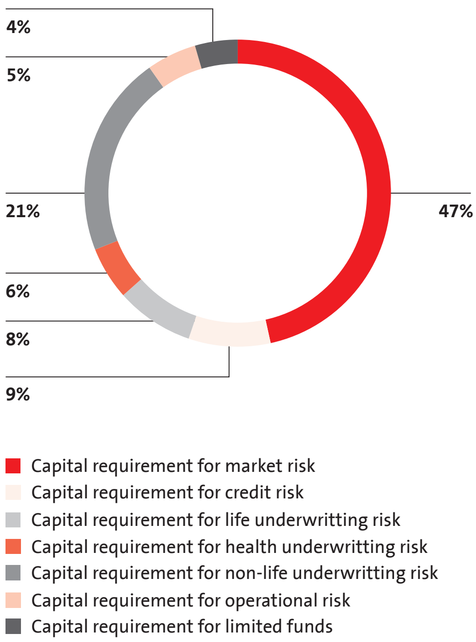
As shown in the table above, the Company and the Group have a strong capital base. The solvency ratios for the periods differ also due to the different treatment of the expected dividends in the calculation of the capital of the Company as the solvency ratio at the 2015 year-end was calculated by taking into account the estimated dividends for 2015, while the solvency ratio as at 30 September 2016 did not take into account the estimated dividends for 2016. Detailed disclosures on capital adequacy in 2016 will be made in the Solvency and Financial Condition Report of the Company and the Group.

The following two figures show the proportion of capital requirements for the Company and the Group by risk type in 2016.

Capital requirements for the Triglav Group in 2016



Capital requirements for Zavarovalnica Triglav in 2016



The most important risks that impact the performance of the Triglav Group arise from the operations of Zavarovalnica Triglav, the largest member of the Group. The most significant and extensive among the risk types faced by Zavarovalnica Triglav and the Triglav Group are market and underwriting risks, followed by credit and operational risks.

The own risk assessment reveals that in 2016 the level of risk exposure was acceptable and in line with the defined risk appetite. During the development of the strategy for the 2017–2020 period, it was estimated that the Company and the Group will meet the capital requirements in accordance with the defined risk appetite also in the future.

Decisions concerning capital management are supported by the results of other capital models, based on which the credit ratings are assigned. Different capital adequacy measurements provide for the safety of operations, while also being useful as the basis for optimising the operations as well as for active capital management and allocation in line with the strategic objectives and the owners'/stakeholders' interests.

2.2 Risk profile of Zavarovalnica Triglav and the Triglav Group

The risk profile of Zavarovalnica Triglav and the Triglav Group is presented in the following table showing exposure to material risk types.

In 2016, apart from the existing risk measurement methods, the Allianz Risk Barometer for risk assessment on strategic markets of the Group was used in the Company and the Group. In this way, the TINT subsidiaries assessed the risks faced in their operations. According to the results, the highest risk is the development of the insurance market, both supply (strong competition) and demand (e.g. economic growth and the employment rate), followed by regulatory risk, the risk of theft, fraud and corruption, macroeconomic risks and natural disasters.

Risk Dashboard of Zavarovalnica Triglav and the Triglav Group for 2015 and 2016*

Risks	Q4 2015 assessment	Q4 2016 assessment	Trend	Note
Capital adequacy				The risk is further decreasing as the capital adequacy is increasing in the framework of Solvency II; sound performance (profitability) at an acceptable level of risks increases the available funds, which are eligible to cover the solvency capital requirements (SCR), which due to the unchanged risk profile remain at the same level.
Underwriting risks				Despite fierce competition in the insurance sector, the Triglav Group maintains premium growth and achieves the target value indicators on strategic markets. All main indicators (combined ratios, best estimates of insurance technical provisions, coverage of provisions with assets of guarantee funds) are within the target values defined in the risk appetite or internally. Higher underwriting risks (between the compared periods) were the result of low interest rates, which will continue in the future.
▪ Non-life insurance				Combined ratios are within the target values, the loss ratio is favourable. The best estimates of provisions point to adequate statutory insurance technical provisions. Due to low returns, the result depends more on the insurance technical result.
▪ Life insurance				The low interest rate period has adverse effects on the profitability of life insurance products with a guaranteed element. Given that the expectations of low interest rates are still high, increased life underwriting risks are expected.
Market risks				Despite the environment of low and negative interest rates, the Triglav Group achieves the target values of results even in relation to investments by taking appropriate interest rate risk management measures.
▪ Interest rate risk				In 2016, interest rate risk significantly increased in the euro area. The sensitivity of the investment portfolio to changes in the level of interest rates declined throughout 2016. The regulator (EIOPA) performed interest rate stress tests.
▪ Equity risk				Zavarovalnica Triglav and the Triglav Group remain within the mentioned volume of investment in equity securities in accordance with the adopted risk appetite. In 2016, the proportion of non-listed equity securities appropriately decreased.
▪ Currency risk				Zavarovalnica Triglav and the Triglav Group upgraded the currency risk management system by defining exposure limits in currencies other than EUR. Considering the low exposure to currency risk, this risk has been assessed as immaterial for Zavarovalnica Triglav.
▪ Real property market				Zavarovalnica Triglav maintains a low investment appetite with regard to investment property.
Liquidity risk				Indicators show a high liquidity of Zavarovalnica Triglav. The Company is upgrading its liquidity risk assessment methodology at the Group level.
Credit risks				In line with the risk appetite, credit risk is managed through the upgraded credit rating and limit system for monitoring exposures to counterparties (banks).
Operational risks				On the basis of a process analysis, Zavarovalnica Triglav and the Triglav Group are developing a robust operational risk management system. The Company is intensively upgrading the operational risk identification, monitoring and management system. Greater risks have been identified with respect to future employment of staff with relevant technical expertise, especially under the assumption of poor demographic projections in Slovenia.
Non-strategic and non-financial risks				The Triglav Group responded to the challenging conditions in the external environment of low interest rates and fierce competition in the insurance sector and to the challenges brought by changes in the environment and policyholders' behaviour by drawing up a new strategy and implementing projects aimed at digitising its operations and further customising its products to client wishes. Technical progress allows extremely rapid changes in the preferences of policyholders, particularly of younger generations. The euro area Member States, especially Slovenia, are in need of thorough pension and health reforms. Challenges also remain in relation to the Solvency II Directive and coping with constantly changing legislation.

*An overall assessment of the main risk types was made on the basis of quarterly risk reports and the scope of adopted and approved methodologies. The capital and liquidity risk methodologies were adopted and approved. Other methodologies, which are based on the distributional characteristics of indicators of individual risk types and their conditional functions for decision-making (main, auxiliary indicators), are in preparation. Despite the fact that some risk indicators are low/high due to both a too high and a too low value or due to either a too high or a too low value, the final assessment is made by using:

i) the colour scale of assessed risk: very high | high | medium | low | very low and

ii) the risk trend: downward, stable, upward.

2.3 Underwriting risks

The Group assumes underwriting risks in all insurance companies when performing transactions, which represent its core business. Underwriting risk management enables the Group to achieve and maintain the size and quality of the insurance portfolio that provides for stable and safe operations while generating maximum returns. The Company strives for optimal management of the ratio of assumed risks and generated return (the difference between the benefits and the costs of risk management measures) not only in the management of underwriting risks but also of other risks. Therefore, the risk appetite limits were defined, taking into account:

- the long-term strategic guidelines in line with the Strategy and
- the business-financial plans approved by the management bodies.

Insurance operations are performed via four key processes, through which underwriting risks are monitored, assessed and balanced: product development, underwriting, underwriting risk transfer and claim settlement. The risk appetite limits are considered in the **product development** process by setting the underwriting criteria and the premium amount.

The primary responsibility for **the active management of underwriting risk** lies with departments 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, checks the adequacy of insurance technical provisions and optimises reinsurance schemes. The basic tool for underwriting risk management **is a high-quality risk assumption process** that limits assumed risk to acceptable levels.

