RISK REPORT 2014

Topdanmark
Forsikring • Pension

Reg.No. 78040017

Contents

Risk management

Topdanmark's policy is to hedge against risks arising from the Company's activities or to limit such risks to a level that allows the Company to maintain normal operations and implement its planned measures even in the case of highly unfavourable events in the outside world.

As a consequence of this policy the Company has, for a number of years, identified and reduced or eliminated those risks which could potentially cause losses exceeding what Topdanmark considers to be acceptable. For example, major strategic shareholdings have been sold, the catastrophe cover for weather-related events or terror has been increased significantly and the financial risk reduced.

In this light it is Topdanmark's opinion that the Company's future annual results will, with a very high probability, be positive even in the event of, for example, another collapse in the financial markets as in 2008.

In order to ensure strict control of the overall risk, the exposures are calculated as often as deemed necessary, i.e. daily, monthly, quarterly or in a few cases annually, according to the nature of the exposure.

The Board of Directors determines the overall risk policies and limits. The internal auditors report to the Board of Directors and report on, among other things, the observance of these risk policies and limits.

Topdanmark's Risk management function identifies, assesses and quantifies risks. It reports to the Risk Committee, which is responsible for risk policies, risk limits, solvency calculation, capital plans, Topdanmark's own risk and solvency assessment (ORSA) and Topdanmark's partial, internal model for non-life insurance risks. The members of the Risk Committee are the CFO of the Group and the heads of the primary risk areas, which are: Asset Management, Statistical Services, Reinsurance, Finance, Life Actuarial Services and Life Finance. The Risk Committee reports and recommends to the Board of Directors via the Executive Board.

The Risk committee has set up the Model committee, which is responsible for developing and operating Topdanmark's internal model for calculation of results probabilities and risks of the non-life insurance portfolio based on random simulation.

The internal model has been amended to meet the requirements of use in solvency calculations in accordance with the Danish solvency rules in force in 2014 and 2015 and the future EU Solvency II rules with effect from 2016. The model is used for, among other things, optimising the reinsurance programme, cost of capital, forecast balancing and calculating capital requirements.

The risk management function implements an annual ORSA process identifying risks in the business, quantifying these risks and collecting them in a risk register. Additionally, the principles of solvency calculation are reviewed, and the risk management process is updated. An ORSA report has been prepared, which, together with the risk register and risk management process, was considered at a Board seminar in the autumn of 2014.

The risk management function has addressed the new rules for solvency calculation, reporting etc. of the Solvency II Directive in order to ensure that Topdanmark meets this set of rules no later than when it takes effect in 2016.

Review

Topdanmark believes that the Group's most important risks relate to the following main areas:

- Non-life insurance
- Life insurance
- Market
- Credit and counterparty
- Operational
- Strategic.

The most important risks are described in the following survey. A more detailed description is available under Risk factors on page 5.

Risk survey – Topdanmark Group

Non-life insurance risks Personal, liability and property insurance for the personal, SME, industrial and agricultural markets		
Most important risks	**Risk preferences**	**Risk reducing activities**
Underwriting risk • Acceptance policy • Follow-up policy Provisioning risk Disaster risks • Storm and rainstorm • Fire • Terror • Workers' comp Cumulative risk	Profit on both product and customer level Spread of risk on different types of insurance / customer groups Limited effect on results from individual damage by using reinsurance	Risk-based price models allowing for market situation Clear rules for new business Risk equalisation through extensive reinsurance programme Systematic follow-up on profitability High data quality Use of statistical models for pricing and calculation of provisions

Life insurance risks Life insurance contracts with bonus entitlement, unit-linked contracts with no investment guarantees and group life		
Most important risks	**Risk preferences**	**Risk reducing activities**
Limited loss-absorbing buffers in the event of low interest rates Disability, which is the risk of increasing disability intensity or declines in the rates of resumption of work Lifetime, where customers with life dependent policies live longer than expected	For agreements with bonus entitlement we aim at balancing return and risk so that ordinary risks are covered by the related bonus potential The calculation of profit is viewed as a risk return on shareholders' equity where fluctuations are adjusted via bonus potential and shadow account	All policies are classified by the guaranteed benefit, and the investment policy is intended to ensure the ability to meet the benefits guaranteed The market risk is freely adjustable in relation to each customer group's risk capacity Normal fluctuations in investment return and risk results are provided for by the bonus potential per contribution group Bonus potential on paid-up benefits is protected by loss participation schemes Reinsurance Guarantees are, to a significant extent, hedged in portfolios with high guaranteed benefits. In portfolios with low guaranteed benefits, movements in interest rates are followed and risk reducing actions are performed as required Prices relating to death and disability are regularly adjusted to the market situation and the observed claims record The basis of new business is changed as needed

