AAS „BTA Baltic Insurance Company”
Risks and Risk Management

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RISK MANAGEMENT SYSTEM

The business of insurance represents the transfer of risk from the insurance policy holder to the insurer and management of this risk.

The Company, pursuant to the Insurance and Reinsurance law, which includes the requirements of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on starting and doing the business of Insurance and Reinsurance (Solvency II) requirements, and VIENNA INSURANCE GROUP AG Wiener Versicherung Gruppe (hereinafter referred to as the Group) requirements, has established a risk management framework as a systematic set of measures that provides risk identification, assessment, risk mitigation, and risk monitoring and reporting, with a clearly defined rights and obligations of all involved structural units and individuals.

The company's risk management system covers the following areas: risk underwriting and reserving, asset and liability management, investment management, liquidity management, operational risk management and risk mitigation activities.

Each of the above areas has clearly defined risk management principles, responsible departments and individuals.

All risks are divided into three groups:

- insurance risks;
- financial risks;
- operational risks.

The risk management process starts with the identification of risks. Its purpose is to detect, identify and document all possible sources of risk that could affect the attainment of the Company's objectives. Risk identification is carried out regularly, at least once a year. It includes the existing risks that might have changed and the review of their sources as well as the detection and documentation of new risks. In order to avoid unacceptable risks, a risk analysis is carried out before the introduction of new products or processes.

For risk assessment of risk categories, when sufficient historical data are available for statistical analysis such as market risk, credit risk, insurance risks and others, the Company uses a quantitative risk assessment using the standard formula. The Company uses qualitative risk assessment, e.g. an expert assessment, when sufficient data are not available to perform statistical analysis, such as operational, strategic, reputational risks. The result of the expert assessment is the result of the possible occurrence and impact interactions.

After qualitative or quantitative risk assessment and materiality assessment of the risk, the Company chooses the control methods to reduce the risk. In order to ensure the effectiveness of control measures, the Company prefers preventive and automatic controls.

The Company regularly monitors its risk profile. The full calculation of the required solvency capital is carried out once a quarter, as well as regular stress tests, sensitivity tests if the actual indicators differ from estimates of the own risks and solvency assessment. The use of the standard formula corresponds to the Company's risk profile, which is assessed in the own risk and solvency assessment.

The Company ensures annual own risk and solvency assessment by assessing the possible impact of various exceptional, but possible adverse events or changes in market conditions on

the Company's ability to meet its obligations under insurance contracts and to ensure the stability of its financial performance.

Based on the assessment prepared, the Management Board of the Company makes decisions on the actions to be taken in the event of changes in the assessment of events or market conditions subject to certain conditions, measures and follow-up. The results of the evaluation are used in strategic and operational planning, budgeting process, as well as in cases when significant changes in the Company's activities are planned.

The company performs stress tests at least once a year, in which potential scenarios are assessed and documented. Stress tests use sensitivity and scenario analysis. The sensitivity test is performed to determine the effect of the negative effects of a particular risk factor, but a scenario analysis is performed to determine the impact of multiple risk factors when assessing the occurrence of an extreme but a potentially adverse event or market situation. Also reversal stress tests are performed, that show what a set of events should take for the Company to have a solvency ratio of less than 100 percent.

In order to ensure the reliability of the risk management system, risk measurement, analysis and control functions are separated from business functions, e.g. the Company ensures that those who affect the risk profile are not simultaneously assigned risk monitoring and risk control, as well as the Company regularly and systematically educates its employees in order to raise their awareness of the risks.

INSURANCE RISK MANAGEMENT

RISK UNDERWRITING

The underwriting of insurance risks includes all types of non-life insurance, as defined in the Insurance and Reinsurance law. The peculiarities of insurance products, insured risks and their limitations are set out in the Company's internal regulatory documents and publicly available product terms and conditions.

The underwriting risk of the company is comprised of three components:

- risks arising from non-life insurance underwriting liabilities;
- risks arising from health insurance underwriting liabilities;
- risks arising from life insurance obligations. As the Company is a non-life insurance company, the risk of underwriting of life insurance arises from claim payments in compulsory third-party motor vehicle insurance (MTPL).