Reinsurance is one of the main tools used in underwriting risk management in terms of **risk transfer**. The annual planned reinsurance programme includes calculated own shares by individual insurance class, the maximum coverage table prepared based on own shares, and procedures, bases and criteria for determining the maximum possible loss with regard to individual underwritten risks. The choice of suitable reinsurers depends to a great extent on their credit rating. **By resolving and settling claims**, the Triglav Group fulfils its obligation to the policyholders. The Company 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 manage loss events, which includes determining the appropriate bases of claims and controlling the amount to be paid out. The Company set up procedures to process the claims and assess the damage in proportion to the amount, nature and complexity. This also includes the assessment of not yet reported claims.

The risk appetite defines the level of risk and the potential loss arising from this risk that the Company is able to accept in the course of its business 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.

Every type of insurance has its own specific risks, which the Triglav Group duly identifies and manages. In the context of direct insurance operations, the Company is predominantly faced with traditional underwriting risks, which are divided into:

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

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

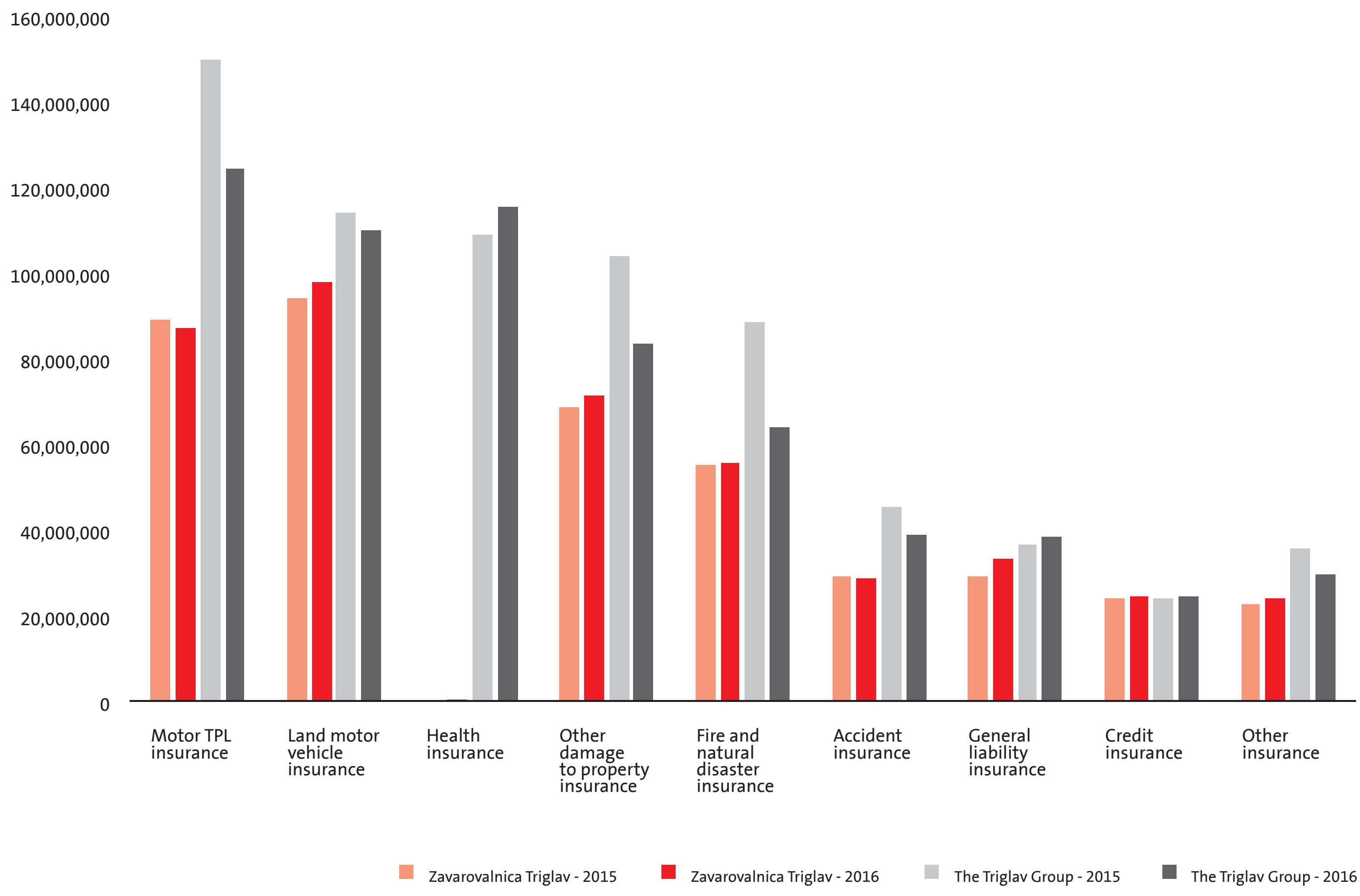
2.3.1 Non-life underwriting risks

Non-life 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 underwriting risks also include the risks related to the performance of active reinsurance operations and the risks associated with health insurance.

In quantitative terms, as a whole they are monitored through combined ratios, which measure the actual claims and expenses arising from concluded insurance policies in relation to the expected claims and expenses calculated in the premium (Sections 2, 3, 4 and 8 of the Management Report). In 2016, the combined ratio in non-life insurance at the Group level was 92.9% (in 2015: 92.8), which reflects good 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 of the Business Report 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 size of the portfolio of each insurance segment and 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 entire 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 of the Triglav Group



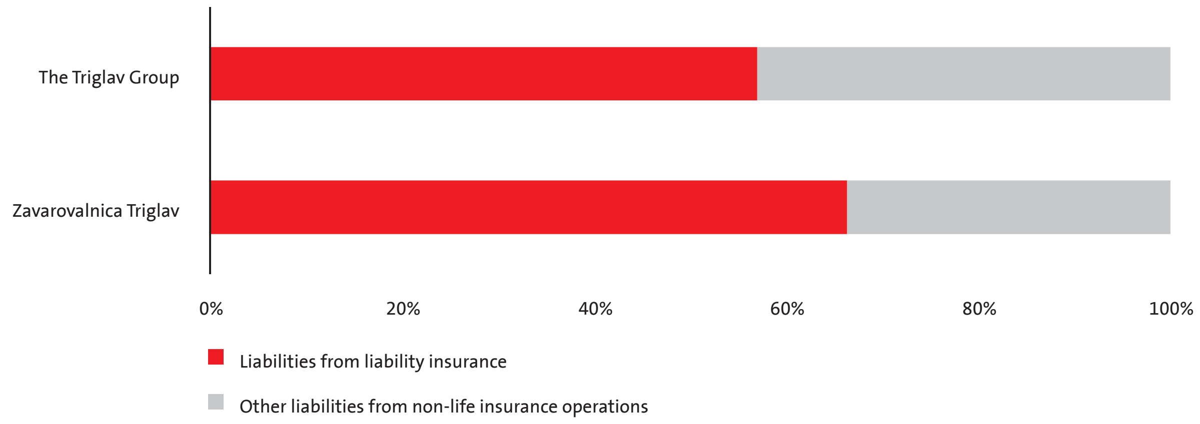
Zavarovalnica Triglav and the Triglav Group pursue a balanced diversification of the non-life insurance portfolio in different insurance segments.

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 considered as catastrophe risk, which is presented in [→ *Section 2.3.3 Underwriting risk concentration*].

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 considered. 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 based on the analyses performed. The described methodological appropriateness of provisions for individual insurance classes (see [→ *Section 2.6 of the Accounting Report*]) is verified by regularly performing the liability adequacy test based on the balance as at the last day of the business year and regular calculation of 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 2016 year-end at the level of both the Triglav Group and Zavarovalnica Triglav (see [→ *Sections 2.6.2 and 3.14 of the Accounting Report*]). Other adequacy tests of insurance technical provisions for non-life insurance produced similar results.