Market risks		
Most important risks	**Risk preferences**	**Risk reducing activities**
Interest rate risk Equity risk Property risk Currency risk Inflation risk Liquidity risk	Topdanmark's policy is to accept a certain level of market risk in order to profit from the Group's strong liquid position and its high, stable earnings from insurance operations In order to improve the average investment return and limit the overall market risk, Topdanmark invests in a wide range of asset categories	Topdanmark's Board of Directors has set limits on the acceptance of market risks in the form of risk limits and scenario based requirements on the overall maximum loss Compliance with these limits is regularly controlled

Credit and counterparty risks		
Most important risks	**Risk preferences**	**Risk reducing activities**
Reinsurance	To obtain efficient and secure reinsurance cover which is price competitive, a certain level of counterparty concentration is required	Counterparty risk is limited by mainly buying hedging from reinsurance companies which as a minimum have a rating of A-
Investment	A certain level of credit risk is accepted as an element of the creation of return. Counterparty risk is due to the use of derivatives which are primarily used to control and reduce market risk	Credit risk is limited by diversification both geographically and in terms of type of debtor Counterparty risk on financial contracts is limited by the required security when overall risk on any given counterparty reaches a relatively low threshold value

Operational risks		
Most important risks	**Risk preferences**	**Risk reducing activities**
IT	Generally, operational risks are to be reduced to an acceptable level	Group IT security function Risk assessment, IT security policy, gu idelines, controls and IT emergency plans based on ISO27001 Group IT security department
Errors in internal processes, human errors insurance fraud and deceit		Policy for routines, process descriptions, controls and division of duties

Strategic risks		
Most important risks	**Risk preferences**	**Risk reducing activities**
Generally, strategic risks are related to the Company's business model, political conditions, reputation, alliance partners' and competitors' behaviour as well as macroeconomic conditions	Low strategic risk due to strong business model	Topdanmark's business model stands strong against strategic risks. The results of the Company will, with a very high probability, be positive even in the event of another collapse in the financial markets as in 2008. The results of the Company will also be positive if it is hit by a storm like the 1999-hurricane, which was the largest storm event in the Company's history In a situation where Topdanmark's solvency might come under pressure, the share buy-back will be stopped. Additionally, the cancellation of own shares bought under the buy-back programme will be effected with a certain delay giving Topdanmark the opportunity to increase its solvency capital by selling own shares

Risk factors

The following description of risks for the Topdanmark Group provides more details of “Risk survey – Topdanmark Group” on pages 3-4.

Non-life insurance

Underwriting risk

Acceptance policy

Topdanmark's acceptance policy is based on a desire to make a profit from both products and customers. Topdanmark varies the pricing of its products depending on the relevant risk criteria and the costs of administering those products.

Topdanmark's pricing has been aligned with the individual markets and types of customers. In the personal and commercial markets, prices are mostly based on standardised rates while major commercial and industrial customers are offered more individualised charges.

Danish insurance companies do not cover damage arising from floods or the cost of replanting forests following storms, industrial diseases, war or warlike acts, earthquake or other natural disasters and with certain exceptions damage due to nuclear energy or radioactivity.

Follow-up policy

In order that both products and customers are profitable, Topdanmark systematically acts upon changes in its customer portfolios.

The historical profitability of major industrial and SME customers with individual insurance schemes is monitored using customer assessment systems.

General insurance rates are re-calculated at least every three years and motor and workers' compensation rates are reviewed annually.

Provisions are generally calculated on a monthly basis across all lines of business. The claims trend is assessed monthly, followed up by any necessary price changes.

Topdanmark continues to improve its administration systems to achieve more finely meshed data capture, which in turn enables it to identify the claims trends at an earlier point in time and compile information on the constituent parts of the various types of claims.

Claims handling

In order to ensure uniform and efficient claims handling Topdanmark has grouped the handling of all types of claims into one operational unit.

The handling of claims is intended to make the customers feel "well-helped" while at the same time ensure efficient management and control of the claims incurred.