In order to reduce the risk, the Company's underwriting strategy is based on diversification of risks, which ensures the maintenance of a balanced portfolio of risks for several years. The Company carries out thorough product monitoring in order to prevent the emergence of negative trends in a timely manner to improve the required performance and adjust the risk level in accordance with the strategy and the annual plan.

The main measure of risk level is the loss ratio, the combined ratio and the net earned premium for each insured risk, for each type of insurance and country. To generate revenues from insurance premiums that could cover expected insurance claims and costs, for the identification and measurement of risk, the Company:

- carries out market analysis;

- analyses the potential limitations of insurance premium reserves in relation to the investment environment;
- analyses market loss statistics;
- analyses individual customer historical loss statistics together with relevant insurance coverage information;
- constantly monitors the key risk events, risk factors, as well as new risks;
- assesses the level of prices in the insurance market.

In order to ensure that the risk underwriting process always meets the qualitative and quantitative standards set by the Company, internal regulatory documents have been developed that ensure a unified risk underwriting process in all the Baltic States.

The company prepares reports for types of insurance as well as for sales channels, assessing the impact of the internal and external environment on the particular service. In order to ensure the fulfilment of strategic goals based on the results of the analysis, the Company decides on changes in price policy, methodology, priority segments (customer, product, geographic), and ensuring diversification of risks.

RESERVING

The Company ensures that the technical reserves are set up to the extent that the Company can fully meet its obligations under the insurance and reinsurance contracts concluded. Reserves are calculated on the basis of the insurance contract data in the accounting system and the necessary calculations are made in accordance with these data, cautiously, reliably and impartially.

The key assumption used in the calculation of technical provisions is that the claim statistics are stable and that the future claim development will be the same as in the past. Reserves, excluding the life reserves, are not discounted.

Insurance case estimates are regularly reviewed and updated when new information becomes available.

Within the actuarial function, the Company ensures the accuracy and completeness of the data used, performing sufficiently extensive and detailed inspections.

The Company regularly performs technical reserve sufficiency controls.

INSURANCE RISK CONCENTRATION

In the insurance process, the risk concentration arises when an individual event or series of events can have a significant effect on the amount of liabilities of the Company. Risk concentrations may arise in connection with one insurance contract or several related contracts that may result in significant insurance liabilities.

Risk concentrations may arise due to different regularities and cases. The most frequent risk concentration is observed in personal risk insurance, e.g. assistance or accident insurance, when a group of people suffers from an accident, and all of these persons are insured in the Company. In property insurance, risk concentration could arise if one of the small, densely populated areas encounters one of the risks (for example, a fire) that can easily move from one object to another and can not be prevented.

The Company is aware that risk concentration is possible for one company or economic sector as a whole, which is insured for several risks. When insuring such risks, a mandatory precondition is to assess the financial position and capacity of the client, as well as to determine how big a financial liability can arise, how much risk the Company already carries in relation to this customer and what additional risk it can take. In assessment of financial risks, the Company evaluates trends and risks of economic development that can affect the respective industry.

To reduce the concentration risk the Company:

- determines the total risk that it is prepared to take in relation to the risk concentration. The Company monitors these risks both at the time of signing the risk and regularly reviewing the reports showing the concentration of the main risks to which the Company is exposed;
- uses reinsurance – both proportional and non-proportional. When obtaining reinsurance, the Company's share in risk is determined per one object and one event, when losses can happen simultaneously for several objects. The Company constantly evaluates the costs, benefits and the impact on capital with regards to the reinsurance programme.

Concentration risk is tested and evaluated in different scenario tests. Stress testing results are used in decision making to understand what concentration risk the Company can accept.

CATASTROPHE

The management of the Company is aware of the potential man-made and natural disaster risks. In the geographical situation of the Company, these risks are most related to meteorological phenomena. The most common natural disasters are floods and storms. Large-scale fires and earthquakes are unlikely, but probability of them exists. In order to reduce the impact of natural disaster risks on the Company, proportional and non-proportional reinsurance is used. The Company has developed a methodology for determining the retention. It depends on many factors and historical statistical information in each product group. Catastrophe risk is also tested and evaluated in scenario tests, controlling its impact on the capital.