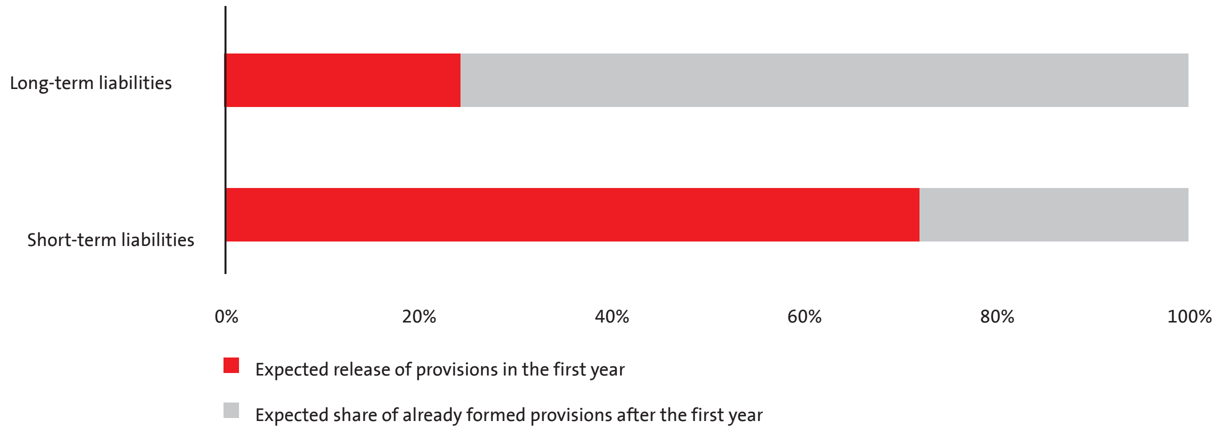
The provision risk can be influenced *inter alia* by the amount of the provisions set aside and the maturity of the liabilities. The latter represents the average duration of the claim settlements for which provisions were made. With respect to liability insurance, more than half of the claims are settled after one year, while in other insurance segments more than half of the claims are paid within one year.

The ratio between long-term and short-term insurance in 2016



In the Triglav Group, the proportion of long-term provisions is lower, as other Slovene insurance subsidiaries of the Group primarily underwrite short-term insurance policies.

Expected release of provisions after one year



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

Lapse risk and the risks related to the volume of new business represent the uncertainty and deviations from the planned level of lapses, the level of future renewal of existing insurance and the volume of new insurance policies taken out. Both risks are usually the result of realised reputational risk, strategic risk, technological progress risk and macroeconomic risks. These risks are discussed in detail below.

Supplemental voluntary health insurance, governed 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 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 coverage 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. 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 risks account for around a third of total non-diversifiable risks, both in the Company and the Group.

2.3.2 Life underwriting risks

The life insurance portfolio includes traditional, unit-linked and pension insurance policies. Additional insurance can be added to unit-linked and traditional insurance policies. **Life underwriting risks** are all underwriting risks covered by life insurance policies as well as some underwriting risks related to these risks and life insurance policies. The Company underwrites mortality, longevity and morbidity risks as well as permanent total incapacity for work risk. Within additional insurance, the Company underwrites disability risk, accidental death risk, critical illness or injury risk, medical expense risk, daily benefit risk, second medical opinion etc.

Mortality risk is the risk that the actual future mortality rate will be higher than expected. This difference will affect:

- 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 insurance),
- incorrectly estimated level, trend or volatility of future mortality rates for a particular homogeneous risk group (e.g. the lack of empirical data) and
- future catastrophic events that affect mortality (e.g. a pandemic), as well as other sources leading to an incorrect estimate.

Moreover, mortality risk includes its opposite, i.e. **longevity risk**, which is closely monitored primarily in annuity or pension insurance.

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

Life insurance policies are also associated with the **risk of policy changes** (required 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 risk of policy changes may arise from changes in the general economic environment, which affects 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 or an integral part of underwriting risks, as in Solvency II for example. This risk is reflected in inappropriately calculated premium, insufficient insurance technical provisions and in the difference between the actual and the expected results of the Company. Expense risk may arise from miscalculations and incorrect allocation of actual expenses (the inadequacy of the cost model) and incorrectly estimated level, trend or volatility of expenses.

Adequate risk equalisation which is the basic principle on which the insurance industry functions, is achieved through sufficiently large homogenous risk groups, which constitute the entire portfolio of the above risks. An important component here is efficient and correct classification of risks in underwriting, based on which a specific risk is assessed and classified into an appropriate group, which is the condition for appropriate management of that risk. Therefore, new findings related to individual risks are taken into account in underwriting. Also considered are the know-how and procedures of reinsurers who assume a portion of 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 parameters 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.

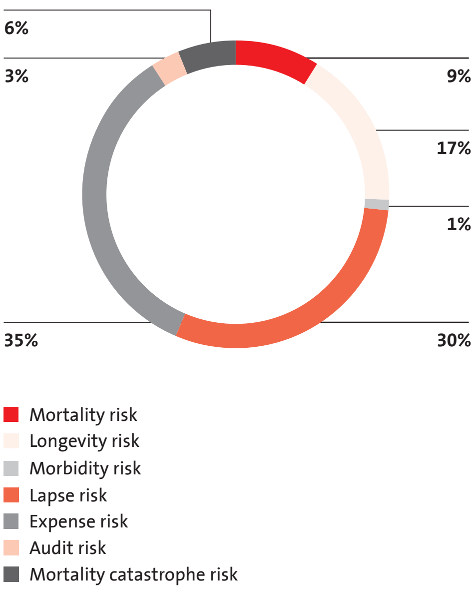
The adequacy of provisions is regularly tested using the liability adequacy test (LAT) and calculating the "realistic" provisions set based on the present value of the best estimate of future expected contractual and other cash flows. The test is performed at least once a year based on the balance as at the last day of the business year (see [→ *Section 2.6 of the Accounting Report*]). The test results for 2016 show that an adequate level of insurance technical provisions for life insurance was formed at the level of both the Triglav Group and individual subsidiaries, with the exception of an identified shortfall in the guarantee fund backing supplemental voluntary pension insurance, for which additional other insurance technical provisions were created.

A part of life underwriting 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 described 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 the market risks in [→ *Section 2.5*].

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.

Structure of life underwriting of Zavarovalnica Triglav



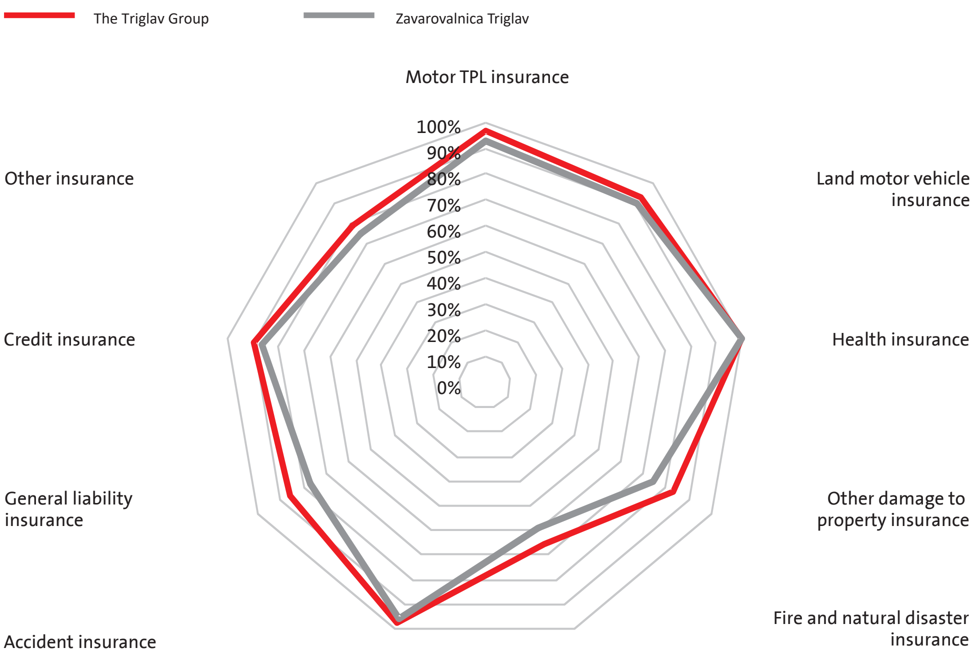
2.3.3 Underwriting risk concentration

Underwriting risk concentration occurs due to the concentration of an insurance operation in a geographic area, or an industry or an insurance peril. It may also occur as a result of a 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 event in a business segment or industry may have a material impact on the repayment capacity.