Customers should feel ”well-helped”

Topdanmark works to ensure that its customers feel “well-helped” in every situation during the claims handling process. It is crucial for the customers’ experiences that:

- The customer feels LISTENED TO
- The customer has an OVERALL VIEW of the entire claims process – particularly who is doing what and when
- The customer is CONFIDENT that Topdanmark helps the customer to solve the claims problem.

Customers’ satisfaction with visits and telephone and internet contact is monitored daily to act immediately on each dissatisfied customer enabling us to help the customer and also to learn from the incident.

Efficient management of claims incurred

Topdanmark is continuously focusing on making its claims handling processes more efficient under the following three main headings:

- Promptness
- Better replacement purchasing power
- Quality.

Promptness

It is important to promptly obtain an overall impression of the size of a claim, implement any damage controlling actions and / or commence the claims handling process. Prompt attention not only reduces the compensation paid but also provides a better experience for the customer.

Typically, the claims department operates with day-to-day management of claims notifications and other claims handling in order that the value of the claim does not increase. Simple notification is attended to immediately over the telephone. Turnaround times are continuously monitored.

Better replacement purchasing power

The claims department's purchasing power in terms of replacement products and services provides financial advantages for customers and shareholders alike.

The responsibility for arranging co-operation and purchase agreements has been channelled into one centralised purchasing function to ensure the highest possible discount, quality and security when delivering products and services. Service agreements have been made with, for example, Falck, Falck Health Care, Scalepoint, Bygma, tradesmen, garages and damage service companies.

Quality

Topdanmark has developed routines for all major claims processes to ensure that they are handled in a uniform and controlled manner. These are supplemented by rules governing the level of professional and financial competence expected of each of the claims employees.

The overall professionalism is controlled by regular quality assessment of a random sample of claims. For example, it is investigated whether the cover, reason for the claim and provisioning are correct, the recourse possibilities have been tested and that the excess, VAT etc. have all been charged.

Claims handling supported by Topdanmark's claims handling system

Topdanmark's claims handling system supports professional accuracy. Measurements show that there has been a significant improvement in the quality of claims handling.

The claims organisation has implemented the version of the Lean / TRIM concept used by service organisations in several departments where it has improved the time it takes to handle a claim, the quality of the claims handling and employee satisfaction.

Emergency plan

Topdanmark has an emergency plan to ensure that prompt, correct and targeted action is taken on a major weather event such as storm, hurricane, rainstorm or flood. The emergency programme consists of several levels, and this enables a proportional response depending on the size of the event. Topdanmark has appointed emergency helpers throughout the company whose claims handling knowledge is regularly kept up-to-date. Furthermore, alert drills are held twice a year in order to prepare the employees and improve the emergency programme.

Loss prevention and loss limitation

Topdanmark focuses on loss prevention and loss limitation. The main objective is to incline customers towards pro-active risk handling so that they themselves can keep abreast of reducing their vulnerability. By doing this Topdanmark ensures security for the customer and also reduces its own risk.

Provisioning risk

Provisions for outstanding claims

Traditionally, the insurance classes are divided into short-tail (i.e. those lines where the period from notification until settlement is short) and long-tail (those lines where the period from notification until settlement is long).

Examples of short-tail lines are building, personal property and comprehensive motor insurance. Long-tail lines relate to personal injury and liability such as workers' compensation, accident, third party insurance and commercial liability.

Composition of Topdanmark's overall provisions for outstanding claims:

Provisions for outstanding claims (%)	2013	2014
Short-tail	15	13
Annuity provisions in workers' compensation	23	24
Other claims provisions in workers' compensation	22	23
Accident	24	24
Motor personal liability	12	12
Commercial liability	4	4

The much higher provisioning risk in long-tail than in short-tail lines is due to the longer period of claims settlement. It is not unusual that claims in long-tail lines are settled three to five years after notification and in rare cases up to 10-15 years.

During such a long period of settlement the levels of compensation could be significantly affected by changes in legislation, case-law or practice in the award of damages adopted by, for example, the Danish National Board of Industrial Injuries which awards compensation for injury and loss of earnings potential in all cases of serious industrial injuries.

The practice adopted by the Danish National Board of Industrial Injuries also has some impact on the levels of compensation for accident and personal injury within motor, liability and commercial liability insurance.

The provisioning risk represents mostly the ordinary uncertainty of calculation and claims inflation, i.e. an increase in the level of compensation due to the annual increase in compensation per policy being higher than the level of general indexation or due to a change in judicial practice / legislation.

