# Subsidiaries' Activities and Risk Management

Sampo Group's subsidiaries independently decide on the governance structure of their own operations as well as on the policies, limits, authorizations and instructions relating to specific areas in accordance with the guidelines defined by the parent company.

The executive management of the subsidiaries have extensive experience in the insurance industry as well as in financial and risk management. The members of the subsidiaries' Boards of Directors, who are mainly in senior management positions in Sampo plc, have also complementary investment, financial, risk and capitalization as well as mergers and acquisitions expertise. The members of different committees and governing bodies represent expertise related to business and other functions. The subsidiaries' operations are monitored by the different governing bodies and ultimately by the Boards of Directors.

Since only the main guidelines are prepared by the parent company, the subsidiaries' managements have the power and responsibility to incorporate the specific characteristics of their own operations to the company specific policies and instructions. The regulatory environment and stakeholders' expectations are naturally also directly reflected in the organization of the subsidiaries' operations.

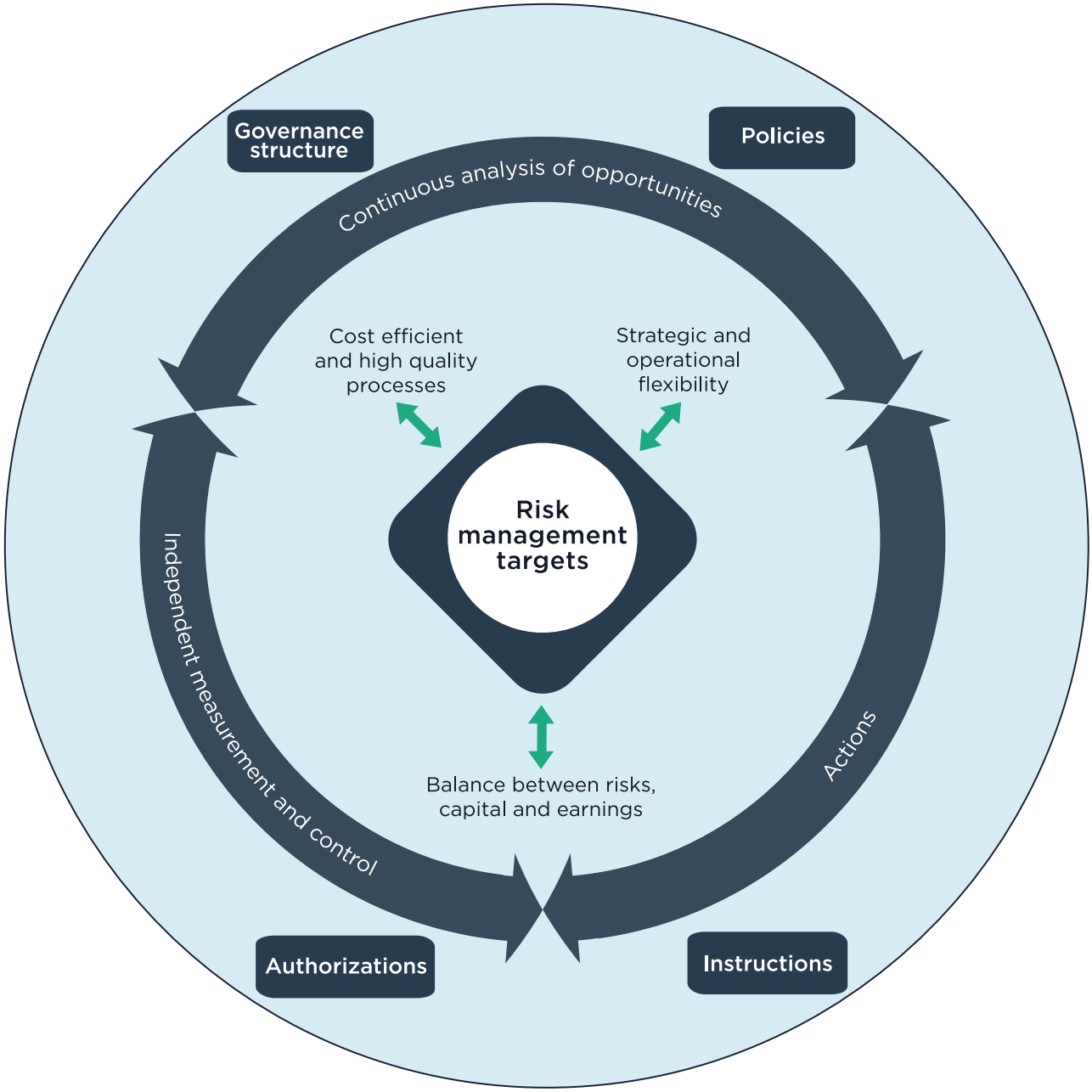
At operative level, the subsidiaries are focusing on effective execution of insurance operations and financial and risk management activities. Investments are managed according to the Investment Policies which are approved by the Board of Directors of the respective subsidiaries. Parent company led day-to-day management of investments facilitates simultaneously effective execution of subsidiaries' investment policies and the group wide oversight of investment portfolios.