The aim of underwriting risk concentration management is to establish efficient procedures for reducing risk and limiting losses arising from underwriting risk concentration at the level of Zavarovalnica Triglav and the Triglav Group.

The share of net written premium in relation to gross written premium in 2016



Larger claim amounts can occur in the case of substantial individual damages, such as a fire in a large building, or a large number of minor damages caused simultaneously, e.g. in the event of an earthquake. Both categories of exposure can be managed using reinsurance cover. The insurance portfolio in ire and natural disaster insurance segment 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.

The Company was able to discharge its obligations arising from insurance contracts without exposure to increased liquidity or capital adequacy risk.

2.3.3.1 Geographical and sectoral concentration

The Triglav Group mainly operates in Slovenia and the countries of the former Yugoslavia. The Group also provides fronting services, ceding most of the business to foreign insurance companies. On the basis of previous experience, the Group believes that all potential risk concentrations have suitable reinsurance cover. The table below summarises the consolidated gross written premium in the countries in which the insurance companies of the Group operate. The Group's main exposure is in Slovenia, as almost 83% of premium income is generated on the Slovene market.

	Gross written premium		Share (in %)	
	2016	2015	**2016**	2015
Slovenia	774,450,456	760,924,325	82.7%	82.8%
Croatia	48,937,278	45,168,268	5.2%	4.9%
Montenegro	31,169,916	30,433,416	3.3%	3.3%
Czech Republic		9,636,056	0.0%	1.0%
Bosnia and Herzegovina	25,483,087	23,671,756	2.7%	2.6%
Serbia	34,407,999	28,238,446	3.7%	3.1%
Macedonia	21,555,079	21,043,998	2.3%	2.3%
Total	**936,003,815**	**919,116,265**	**100.0%**	**100.0%**

2.3.3.2 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 4.5 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 Triglav Group amounts to EUR 10.6 million.

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

In this segment, the threat of earthquakes represents the largest 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 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.

The table below shows the earthquake model for Zavarovalnica Triglav for 2016. The results of the model for the Triglav Group do not differ 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 the correlation between such a potential loss event and the arising liabilities is low or null. There were no such significant low frequency and high severity events in 2016.

The earthquake damage model with return periods for 2016

	2016	
Return period in years	**Share of total exposure in %**	**Gross claims in EUR**
100	0.34	70,064,330
250	0.72	146,532,328
500	1.36	278,258,021
1000	2.90	593,257,882

The following table shows the assumption of individual capacities of reinsurance risks arising from the nuclear threat by Group companies.

Assumption of individual capacities of reinsurance risks arising from the nuclear threat for 2015 and 2016

	Assumed capacity in EUR	
	2016	**2015**
Zavarovalnica Triglav d.d.	7,500,000	7,500,000
Pozavarovalnica Triglav Re d.d.	2,520,000	1,400,000
Triglav Osiguranje d.d., Zagreb	650,000	650,000
TOTAL AFTER THE EVENT	**10,670,000**	**9,550,000**

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.

2.3.3.3 Underwriting risk concentration by other insurance classes

The concentration of **life** underwriting risks is low as the life insurance risk portfolio is well dispersed 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 an appropriate reinsurance scheme. The sum insured risk 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% of other life insurance portfolio. For additional accidental death insurance, the sum insured is lower than EUR 50,000 and represents 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. These sums insured represent the stipulated retention in line with the reinsurance agreement for most insurance policies.

With a 23% market share, the Triglav Group is one of three providers of **supplemental health insurance**, and with a 43% share one of two reinsurance providers. This is why in both peril segments the Group was exposed to the risk of concentration of supply in the insurance and reinsurance market in 2016. As regards the reinsurance portfolio, the Group manages the reinsurance portfolio concentration risk by the international geographical spread of inwards reinsurance risks and with adequate retrocession of outwards reinsurance risks.

2.4 Market risk

Asset management is an important business activity of the Company and the Triglav Group. In this way, insurance liabilities and capital requirements are covered while ensuring an appropriate return. The Company and the Group are exposed to market risks, which are mostly related to exposure to different asset classes. The Company and the Group manage at least the following types of market risks:

- interest rate risk,
- equity risk,
- property risk,
- credit spread risk,
- currency risk.

In order to achieve the market risk management goal, methods and processes with clearly defined powers and responsibilities were established so as to identify, measure, assess, manage and monitor the market risk. The system enables additional 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.

The market risk management system and its objectives are specified in detail in the Market Risk Management Policy. The main objectives relate to market risk management while ensuring the following:

- efficient and effective identification, measurement, assessment and management of market risks;
- minimisation of potential losses due to adverse changes in market variables;
- management and regulation of asset duration with regard to liability features;
- management and regulation of asset-liability currency matching;
- management and regulation of timing matching of interest-sensitive assets and liabilities;
- appropriate return on financial investments and their diversification;
- adequate coverage of provisions with investments;
- regular monitoring of market risk exposure and verification of correctness and adequacy of the assumptions used in the development of the Market Risk Management Policy;
- adequate market risk assessment as part of the own risk and solvency assessment (ORSA) process;
- risk analyses and reports and briefing on market risk exposure levels.

To monitor market risks, the Company also uses a limit system defining the limits for underwriting risks at the highest level. The limits specify the desired investment portfolio structure and maximum permissible exposure to counterparties. In this way, the possibility of losses due to underwritten risks is limited to the level which is still acceptable in terms of complexity of the business model, strategic objectives and capital strength of the Company.

Apart from an appropriately diversified investment portfolio, the Company uses, where necessary, various derivatives to reduce market risks as one of the risk-reducing techniques.

In the context of the investment portfolio, the Company and the Group are exposed to market risks arising from each type of investment securities. The risk size depends on the exposure to each category of investment securities and the volatility of macroeconomic indicators. Based on the investment structure (see [→ *Section 7.9 of the Business Report*]) the Company and the Group are most exposed to debt securities, followed by investments in shares and other variable-return securities as well as investment property.

2.4.1 Interest rate risk

The interest rate risk sensitivity analysis includes all financial assets exposed to interest rate risk, i.e. debt securities classified into the "measured at fair value through profit and loss" and "available-for-sale" categories and derivatives. The proportion of debt securities in the total portfolio is shown in the detailed overview of financial assets per group of assets in [→ *Section 3.6 in the Accounting part of the 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*].

The table below shows the sensitivity analysis of the Group's portfolio to interest rate risk and its impact on comprehensive income and the income statement of the Triglav Group and Zavarovalnica Triglav.

	The Triglav Group				Zavarovalnica Triglav			
	31 December 2016		31 December 2015		31 December 2016		31 December 2015	
	+100 bp	-100 bp	+100 bp	-100 bp	+100 bp	-100 bp	+100 bp	-100 bp
Debt securities issued by states	-39,339,300	42,114,784	-46,428,397	46,428,397	-28,919,156	31,116,692	-36,400,283	36,400,283
Debt securities issued by financial institutions	-19,103,053	20,507,883	-13,923,959	13,923,959	-16,813,023	18,086,978	-12,236,565	12,236,565
Debt securities issued by companies	-23,058,962	24,443,159	-19,229,330	19,229,330	-19,091,774	20,394,715	-15,731,019	15,731,019
Composite securities	-588,162	1,064,514	-441,358	441,358	-584,398	1,060,675	-441,358	441,358
Other	9,707,396	-10,726,699	153,372	-153,372	9,707,396	-10,726,699	153,372	-153,372
TOTAL	**-72,382,081**	**77,403,641**	**-79,869,672**	**79,869,672**	**-55,700,955**	**59,932,361**	**-64,655,853**	**64,655,853**
Impact on comprehensive income	-69,840,458	74,996,286	-69,953,129	69,953,129	-57,895,272	62,261,040	-58,733,375	58,733,375
Impact on the income statement	-2,541,623	2,407,355	-9,890,022	9,890,022	2,194,317	-2,328,679	-5,922,477	5,922,477

The table above shows that the sensitivity of the portfolio to change in interest rates in 2015 decreased. The positive and negative changes in interest rates have the strongest impact on government securities. The latter account for the bulk of the investment portfolio of the Group or Zavarovalnica Triglav.