The sufficiency of the provisions is tested in key lines by calculating the provisions using alternative models as well, and then comparing the compensation with information from external sources, primarily statistical material from the National Board of Industrial Injuries and the Danish Road Sector / Road Directorate.

The actuarial team is in constant dialogue with the claims departments on any changes in the practices stemming from new legislation, case law or compensation awards as well as the impact of such changes on the routines used to calculate individual provisions.

Provisions for unearned premiums
The risk on provisions for unearned premiums is relevant particularly within change of ownership insurance and lines with high levels of compensation, for example, workers' compensation and motor liability insurance. In the event of a change in the level of either premiums or compensation in these lines, the provision for unearned premiums could be insufficient to cover the related expenses. In this case it will be necessary to strengthen this provision.

For change of ownership insurance, the policy covers a period of five or ten years and the full five or ten-year payment is made up front. Topdanmark's level of provisions for change of ownership policies is based on statistical analyses of the pattern of claims notifications as compared to the remaining period of the policies.

For workers' compensation and motor liability insurance policies, which unlike change of ownership are one-year policies, the need for strengthening the provision for unearned premiums is assessed on the basis of quarterly analyses of the development in premiums and claims.

Disaster risks
Topdanmark limits its insurance risk on significant events through a comprehensive reinsurance programme.

Storm and rainstorms
Reinsurance covers storm claims of up to DKK 5.1bn with a retention of DKK 100m. Snow loading, snow thawing and rainstorms are also covered. Reinstatement for the proportion of the cover used up is activated by payment of a reinstatement premium. In the event of another storm within the same year, there is cover of a further DKK 5.1bn with a retention of DKK 100m. In the event of a third and fourth storm, there is cover of up to DKK 670m with a retention of DKK 20m if the events occur within the same calendar year. To this should be added the cover not already hit twice by the first two storms. The cover of a third or fourth storm is dependent on the storm programme not having been hit previously by two individual storms each exceeding DKK 3.5bn. The storm programme is renewed on 1 July.

Specific reinsurance cover of DKK 100m for rainstorms takes effect if accumulated annual rainstorm claims exceed DKK 50m. For a claim to be accumulated, the event must exceed DKK 10m. The maximum retention in the event of an extreme rainstorm is DKK 75m plus reinstatement premiums.

Fire
Topdanmark has a proportional reinsurance programme for fire with a maximum retention of DKK 25m per claim on any one business.

Terror
With certain restrictions terror is covered by the reinsurance contracts.

A national guarantee scheme of DKK 15bn covering terror claims including an element of NBCR (nuclear, biological, chemical, radiological) has been established. The national guarantee scheme covers any market retention in excess of DKK 5.5bn. The Danish non-life insurance companies have established a terror pool to protect the market retention. Industrial injuries caused by any form of terror are covered by the Government with a few exceptions.

Workers' compensation
In workers' compensation up to DKK 1bn is covered with a retention of DKK 50m.

Cumulative risk
Known cumulative risk is where it has been recognised prior to the event that several policyholders could be affected by the same event. In personal lines Topdanmark's retention is DKK 15m for the first claim, DKK 5m for the second and DKK 15m for any third or subsequent risk. The retention is a maximum of DKK 25m in SME and industrial lines. Unknown cumulative risk is where several policyholders could be affected by the same individual event (conflagration damage) without the common risk being recognised prior to the event occurring. The retention is a maximum of DKK 50m.

Life insurance
Loss absorbing buffers in the event of low interest rates
Bonus potential on paid-up benefits and collective bonus potential are the loss absorbing buffers in life insurance against any losses incurred by customers on investment activities.

Low interest rates mean that the market value of the guarantees granted is high and that the related bonus potential is low. The lower the bonus potential, the higher the risk of any losses being wholly or partially born by shareholder's equity. If interest rates are high, the same losses could, to a larger degree, be absorbed by the bonus potential.

Declines in the collective bonus potential are most frequently due to the investment return being lower than the addition of interest to deposits. Declines in collective bonus potential are also possible if interest rates are relatively high.

In order to protect shareholders' equity it will be relevant to reduce market risks in the event of low interest rates.

All policies have been split into contribution groups according to the guaranteed benefit scheme. In each contribution group, the investment policy is intended to ensure the ability to meet the guaranteed benefits, and the market risk is adjusted in accordance with the risk capacity of the contribution groups.