FINANCIAL RISK MANAGEMENT

The Company is exposed to financial risks in its investment activities. Financial risks include:

- market risk (including interest rate risk, equity risk, property risk, spread risk, market concentration and currency risks);
- credit risk (counterparty default risk);
- liquidity risk.

Financial risks are managed in accordance with the Group guidelines for Asset Management. For risk mitigation purposes, investments are made in different financial instruments - diversifying the investment portfolio, analysing assets before their acquisition, regularly monitoring financial instruments, obtaining and analysing available information.

The Company has developed an Investment and Risk Strategy that defines the security, quality, liquidity and profitability requirements that Company intends to achieve for the entire

investment portfolio, activities aimed at achieving them, as well as the internal quantitative limits for assets and exposure to risk.

The Company, on the basis of its investment strategy, asset and liability strategy, regularly assesses the short-, medium- and long-term effects of financial and insurance risks on its assets and liabilities.

MARKET RISK

With the market risk, the Company understands the risk of a loss or a negative change in financial position that may arise from fluctuations in market prices of assets, liabilities and financial instruments, including interest rate risk, equity risk, property risk, spread risk, market concentration and currency risks.

Market risk is limited by diversifying the investment portfolio and analysing assets before they are acquired, as well as ensuring their regular monitoring. The management of assets and liabilities closely monitors the currency and maturity matching. When making investments, preference is given to high-rated and low risk financial instruments. In accordance with the investment policy, the Company ensures that at least 90% of the assets required to cover technical provisions are placed in high-liquidity investments.

To regulate the risk concentration in financial instruments, the Company has set investment limits for one counterparty and a group of financial instruments as a whole, thus controlling the concentration risk and the required solvency capital.

CREDIT RISK (COUNTERPARTY DEFAULT RISK)

The credit risk or counterparty default risk reflects losses or adverse fluctuations in value of financial instruments that may occur in the next twelve months because of an unexpected default of counterparty or debtor or a decrease in their creditworthiness.

For risk mitigation and control of investment and reinsurance activities, strict conditions are set at the Group level, such as certain limits for investments, for business partners, for reinsurance: certain criteria for the selection of business partners, such as reinsurers (for example, ratings), cooperation limits and rules.

In addition to the above, the Company ensures effective debtor monitoring, which allows to detect possible defaults timely and to mitigate potential consequences.

LIQUIDITY RISK

Liquidity risk is the risk that the Company will not have funds available to meet its obligations without additional expenses or time delay. This risk includes the mismatch in maturity structure of assets and liabilities.

In accordance with the Company's investment strategy, the Company makes investments in high liquidity financial assets. The prevailing part of the financial assets has an active market, which allows selling assets in a short time and with minimal or no expense. Taking into account the above, the liquidity risk is considered low. The Company controls this risk through continuous monitoring of financial markets, as well as maintaining a part of the available financial resources in credit institutions on current accounts.

OPERATIONAL RISK

In the definition of operational risk, the Company includes the risk of inadequate or incorrect internal procedures, mistakes of personnel or systems, or external events. To cover operational risk, the capital requirement is calculated using the standard formula. As a result of the annual assessment of risk profile and internal control system, three most material operational risk categories were defined:

- other legal and compliance risks (mainly related to the protection of personal data and competition law);
- the risk of human error;
- process and organizational risk.

In order to minimize the operational risk, the Company chooses different control strategies - preventive, for example, by setting access/authorization levels, corrective (focused on early warning and mitigation of an operational risk event recurrence), and identifying ones that are targeted to detect operational risk events. The company develops internal regulatory documents for essential processes and provides staff training.

The Company collects and register the data on operational risk events, their causes, consequences and measures taken to prevent their recurrence. One of the objectives of operational risk management is to ensure that the control efficiency indicator is not less than 95% (calculated in the process of evaluating the internal control system).

In order to ascertain the conformity of the standard formula with the operational risk assessment, the Company also uses the operational risk self-assessment (risk assessment probability and potential impact assessment) to identify and evaluate operational risk. The Risk Management Function, in co-operation with each risk holder, expresses qualitative and quantitative assessments and classifies possible operational risk events, thus identifying the Company's operational risk level and the necessary controlling activities to reduce it.

The Company considers the capital requirement for operational risk calculated with the standard formula, to be adequate.