2.4.2 Equity risk

The Group manages the equity risk of securities in the portfolio through exposure limits as well as through geographical and sectoral diversification. The Group invests most of its assets within the European Union and only spreads the investments to other geographic areas in order to balance the risks and the profitability of its equity portfolio. To a large extent, the portfolio consists of debt securities and this diversification results in a slightly lower equity risk. An important factor affecting any investment decision is also the liquidity of shares. Due to the diverse market-related (development of capital markets) and local statutory limitations in the strategic markets of the Triglav Group, each subsidiary of the Group in this region pursues an investment policy that is adapted to its individual market. The portfolios of these subsidiaries contain a smaller share of equity securities compared to the portfolios of other subsidiaries and collectively they represent only a small percentage of the Group's portfolio.

The equity portfolio structure by geographical exposure to issuers is shown in the table below. The amounts shown are based on the carrying amount of the equity portfolio of the Triglav Group and Zavarovalnica Triglav. The largest part of the portfolio of the Group consists of shares of issuers originating from the EU, followed by globally diversified equity investments and shares in emerging markets. Compared to the preceding year, no significant change was recorded in investments in shares at the level of the Group and the Company.

	The Triglav Group		Zavarovalnica Triglav	
	2016	2015	2016	2015
Equities in the EU	323,249,208	309,775,324	231,384,899	240,007,693
Equities in the USA	3,755,561	845168	453,264	0
Equities in Asia*	67,979	0	67,979	0
Equities in emerging markets	61,213,205	59,359,263	56,192,389	50,680,122
Global equities**	233,794,996	236,072,765	196,560,088	203,287,023
Total	**622,080,949**	**606,052,520**	**484,658,619**	**493,974,838**

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

The equity portfolio's sensitivity to equity price fluctuations and its impact on the comprehensive income and/or the income statement of the Group and Zavarovalnica Triglav is shown in the table below.

	The Triglav Group				Zavarovalnica Triglav			
	31 Dec. 2016		31 Dec. 2015		31 Dec. 2016		31 Dec. 2015	
	10%	-10%	10%	-10%	10%	-10%	10%	-10%
Equities in the EU	32,324,921	-32,324,921	32,319,310	-32,319,310	23,138,490	-23,138,490	24,000,769	-24,000,769
Equities in the USA	375,556	-375,556	84,517	-84,517	45,326	-45,326	0	0
Equities in Asia*	6,798	-6,798	0	0	6,798	-6,798	0	0
Equities in emerging markets	6,121,321	-6,121,321	5,909,147	-5,909,147	5,619,239	-5,619,239	5,068,012	-5,068,012
Global equities**	23,379,500	-23,379,500	23,607,276	-23,607,276	19,656,009	-19,656,009	20,328,702	-20,328,702
Total	**62,208,095**	**-62,208,095**	**61,920,250**	**-61,920,250**	**48,465,862**	**-48,465,862**	**49,397,483**	**-49,397,483**
Impact on equity	18,641,767	-18,641,767	16,136,108	-16,125,272	12,720,918	-12,720,918	11,017,666	-11,006,625
Impact on the income statement	43,565,754	-43,565,754	44,469,134	-44,479,970	35,744,943	-35,744,943	38,379,818	-38,390,859

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

The above analysis demonstrates the sensitivity of the equity portfolio to equity price fluctuations. If market prices of the equities in the portfolio as at 31 December 2016 had been 10% above their disclosed values, the equity and profit of the Group would have been higher by EUR 18.6 million and EUR 43.6 million, respectively. In contrast, if the prices of the equities in the portfolio as at 31 December 2016 had been 10% lower than their disclosed values, the equity and profit of the Group would have been lower by EUR 18.6 million and EUR 43.6 million, respectively. The sensitivity of the equity portfolio presented in the table does not take into account the impact of changes in liabilities relating to unit-linked life insurance. In the equity portfolio of the Group, around 60% of the shares are tied to the liabilities of unit-linked insurance, while in Zavarovalnica Triglav their share is 71%. The impact of the change in shares on the income statement would have been even lower if the fact above were taken into account. The risks in both Zavarovalnica Triglav and the Group remain at the same level.

2.4.3 Property risk exposure

The value of investment **property** is calculated using valuation techniques. Valuation of property based on the existing methodology is performed by a an authorised valuer.

The share of investment property of Zavarovalnica is relatively low, representing just over two percent of the investment portfolio value, or EUR 46.5 million. The share of investment property of the Group amounted to EUR 95.8 million, accounting for three percent of the investment portfolio value. Immovable property of the Company and the Group is primarily located in Slovenia. Compared to the previous year, property risk exposure remained unchanged both at the Company and the Group level.

2.4.4 Credit spread risk

About two thirds of the Company's and the Group's investments are bond investments subject to the risk of growth and increased volatility of credit spreads. The sectoral analysis of bond exposure shows that the highest exposure is to issuers from the public and financial sector, together accounting for three quarters.

In their investment portfolio, the Company and the Group are exposed to counterparties with a high credit quality. Credit risk exposure resulting from debt securities is limited by the investment policy aimed at investing in high-quality securities. Over 40% of the debt securities in the Group's portfolio have a credit rating of at least "A", while those of the Company account for almost 50%. An overwhelming majority of debt securities in the investment portfolio of the Company and the Group are investment grade.

The structure of debt investments is presented in detail in the Management Report in [→ *Section 7.9*].

2.4.5 Currency risk

In 2016, 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.

The Company and the Group are only slightly exposed to currency risk as the currency structure of assets almost fully matchesthe currency structure of liabilities. Compared to the year before, currency risk exposure remained unchanged both at the Company and the Group level.

2.5 Credit risk

Credit risks arise in:

- basic insurance transactions with the clients who are in different financial positions at the time of existence of the obligation to pay the premium;
- conclusion of agreements with reinsurers as there is the risk of inability to pay out claims in the case of a loss event;
- management of investments in the framework of investment policies and therefore the risk of downgrade or insolvency of banks, in which the Company or the Group deposit their assets and the assets of counterparties in the conclusion of derivatives contracts.

The credit risk management system and its goals are defined in greater detail in the Credit Risk Management Policy. The main goals of the credit risk management process include:

- efficient and effective credit risk identification, measurement, assessment and management;
- establishment of appropriate procedures for minimising the probability of loss occurrence and limiting the loss arising from credit risk;
- management of the portfolio credit risk by investing assets in investments with an adequate credit rating, an expert analysis of counterparty credit risk and a sufficient degree of portfolio diversification;
- regular monitoring of credit rating of external institutions and limiting the exposure to non-rated counterparties;
- definition of restrictions and limits for permissible types of investments or types of financial instruments as well as the maximum permissible exposure to individual counterparties or a group of related parties;
- prudential consideration of the eligibility of business partners for reinsurance and fronting transactions and regular monitoring of their eligibility based on their credit rating and the adequate degree of diversification;

- regular monitoring of the Company's exposure to credit risk and checking of correctness and appropriateness of the assumptions used in establishing the credit risk management policy;
- implementation of an appropriate credit risk assessment in the context of own risk and solvency assessment;
- preparation of analyses, appropriate information and compiling of reports on credit risk exposure.

A limit system was established so as to achieve the goal of credit risk management. In terms of credit and concentration risks, the limit sets a reasonable and expertly determined maximum recommended exposure to counterparty.