In portfolios with high guaranteed benefits, including the portfolio of policies with 4.5% guaranteed benefits, the interest rate risk in interest groups with such schemes has been countered by EURO CMS floors with a strike rate of 5%.

In portfolios with low guaranteed benefits, comprising policies with guaranteed benefits of 2.5%, 1.5% and 0.5%, the movements in interest rates are monitored and risk reducing actions are taken as needed.

Disability

Disability risk is the risk of increasing disability intensity or declines in the rates of resumption of work, in that the benefits have been guaranteed until expiry. Losses may be incurred due to an increase in disability frequency or due to inadequate health evaluation when the policy is written.

Extra costs due to a permanent change in disability risk will be partially covered by collective bonus potential and bonus potential on paid-up benefits. The remainder affects profit / loss for the year and consequently shareholders' equity.

Lifetime

Lifetime risk is the risk customers with life dependent policies, primarily annuities, live longer than expected, which will increase provisions for lifetime products.

Extra costs due to longer lifetimes will be partially covered by collective bonus potential and bonus potential on paid-up benefits. The remainder affects profit / loss for the year and consequently shareholders' equity.

Market

Market risk represents the risk of losses due to changes in the market value of the Group's assets, liabilities and off-balance items as a result of changes in market conditions. Market risk includes interest rate, equity, property, currency, inflation and liquidity risk.

The limits for these financial risks are fixed by Topdanmark's Board of Directors. In practice, Topdanmark Kapitalforvaltning (asset management) handles the investment, finance and risk alignment processes. Compliance with the limits set by the Board of Directors is regularly controlled. The result of this is reported to the Board of Directors.

Market risks	Risk reducing activities
Interest rate risk Topdanmark is exposed to interest rate risk due to provisions for outstanding claims in non-life insurance and guaranteed benefits in life insurance	Generally, the interest rate risk is limited and controlled by investing in interest-bearing assets in order to reduce the overall interest rate exposure of the assets and liabilities to the desired level In life insurance the interest rate risk on 4.5% guaranteed benefits is hedged by interest rate options − EURO CMS floors with a strike rate of 5%, while standard swaptions have been bought for benefits guaranteed lower interest rates in order to supplement the investments in interest-bearing assets
Equity risk Topdanmark is exposed to equity risk from direct investments as well as those investments made via derivatives	The equity risk is alleviated by trades in the market and by derivatives
Property risk Topdanmark is exposed to property risk from investments in properties rented out for business or private residence	The risk on the property portfolio is limited by a strategy focusing on the four largest cities in Denmark, with main emphasis on Copenhagen and Århus. Topdanmark invests in well-situated properties within the segments of housing and flexible office properties
Currency risk Topdanmark's currency risk relates in practice only to investments	The currency risk is alleviated by derivatives
Inflation risk Future inflation is implicitly included in a number of the models Topdanmark uses to calculate its provisions Workers' compensation and illness / accident insurance differ from the general principles regarding the inclusion of an allowance for inflation. The provisions in workers' compensation insurance are calculated on the basis of the expected future indexation of wages and salaries and those in illness / accident insurance on the basis of the expected net price index	An expected higher future inflation rate would generally be included in the provisions with a certain time delay, while at the same time the result would be impacted by higher future indexation of premiums In order to reduce the risk of inflation within workers' compensation and illness / accident insurance Topdanmark uses index-linked bonds and derivatives hedging a significant proportion of the expected cash flows
Liquidity risk In insurance companies the liquidity risk is very limited as premiums are paid prior to the beginning of the risk period Topdanmark's liquidity risk is therefore primarily related to the parent company	Topdanmark finances its activities and share buy-back programme by using its subsidiaries' surplus liquidity via inter-group accounts, which are reduced by paying dividends Further financing requirements are covered by short-term money market loans, typically with a maturity of one month or less

The liabilities of the Group's insurance companies are primarily technical provisions on which the payment obligation is met by means of the cash flow from operations.

Undiscounted expected cash flow for the Group's most significant liabilities:

(DKKm)	Book value	1 year	2-6 years	7-16 years	17-26 years	27-36 years	>36 years
2013							
Provisions for claims	13,929	4,482	6,146	3,214	1,468	602	158
Life insurance provisions	24,982	945	1,408	6,392	9,810	7,903	4,172
2014							
Provisions for claims	13,723	3,748	6,062	3,178	1,410	573	153
Life insurance provisions	23,761	1,026	2,265	6,875	8,578	6,191	2,833

Future cash flows for life insurance will deviate from those expected due to observed insurance events, surrenders etc.