The risk management process consists of continuous activities that are partly a responsibility of the personnel involved in business activities and partly a responsibility of independent risk management specialists. The responsibilities of business lines and independent risk management are clear. In addition in Sampo Group these functions are in a continuous dialogue.

Parties independent of business activities are responsible for the risk management governance framework, risk policies, risk limits and authorizations, which form the structure that sets the limits for business and investment units' risk taking and principles for risk monitoring. These structures are one prerequisite for the risk management process and they reflect capital adequacy targets and risk appetite in general.

The figure Company Level Risk Management System illustrates the (i) prerequisites, (ii) tasks and (iii) targets of company level risk management.

## Company Level Risk Management System




The central **prerequisites** for facilitating successful risk management include the following:

- Risk management governance structure and authorizations (see Risk Governance section)
- Companies' own risk policies and more detailed instructions related to risk management
- Prudent valuation, risk measurement and reporting procedures

The **tasks** included in the risk management process can be classified as follows:

Financial and risk management functions are explicitly responsible for **independent measurement and control**, including monitoring of operations in general as well as profitability, risk and capitalization calculations.

In addition to the statutory financial statements and solvency figures, Sampo Group companies also use internal performance, risk and capital measures based generally on fair values of assets and liabilities. Capital

adequacy is assessed internally by comparing the available capital (adjusted solvency capital "ASC") to the amount of capital needed. ASC includes, in addition to the capital components included in the Solvency I framework, other loss absorbing items (equalization provision, discounting effects) which will be part of capital base in Solvency II framework.

The assessment of capital need includes the following phases:

- The Economic capital model is used to define the capital needed for measurable risks of current activities (Economic Capital "EC");
- An additional risk buffer is added over the measured EC. General uncertainty of business environment, less quantifiable risks (e.g. strategic risks, low probability and high impact events, liquidity risks) and potential model risks affect the size of the additional buffer;
- Because earnings are the first buffer against potential losses, expected profitability is also taken into account when considering the buffer needed over the EC.

## Independent Measurement and Control - Output Examples:

- Detailed reporting on risks to subsidiaries' and Sampo plc's Risk Committees and the Boards of Directors.
- EC and ASC is reported internally at least on a quarterly basis.
- Regulatory and rating agency capital charges and capital positions are reported internally on a quarterly basis.
- Internal and regulatory capitalization figures are disclosed quarterly as well.

Business lines and financial and risk management functions are both active in supporting the business with **continuous analysis and assessment of opportunities**. This can be seen as a separate phase in the risk management process since a significant part of the time in insurance and investment business units is consumed on a daily basis on assessing different business opportunities and especially their risk return ratios. In financial and risk management functions, on the other hand, considerable amount of time is spent on risk assessment and capital planning.

## Continuous Analysis of Opportunities - Output Examples:

- Business opportunities and respective earnings potential and capital consumption are identified.
- Product and service development, investment opportunities and respective earnings potential and capital need.
- Plans for intra-group and external dividends.
- Initiatives on hybrid and senior debt issuance.

**Actions**, i.e. transactions representing the actual insurance and investment operations are performed in accordance with the given authorizations, risk policies and other instructions. These actions are the responsibility of business and centralized functions such as the investment unit. Activities related to capitalization and liquidity positions are included in this part of the process. In Sampo Group, proactive profitability, risk and capital management actions are seen as the most important phase in the risk and capital management process. Hence, risk policies, limits and decision making authorizations are set up in a way that they, together with profitability targets, facilitate business and investment units to take carefully considered risks.

## Actions - Output Examples:

- Pricing of insurance policies and execution of investment asset transactions.
- Execution of dividend payments, share buy-backs, hybrid issuances and senior debt issuances.
- Execution of derivative and reinsurance transactions.
- Business acquisitions and divestments.

High quality execution of the tasks above contributes to the achievement of the three central **targets** of the risk management process:

**Balance between risks, capital and earnings**

- The risks affecting profitability as well as other material risks are identified, assessed and analyzed;
- Capitalization is adequate in terms of risks inherent in business activities and strategic risks, taking into account the expected profitability of the businesses;
- Risk bearing capacity is allocated to different business areas in accordance with the strategy;
- Underwriting risks are priced reflecting their inherent risk levels, expected returns of investment activities are in balance with their risks, and consequential risks are mitigated sufficiently.

**Cost efficient and high quality processes**

- Client service processes and internal operative processes are cost efficient and of high quality;
- Decision making is based on accurate, adequate and timely information;
- Continuity of operations is ensured and in case of discontinuity events recovery is fast and comprehensive.

**Strategic and operational flexibility**

- External risk drivers and potential strategic risks are identified and the company is in a good position, in terms of capital structure and management, to react to changes in business environment;
- Corporate structure, knowledge and processes in companies facilitate effective implementation of changes.

When the above targets are met, risk management is contributing positively on return on equity and mitigating the yearly fluctuations in profitability. The risk management process is therefore considered to be one of the contributors in creating value for the shareholders of Sampo plc.