The portfolio credit risk is managed by performing an expert analysis of counterparty credit risk and through a sufficient degree of portfolio diversification. Credit ratings of external institutions are regularly monitored, while limiting the exposure to non-rated counterparties. In addition, in order to monitor and limit the credit risks arising from the investment portfolio, the Company defined restrictions and limits for permissible types of investments or types of financial instruments as well as the maximum permissible exposure to individual counterparties or a group of related parties.

The limit system of exposure to banks was upgraded in 2016. In accordance with good practices and the market situation, both the credit rating methodology and the process of setting limits were upgraded. The latter now includes additional internal controls and allows for greater transparency. The limit system also includes soft indicators and additional warning signals.

The Group's total financial assets that may be exposed to credit risk (i.e. bonds, loans, derivatives, assets from reinsurance contracts, receivables and cash or cash equivalents) as at 31 December 2016 amounted to EUR 2,251,136,836 (vs. EUR 2,269,259,343 as at 31 December 2015). The structure of the abovementioned financial assets is discussed in greater detail in [→ *Section 7.9 of the Business Report*].

The credit risk of securities issuer default is primarily monitored in the context of market risk, specifically credit spread risk. See [→ *Section 2.4.4*] for a detailed description of exposure and management of such risk.

In addition to the abovementioned credit risk management techniques, prudential consideration of the eligibility of business partners for reinsurance and regular monitoring of their eligibility (credit rating, diversification) are of key importance. The adequacy of reinsurers' ratings is defined and monitored by the criteria of S&P rating agency, with the aim that the exposure to such risks never exceeds the criteria to be met by the insurers with the A credit rating. Risk reduction techniques are not used in this segment.

The Group's total credit risk exposure relating to reinsurers as at 31 December 2016 amounted to EUR 112,184,633 (vs. EUR 111,547,973 as at 31 December 2015), of which EUR 77,084,783 (vs. EUR 68,724,305 as at 31 December 2015) was accounted for by insurance technical provisions transferred to reinsurance contracts and EUR 35,099,850 (vs. EUR 42,823,668 as at 31 December 2015) by receivables for reinsurers' and co-insurers' shares in claims. As at the reporting date, the Group's total exposure to reinsurers accounted for 3.1% of assets (vs. 3.2% as at 31 December 2015). For further details see the tables in [→ *Sections 1.1 and 3.8 of the Accounting Report*].

2.6 Liquidity risk

The Group manages investments and assets in a manner allowing it to meet, at any given moment, all of its matured liabilities. To meet these liabilities, the appropriate structure of assets is maintained 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. Exposure to liquidity risk is limited by setting the relevant limit systems.

The Company is traditionally an institution with strong liquidity as the inflows from the core activity are permanent and additional security mechanisms (credit lines, repurchase agreements, etc.) were established for ensuring sufficient liquidity.

The liquidity risk management system and its goals are defined in greater detail in the liquidity risk management policy. Its main goals ensure:

- efficient and effective liquidity risk identification, measurement, assessment and management;
- availability of a sufficient quantity of liquid assets at any given time for the timely repayment of liabilities, which means ensuring the Company's liquidity at all times;
- daily meeting of all liabilities of the Company (on-balance-sheet and off-balance-sheet) in different currencies;
- meeting of liquidity ratios;
- economical management of any daily surplus liquid assets;
- monitoring of the liquidity gap (liquidity gap analysis);
- preparation, proposal, coordination and implementation of measures to prevent or eliminate the causes for the occurrence of illiquidity;
- regular monitoring of liquidity and checking of correctness and appropriateness of the assumptions used in establishing the liquidity risk management policy;
- implementation of an appropriate liquidity risk assessment in the context of own risk and solvency assessment;
- preparation of analyses, appropriate information and compiling of reports on liquidity risk exposure.

Total financial assets in both compared years significantly exceed total financial liabilities of the Triglav Group. The table shows the distribution of assets and liabilities as at the date of calculation by contractual maturity, which are not necessarily matched with the actual payments. As at the 2016 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 facts 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. The Group has high liquidity.

Financial assets and liabilities of the Triglav Group* by remaining maturity

in EUR

The Triglav Group as at 31 December 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**

* 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.).

in EUR

The Triglav Group as at 31 December 2015	Not defined	Under 1 year	From 1 to 5 years	From 5 To 10 Years	Over 10 years	Total
FINANCIAL ASSETS						
Financial investments	601,705,284	283,197,194	1,009,287,798	742,968,659	238,297,033	2,875,455,968
Debt securities	0	198,057,351	963,765,270	721,050,671	227,933,945	2,110,807,237
Held to maturity	0	8,505,634	91,273,061	55,229,894	87,815,548	242,824,137
At fair value through profit and loss	0	111,085,376	200,038,383	82,946,579	2,734,381	396,804,719
Available for sale	0	73,109,146	662,559,699	572,143,153	137,230,058	1,445,042,056
Loans and receivables	0	5,357,195	9,894,127	10,731,045	153,958	26,136,325
Equity securities	596,631,827	0	0	0	9,420,694	606,052,521
At fair value through profit and loss	443,056,414	0	0	0	0	443,056,414
Available for sale	153,575,413	0	0	0	9,420,694	162,996,107
Derivatives	21,472	0	3,721,910	1,101,100	0	4,844,482
Loans and receivables	5,051,985	85,139,843	41,800,618	20,816,888	942,394	153,751,728
Reinsurers' share of insurance technical provisions	3,430,237	31,954,458	15,234,155	12,402,652	5,702,803	68,724,305
Operating receivables	17,463,403	149,027,767	2,735,354	383,337	0	169,609,861
Cash and cash equivalents	31,714,529	18,108,189	0	0	0	49,822,718
Total	**654,313,453**	**482,287,608**	**1,027,257,307**	**755,754,648**	**243,999,836**	**3,163,612,852**
FINANCIAL LIABILITIES						
Insurance technical provisions	445,058,780	654,137,863	396,569,539	433,142,237	671,533,704	2,600,442,123
Other financial liabilities	1,289,449	7,462,804	602,853	1,238,864	17,596	10,611,566
Total	**446,348,229**	**661,600,667**	**397,172,392**	**434,381,101**	**671,551,300**	**2,611,053,689**

Total financial assets in both compared years significantly exceed total financial liabilities of the Triglav Group. The table shows assets and liabilities as at the date of calculation by contractual maturity. As at the 2016 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 facts 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. The Group has high liquidity.

Financial assets and liabilities of Zavarovalnica Triglav by remaining contractual maturity

in EUR

Zavarovalnica Triglav as at 31 December 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	104,330,575	705,720,151	728,874,355	192,809,428	2,227,311,934
Debt securities	0	94,844,225	679,033,655	700,604,727	191,210,303	1,665,692,910
Held to maturity			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		51,304,726	518,027,863	596,061,537	62,250,550	1,227,644,676
Loans and receivables						0
Equity securities	484,658,619	0	0	0	0	484,658,619
At fair value through profit and loss	348,635,283					348,635,283
Available for sale	136,023,336					136,023,336
Derivatives		1,357,920	1,885,594			3,243,514
Loans and receivables	10,918,806	8,128,430	24,800,902	28,269,628	1,599,125	73,716,891
Reinsurers' share of insurance technical provisions		2,834,169	3,835,906	1,686,119	2,485,463	10,841,657
Operating receivables	42,228	69,062,013	2,549,299	31,959		71,685,499
Cash and cash equivalents	27,653,646					27,653,646
Total	**523,273,299**	**176,226,757**	**712,105,356**	**730,592,433**	**195,294,891**	**2,337,492,736**
FINANCIAL LIABILITIES						
Insurance technical provisions	431,125,308	419,247,953	350,633,462	388,091,281	487,262,659	2,076,360,663
Other financial liabilities		1,288,664	427,844	99,630	36,578	1,852,716
Total	**431,125,308**	**420,536,617**	**351,061,306**	**388,190,911**	**487,299,237**	**2,078,213,379**