The Group uses derivatives to hedge investment risks. The hedging of currency risk in particular often results in significant positive or negative changes to balance sheet values.

Topdanmark pays or receives cash security for any changes in value. The extent of these daily changes is limited such that there is no challenge to liquidity.

Generally, there are no maturity concentrations on derivative contracts.

The Group's insurance companies may raise money market loans as part of the day-to-day liquidity management. Typically the maturity of such loans is less than a month. Both the subordinated loans raised by Topdanmark Forsikring and any outstanding money market loans will be repaid from the cash generated from operations.

Furthermore, the Group has a significant liquidity base of high-quality liquid bonds.

Credit and counterparty risk

Credit risk is the risk of losses caused by one or more counterparties' full or partial breach of their payment obligations. Topdanmark is exposed to credit risk in both its insurance and investment business.

Reinsurance

Within insurance the reinsurance companies' ability to pay is the most important risk factor. Topdanmark minimises this risk by spreading and primarily buying reinsurance cover from reinsurance companies with a minimum rating of A-. Accordingly almost all of its storm cover has been placed with such reinsurance companies.

Investment

Topdanmark's investment risk is the inability of bond, loan or financial contract counterparties to meet their obligations. Most of Topdanmark's interest-bearing assets comprise Danish mortgage bonds and debt issued or guaranteed by top-rated European states. The risk of losses is considered to be very small due to the high quality of the issuers and a desired spread on both issuers and issues. To limit the risk on other bond and loan debtors, the portfolio is well diversified both geographically and with regard to type of debtor - and therefore the exposure to the concentration of risks is insignificant.

Interest-bearing assets by rating (%)	2013	2014
AAA+AA	77	77
A	3	4
BBB	5	3
<BBB	6	5
Money market deposits	9	11

At the end of 2014 Topdanmark received cash margin payments of DKK 1,497m securing unrealised gains on derivatives (2013: 885m).

To limit the counterparty risk of financial contracts the choice of counterparties is restrictive, and security is required when the value of the financial contracts exceeds the predetermined limits. The size of the limits depends on the counterparty's credit rating and the term of the contract.

Operational risk

Operational risk includes errors in internal processes, human errors, system errors, breakdowns of IT systems and losses incurred due to external events.

Topdanmark regularly develops and improves IT systems, routines and procedures. The responsible business units are also responsible for the risk management of this development.

Projects are to carry out a risk assessment with a description of the risks, possible consequences and measures to limit these risks.

IT

Group IT Security, reporting to the IT manager, is responsible for information security.

Risk assessment

Risk assessments of each operational IT risk are made regularly. Group IT Security reports quarterly on risks and events to the Executive Board.

Topdanmark's risk assessment, IT security policy and IT emergency strategy (based on IS027001), which are submitted to the Risk and Audit Committees, are revised each year by the Executive Board to be accepted by the Board of Directors.

IT emergency plan

The IT emergency plan includes plans for re-establishing the IT environment if the systems suffer breakdowns. The IT emergency plan is tested regularly. Topdanmark's business critical systems can be inaccessible for 24 hours without causing significant business problems. In order to reduce the probability of breakdowns of the IT systems and limit their duration, Topdanmark has invested in, for example, emergency power plants with a diesel generator, disk mirroring, alarms and automatic fire fighting equipment. Critical IT equipment is in duplicate and placed in two physically discrete machine rooms.

Tests

Periodically Topdanmark’s critical IT systems are tested to see if they can be compromised from outside and whether the IT systems have vulnerabilities that need to be repaired.

These tests are made by an external company with special expertise in this area. Topdanmark’s IT security committee discusses and prioritizes the performance and results of the tests.

The implementation of new IT systems is only effected after extensive testing procedures.

Accessibility

It is Topdanmark's goal that the accessibility of its main systems is no less than 99.5%. In 2014 it was 99.99%.

Errors in internal processes, human errors, insurance fraud and deceit

Topdanmark's well-documented routines, procedures and efficient control environment minimise these risks. It has made emergency plans for the most significant areas.

The routines and procedures in all critical areas are regularly checked by the auditors in order to assess the risks and recommend measures to limit each individual risk.

Risk scenarios

The Group's risk factors are illustrated in the following table on the most significant risk factors. The given assumptions do not reflect Topdanmark's expected risks, but are shown only as examples which could be used as a basis for assessing the Company's exposure to the risks mentioned.

In the calculation of the effect on the results it is assumed that the bonus reserves and the individual bonus potential in life insurance could offset adverse fluctuations at the levels described as the overall collective bonus potential was DKK 1,677m at 31 December 2014 (2013: DKK 1,472m), and the bonus potential on paid-up benefits DKK 746m (2013: 2,364m).

Risk scenarios (DKKm) after taxation and pension return tax		2013	2014
Non-life insurance			
Underwriting risk Combined ratio − 1pp increase		(67)	(69)
Provisioning risk Provisions on own account − 1% increase		(94)	(98)
Storm claims up to DKK 5,100m (Plus reinstatement premium etc.)		(75)	(76)
Life insurance			
Disability intensity - 10% increase		0	0
Mortality intensity - 10% decline		(22)	(22)
Market risk			
Interest-bearing assets	1 pp increase	(464)	(484)
Provisions for claims and benefits etc.	in effective interest rate	441	505
Index-linked bonds	5% loss	(27)	(27)
Equities	10% loss	(82)	(68)
CDOs < AA	10% loss	(79)	(65)
Properties	10% loss	(182)	(156)
Annual currency loss with an up to 2.5% probability		(21)	(21)

Solvency

Danish insurance companies are subject to European and Danish solvency rules ensuring that the companies hold sufficient capital relative to the risks they accept. The most important rule sets are:

- Solvency I – the current European solvency rules
- Individual solvency requirement
- Traffic light rules.

Those rules imposing the greatest requirements on the Group's capital are the rules on individual solvency requirement, and Topdanmark's capital planning is based on these rules.

The future EU Solvency II rules will take effect on 1 January 2016. These rules will replace the three sets of rules listed above. Individual solvency requirement has already been aligned with the future rules of Solvency II in respect of contents and the level of capital requirements.

Individual solvency requirement

Individual solvency requirement is a set of Danish rules in force until the Solvency II rules take effect on 1 January 2016. Each insurance company is to calculate a solvency requirement representing their minimum required capital based on the risks they accept. Additionally, the companies are required to provide documentation for how they identify, manage, limit and calculate risks.

On 1 January 2014 a new executive order on solvency took effect. This new order is based on all Danish insurance companies using the same rules when calculating their solvency, while the method was optional up to and including 2013. The rules of the new executive order are close to the future Solvency II rules.

For several years Topdanmark's policy for calculating solvency requirements has been to match the rules which are expected under Solvency II, and therefore the solvency calculation has regularly been aligned with the Solvency II expectations. In this calculation Topdanmark uses a partial, internal model for calculation of the non-life risk.

The most significant changes in the new rules from the most recent solvency calculation of the Topdanmark Group are:

- Change in the calculation of life insurance provisions, including recognition of surrender probabilities
- Recognition as loss absorbing buffer in the solvency calculation of a tax asset due to a negative 200-year-event.

The solvency calculation for Topdanmark Livsforsikring (life Insurance) has been adjusted in keeping with the relevant rules. Particularly, loss absorption is now calculated in accordance with the Solvency II rules and not the Danish accounting rules. For this purpose a model has been developed, which recognises best estimate for the utilisation of a portfolio of its surrender and paid-up options. The calculation of the effect of all the company's risks is now based on this model.

Transitional rules related to the new executive order on solvency require that the calculation of the capital base is substantially, but not fully, adapted to the new solvency rules.

Significant transitional rules which are included in the calculation of capital base:

- Provision for capital costs, calculated in accordance with the Solvency II principles, is deducted from the capital base
- If the accounting provisions for outstanding claims exceed best estimate, the surplus amount is added to the capital base
- Recognition of an expected profit on non-life insurance contracts, concluded for the remaining period of cover.

Significant expected Solvency II elements which are not included in the calculation of capital base according to the transitional rules:

- Recognition of subordinated loan capital, where in 2015 Topdanmark will not be able to recognise the full subordinated loan capital. Full recognition is expected in accordance with new rules as of 2016
- The rules on subsidiaries in the parent company's solvency and capital base will be changed in 2016. The new rules are not expected to bring about further capital requirements.