in EUR

Zavarovalnica Triglav as at 31 December 2015	Not defined	Under 1 year	From 1 to 5 years	From 5 To 10 Years	Over 10 years	Total
FINANCIAL ASSETS						
Financial investments	495,671,585	167,394,494	692,224,379	610,982,866	209,119,300	2,175,392,624
Debt securities	0	118,083,981	662,923,600	589,076,346	208,195,175	1,578,279,102
Held to maturity		6,491,125	40,781,749	46,538,604	84,438,778	178,250,256
At fair value through profit and loss	0	70,270,136	116,732,774	54,117,939	1,630,458	242,751,307
Available for sale		41,322,720	505,409,077	488,419,803	122,125,939	1,157,277,539
Loans and receivables						0
Equity securities	493,974,838	0	0	0	0	493,974,838
At fair value through profit and loss	383,798,181					383,798,181
Available for sale	110,176,657					110,176,657
Derivatives			3,721,910	1,101,100		4,823,010
Loans and receivables	1,696,747	49,310,513	25,578,869	20,805,420	924,125	98,315,674
Reinsurers' share of insurance technical provisions		209,663	918,499	4,673,528	1,998,957	7,800,647
Operating receivables		76,422,804	2,475,181		0	78,897,985
Cash and cash equivalents	7,549,958					7,549,958
Total	**503,221,543**	**244,026,961**	**695,618,059**	**615,656,394**	**211,118,257**	**2,269,641,214**
FINANCIAL LIABILITIES						
Insurance technical provisions	438,920,157	422,794,419	316,076,251	364,322,589	511,142,255	2,053,255,671
Other financial liabilities		151,672	345,756	1,237,963	17,599	1,752,990
Total	**438,920,157**	**422,946,091**	**316,422,007**	**365,560,552**	**511,159,854**	**2,055,008,661**

Similar findings in relation to the financial asset-liability maturity mismatch risk or potential liquidity risk with regard to meeting the financial liabilities to the policyholders of the Triglav Group also apply to Zavarovalnica Triglav in both years.

In recent years, neither the Group nor the Company ever had to liquidate assets in order to cover regular liabilities from insurance thanks to the premium inflow. The Company calculates the liquidity ratios and regularly monitors, analyses and plans the cash flows within the framework of liquidity risk management.

2.7 Operational risk

Operational risk is defined as the risk of loss due to:

- inadequate or inefficient internal procedures (disruption of work procedures, client complaints, lack of reliable information for the management, disruptions to business continuity, improper cost management, poor change management, inconsistent or incomplete process documentation, etc.);
- inappropriate or inefficient staff behaviour (inadequate human resource management, key staff turnover, lack of know-how and skills, inappropriate staff actions, etc.);
- inadequate and inefficient functioning of systems (obsolete software and/or infrastructure, lack of documented audit trails in software, inadequate control of system operability, etc.);
- external events (changes in legislation, natural disasters, competition, etc.).

For identifying and measuring operational risks, the Group established the system and developed tools, which define their type, underlying reasons and consequences, operational risk assessment, measurement and monitoring methodology and internal control identification as one of the key ways of effective and efficient operational risk management. The internal control system focuses primarily on:

- accuracy and reliability of financial and accounting reporting,
- ensuring compliance with the applicable internal documents and regulations,
- effectiveness and reliability of business process implementation, and
- protection of property.

In order to achieve effective and efficient operational risk management, an appropriate work climate and organisational culture are maintained. The Company is aware that the organisational culture is one of the key components for the efficient management of such risks incurred in all business processes. For this purpose, employees need to be encouraged to be active in improving the process and, if necessary, to propose and set up additional controls so as to reduce the number of future loss events and the costs of remedying their consequences. As a result, effective operational risk management can strengthen the confidence and loyalty of clients, shareholders and the general public that the Company is committed to good and fair business practices.

The aim of effective operational risk management is mainly to effectively remedy the consequences of events, mitigate and prevent future losses (preventive effect) and to conduct operations with professionalism, due diligence and business ethics. It is important that all employees are informed about operational risks, threats and benefits of regular and timely notification of loss events.

The system and the Company's own operational risk identification, assessment, management and reporting methodology have been developed in compliance with the established good practices. The quantitative and qualitative exposure to operational risks is measured with the applied methodology, which primarily focuses on the most critical business processes or segments of operational risks. As feedback information, the process analysis uses the loss event database for future process optimisation.

The established operational risk management system is based on four key sets:

1. assessment of potencial operational risks,
2. internal database of operational risks taken or loss events,
3. external database of operational risks faced or loss events and
4. key risk indicators for operational risks, including the early warning signals for individual groups of operational risks.

These four sets provide a complete overview of the assessment of operational risks that are faced in the course of operations. In accordance with The Operational Risk Insurance Consortium, all seven groups of operational risks are integrated into the identification, assessment, measurement, monitoring, management and reporting system:

1. internal fraud or unauthorised activity of employees;
2. external fraud or unauthorised activity of third parties;
3. system break-down and the related system disruption;
4. damage to physical assets;
5. inadequate management of human resources and the safety of the working environment;
6. non-compliance with the applicable regulations, improper business or market practice, as well as clients and products;
7. inadequate implementation and management of processes and the control environment, including suppliers and business partners.

2.7.1 Internal fraud risk management

The Company has zero tolerance to internal crime or internal fraud, including the leaking of information to unauthorised persons.

The analysis has showed that the number of confirmed cases of internal insurance fraud committed by employees declined.

The data have showed strong loyalty and ethics of employees as well as system efficiency. The Compliance Office, which is responsible for handling internal non-insurance fraud cases, neither detected fraud nor received notifications of new suspicions of internal fraud committed by employees in 2016.

2.7.2 External fraud risk management

The insurance industry is faced with a number of adverse effects of fraud. In Zavarovalnica Triglav, the implementation of a comprehensive fraud management policy is the responsibility of the Fraud Prevention, Detection and Investigation Department, the Compliance Office, the Internal Audit Department and the Risk Management Department. Even though the Company is mostly exposed to insurance fraud, its fraud prevention, detection and investigation policy encompasses all business areas. It includes underwriting and claim settlement as well as areas such as relations with suppliers and insurance brokers, financial investments, human resources.

In 2016, the number of frauds committed by third parties increased (insurance fraud committed by persons who are not in an employment or contractual relationship with Zavarovalnica Triglav). The number of received notifications of insurance fraud suspicions went up by 40% over the previous year. The number of detected suspicious loss events mainly grew due to the upgrade of the computer system for monitoring key fraud indicators, which enables better identification of fraud suspicions when compared to the previous period. The number of confirmed insurance fraud cases increased (by 44%) in relation to the higher number of received notifications.

2.7.3 Ensuring business continuity and functioning of systems relevant for smooth business process implementation

The appropriate functioning of IT (key applications) also has a significant impact on the operations of the Company). Consequently, special attention is devoted to IT risk management, information security, the group of operational risks of system break-down and the related business disruptions. Relatively short failures in availability or proper functioning of certain system or application components and inappropriate protection against abuse can lead to a significant loss in operating income and loss of reputation. Last year, the Company conducted a risk analysis concerning the use and development of IT applications. In the case of identified key risks, some measures for reducing these risks were already taken, however further measures have continued to be implemented The main activities include adequate process adjustment, especially the implementation of the entire development procedure, change management and introduction of complete and more appropriate testing, as well as information and application infrastructure optimisation.

In 2016, Zavarovalnica revised its business continuity management rules and system. An extensive stress test as a simulation of losing the primary location and transferring the functioning of key applications to a replacement location was performed in the scope of this process.

In 2016, operational risk indicators of system break-down showed that a high level of availability of information system servers was reached, and it even slightly improved over the last year.

The network availability was also high. It was actually 100% in the headquarters, regional units and representative offices. The risk of computer system virus infection was also controlled adequately. The satisfaction of users with IT support slightly dropped. In spite of this, it was assessed as very good (9.5) on a scale of 1 to 10 (vs. 9.71 in 2015).