A new accounting order is also expected, which will take effect as of 2016. These accounting rules will be amended to comply with the Solvency II principles. The new accounting rules are not expected to materially change the solvency or capital base from the solvency and capital base announced by Topdanmark in 2015, except that no increase is expected in the capital base in 2016 on the basis of a difference in the provisions for outstanding claims between the accounts and Solvency II.

Insurance holding companies are also covered by the new executive order on solvency for insurance companies. According to these rules, Topdanmark A/S is an insurance holding company. These rules do not require the calculation of solvency requirement for Topdanmark A/S, but they require the calculation of a capital base which must be positive after deduction of the solvency requirements for the subsidiaries.

Solvency II

Solvency II is the future EU regulation for insurance companies setting requirements for solvency calculations, capital base and risk management. In addition there are requirements for detailed reporting on risk management to supervisory authorities and for publication. Solvency II will take effect on 1 January 2016.

Solvency calculation and capital requirements

An important goal of Solvency II is to promote good risk management based on market values and actual risk calculations. Solvency II will include a standard model for calculation of solvency requirements, which will be common to all insurance companies in the EU. Although the model will provide the opportunity for company-specific values for some variables, the standard model will not provide a fair view of all the risk elements of all companies.

Therefore, Solvency II gives the companies the opportunity to fully or partially develop their own risk model (internal model) for the solvency calculation. However, the DFSA must approve the model that is used for the calculation of Solvency II capital requirements. Today Topdanmark uses a risk model it has developed in-house to calculate the non-life risk. The inclusion of non-life risks in Topdanmark's calculation of the individual solvency requirement has been based on this model.

Topdanmark is in constant dialogue with the DFSA on the model. The application for Solvency II approval will be submitted to the DFSA in 2015 with expected approval of the model before Solvency II takes effect on 1 January 2016.

So far the size of the necessary solvency capital has been calculated at DKK 4,700m. This amount is the forecast solvency requirement under Solvency II plus an adequate buffer ensuring that usual fluctuations in earnings will not result in insufficient solvency cover.

The new rules seem to indicate some easing of the capital requirement as compared to previous expectations. However, in 2015 a solvency capital cover of DKK 4,700m, as a minimum, will be maintained from the solvency capital elements, shareholders' equity reduced by intangible assets (DKK 3,800m), hybrid capital (DKK 400m) and subordinated loan capital (approx. DKK 500m): see www.topdanmark.com → Investor → Capital model. At the end of 2014, the calculated solvency capital was DKK 5,738m.

Topdanmark Forsikring has already issued further subordinated loan capital of DKK 250m. This amount is expected to be included in the cover of the necessary capital with effect from 2016.

The necessary capital of DKK 4,700m, as stated above, has been based on an expected approval of Topdanmark's internal model for non-life insurance risk. If it is not approved, the Solvency II requirement will increase by around DKK 800m. This is not expected to affect the necessary capital, because in this case the capital increase in the solvency requirement will be reduced, because the said DKK 250m of subordinated loan capital could be included, and because supplementarily the investment risk could be adjusted.

Solvency II will take effect at the beginning of 2016. Subsequently, it will be possible to include subordinated loan capital in the solvency cover by up to 50% of the solvency requirement. Topdanmark expects to present its expected future capital structure when the Q1 2015 interim report is published on 20 May 2015.

Topdanmark's Solvency II project

Topdanmark is preparing for Solvency II by having employees from claims actuarial services, life actuarial services, asset management, financial and compliance departments, IT, Group Development and others working together on a project reporting to the CFO.

Topdanmark is well-advanced in its preparations, and areas like organisation, data and calculation of solvency requirements are practically in place.

There are two important outstanding sub-projects, partly the new, very detailed external report to the DFSA and the report for publication on the website, and partly the approval of Topdanmark's own risk model for non-life risk to be used under Solvency II as partial internal model. Both sub-projects are proceeding to plan towards 2016.

Capital model

Topdanmark pursues a policy of keeping its shareholders' equity at a relatively low level and paying out to shareholders any amounts in excess of the conservatively estimated shareholders' equity sufficient to support the underlying business.

In spite of this policy, Topdanmark has decided on a capital model that has a relatively high proportion of shareholders' equity. This ensures that any regulatory requirements on solvency capital in excess of expectations could be covered solely by issuing further supplementary capital.

Detailed information on, among other subjects, Topdanmark's capital structure model and model for calculation of share buy-back potential is available on www.topdanmark.com → Investor Relations → Capital Model.

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