2.7.4 Protection against damage caused to the physical assets of the Company

In 2016, there were six minor loss events related to the damage caused to the physical assets (nine in 2015); due to appropriate insurance the direct damage was negligible in the income statement.

2.7.5 Management of human resources and safety of the working environment

In human resource management, the average number of training hours per employee went up by 8% when comprared to the previous year. The employee turnover was slightly higher, which is also a result of the optimisation, reorganisation, digitisation and redesign of business processes. Sick-leave absenteeism remained at the similar level as in 2015, the average expense for sickness benefits per employee slightly decreased.

The safety of the working environment additionally improved as the number of accidents was significantly lower.

2.7.6 Compliance with the law and business and market practices

Exposure related to compliance is described in [→ *Section 12.5 of the Business Report*].

2.7.7 Adequate implementation and management of processes and the control environment, including relations with business partners

The Company established a process register and an internal control register, where the responsible persons – owners and managers are appointed for each process and control. With respect to the changes in the Company and the business environment, both registers are updated on a regular basis.

The data quality management (DQM) process was established, which also includes a data flow list and its key controls from the input to the final use.

2.8 Non-financial risks

The major non-financial risks include strategic risks, reputational risk and the Group risks. 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.

Willingness to assume non-financial risks or tolerance to this segment of risks is defined as low in the Strategy and the Risk Appetite. Internal culture, the governance system and all business practices are set up to avoid these risks and minimise their negative effects on the operations of the Triglav Group.

2.8.1 Strategic risk

The Triglav Group addresses strategic risks already within the strategic planning process, including the annual planning process. The business strategies of individual Group members are aligned with one another and with the strategy of the Triglav Group. The strategy implementation process is monitored with internal controls, while competences and responsibilities of the above-mentioned bodies in managing strategic risk are clearly defined. The implementation of strategic objectives is regularly monitored both at the Group level and in individual companies. The implementation of capital requirements is also subject to regular monitoring using contemporary models and tools as well as good business practice, which is possible due to best practices and the exchange of information between the

Triglav Group companies. As the attainment of strategic objectives and performance can also be affected by external factors, the Company also monitors market indicators and indicators related to the broader economic environment.

Due to changes in the environment, strategic risks are defined as material. The Company and the Group manage the demanding circumstances in regulation and supervision of financial institutions by ensuring sufficient responsiveness and resources that enable adapting to the quick changes and new requirements. Additionally, the technological impact and risks associated with digitisation of operations play an important role in the industry. The response to these changes is one of the key elements of the business strategy for the following period. Complex consolidation processes have also taken place in financial markets and the insurance sector, both worldwide and in Slovenia. This is a relevant factor for the Company and the Group as it changes their competitive position. On the one hand, it strengthens direct competition, and on the other it has an impact on the policyholders' business decisions.

2.8.2 Reputational risk

The basic element of the reputational risk management system is a robust corporate governance system, which is supported with internal documents and the following additional activities at the Company and the Group level:

- collecting and analysing client feedback;
- monitoring media reporting on the Company, including the social media;
- monitoring and analysis of semi-annual reputation measurement of the Company;
- public relations management;
- management of investor relations;
- due diligence in ensuring compliance with the applicable legislation and in the management of relations with supervisory bodies and agencies;
- continuous monitoring of business, economic, social and regulatory trends that might be the source of future risk;
- management of relationships with potentially antagonistic special interest groups.

An important element of effective reputational risk management is also an efficient internal information flow and communication system, which ensures proper knowledge and uniform 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 Company in the public.

2.9 Stress tests

In addition to the described riskmeasurement methodologies, the Company and the Group regularly conduct stress tests for all important types of risks, monitor and assess the potential impact of exceptional events on their risk profile.

Stress testing and the scenario analysis are part of the own risk and solvency assessment process (ORSA), which is regularly carried out at the Group level. Stress tests measuring impacts of possible relevant scenarios are performed for the needs of the future-oriented risk assessment.

Stress tests include the establishment of effect of a simultaneous change in several parameters, e.g. simultaneous change in different risk categories that influence the insurance transaction, investment values and changes in interest rates. An appropriate scope of adverse circumstances which could have an impact on the operations is identified on the basis of the risk profile, the proportionality principle and under consideration of the actual or planned exposure to:

- adverse circumstances that can last for long periods of time;
- sudden and major events, such as significant changes in capital markets and natural disasters;
- combinations of circumstances and events from the first and second indents, whichcan include sudden and major events followed by an economic recession.

Stress tests were prepared on the basis of workshops held with functional areas. They include the scenarios which are estimated as relevant for the current and the following financial year. The results of these scenarios showed that market risks are most burdening for capital. In 2016, the scenarios of market, insurance and strategic risks were assessed at the level of the Company and the Group within the scope of the regular own risk and solvency assessment. The conducted analyses confirm that sufficient capital is available to both the Company and the Group to offset the effect of the stress scenarions used. All the scenarios are within the framework of limitations determined in the Risk Appetite Statement.

In mid-2016, the European Insurance and Occupational Pension Authority (EIOPA) tested the resilience of the European insurance sector to a long lasting period of low interest rates, a combination of shock to government bonds and a fall of the risk-free interest rate curve.

It created two market scenarios to assess the main system risks in the financial system. The first scenario is intended for the assessment of resilience of insurance companies to a long-lasting period of low interest rates ("low for long"). The second scenario ("double hit") was prepared in cooperation with the European Systemic Risk Board (ESRB) and represented the dynamics on the global financial markets in the event of a decrease in market prices of government and corporate bonds as well as a decrease in shares and other investments.

The research involved 236 insurance companies from 30 European countries. The sample used included 77% of all life insurance technical provisions (excluding health and unit-linked) in the European Union. These insurance companies had EUR 6.3 trillion assets and EUR 5.2 trillion insurance technical provisions.

The key results of stress tests showed that insurance companies increased their reserves in spite of the unfavourable economic environment in Europe.

The stress test results at the level of Zavarovalnica Triglav showed that the Company is well capitalised and highly resilient to external shocks.

Comparison of EIOPA stress test results

	Double-hit		Low for long	
	in EUR billion	in %	in EUR billion	in %
Change in assets				
Europe – sample	-608.50	-0.10	282.40	0.05
Slovenia	-0.41	-0.09	0.07	0.02
Zavarovalnica Triglav	-0.27	-0.10	0.04	0.01
Change in liabilities				
Europe – sample	-449.50	-0.08	381.50	0.07
Slovenia	0.00	0.00	0.20	0.06
Zavarovalnica Triglav	0.02	0.01	0.13	0.07
Change in the surplus of assets over liabilities				
Europe – sample	-159.00	-0.29	-99.10	-0.18
Slovenia	-0.41	-0.34	-0.12	-0.10
Zavarovalnica Triglav	0.29	-0.34	0.09	-0.11

2.10 Risk management – focus in 2017

As in previous years, Zavarovalnica Triglav and the Triglav Group will continue to maintain high standards in terms of the risk management process. In order to ensure sustainable and profitable growth, great attention is paid to constant improvement of the risk management system.

In future, the Company will continue to develope internal risk measurement methodologies and strengthen their application in the business decision-taking process. In order to ensure high-quality information to the decision-making bodies, risk profile reporting will be upgraded, both at the level of the Group and the Company. A continuous upgrade of the operational risk management system and strengthening of the risk management culture will go on. In 2017, the data presented in the form of the Solvency and Financial Condition Report will be, for the first time, disclosed publicly in line with the legal provisions. Further integration of the management system at the Group level will be also in progress with the aim to provide a higher level of compliance of management, measurement and key risk reporting processes in subsidiaries of the Group.

Summary

The risk appetite is defined in the framework of well-established processes. Zavarovalnica Triglav and the Triglav Group have a clearly defined and documented risk appetite, which has been effectively communicated in the entire Group.

Throughout the year, the Company and the Group regularly assessed their own exposure to risks and compared it to the defined appetite. It is estimated that the Company's and the Group's risk profile are appropriate and that the risk management system is adequate.