ERGO Insurance SE

ANNUAL REPORT
2016

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Company name:	**ERGO Insurance SE**
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Core business:	**non-life insurance**
Beginning of financial year:	**1 January 2016**
End of financial year:	**31 December 2016**
Chairman of the management board:	**Kęstutis Bagdonavičius**
Auditor:	**KPMG Baltics OÜ**
Accompanying documents:	**1. Independent auditors' report 2. Profit allocation proposal 3. Information on the sole shareholder 4. List of business activities**

Contents

Review of operations

A strong owner

Through their parent, ERGO Group, the ERGO insurance companies in the Baltics represent a major global financial services group, Münchener Rückversicherungs-Gesellschaft AG (Munich Re), which has been operating successfully since 1880 and has always been able to satisfy its customers' claims. Reliability is confirmed by the ratings given to the Group's owner and parent company: Munich Re's rating is Aa3 or excellent (by Moody's); ERGO Group's rating is AA– (by Standard & Poor's). Munich Re is included in the DAX 30 / EUROSTOXX 50 list.

ERGO Group serves more than 40 million customers in over 30 countries and is the largest health and legal expenses insurer in Europe.

At the reporting date, the share capital of ERGO Insurance SE ('ERGO Insurance SE', 'ERGO' or 'the company') stood at 6,391,391 euros. The sole shareholder of ERGO Insurance SE is ERGO International AG, registry number HRB 40871, with a registered office at Victoriaplatz 2, 40198 Düsseldorf, Germany.

Since 17 September 2015, the chairman of the board of ERGO Group has been Markus Rieß. His goal is to turn ERGO into a leading company in the international insurance industry which sets benchmarks in terms of customer focus and innovation, creates an environment where its employees and sales partners can develop their strengths and gain new perspectives, inspires its customers, creates added value for the shareholders of Munich Re, and is visible in issues which concern a lot of people.

Partnerships with the world's strongest reinsurance providers

ERGO cooperates with the world's leading reinsurance risk carriers (Munich Re, Gen Re, Swiss Re, SCOR, and Hannover Re), using reinsurance to mitigate its risks and ensure smooth settlement of claims regardless of size.

ERGO Insurance SE: the year 2016 in figures

Gross premium income	136.8 million euros
Total assets	188.8 million euros
Investments in financial instruments	121.4 million euros
Insurance contract provisions	122.1 million euros
Equity	44.3 million euros
Comprehensive expense	0.6 million euros
Return on equity	1.4%

Insurance contracts in force	862,756
Offices	21 in Estonia, 25 in Latvia, 62 in Lithuania
Employees	1,108

Economic environment

According to the European Commission's *Winter 2017 Economic Forecast*, in 2017 and 2018 the European economic recovery will continue similarly to 2016. However, the outlook is surrounded by higher-than-usual uncertainty. General inflation has picked up, mainly because the decline in energy prices has been replaced by a rise. Economic growth in the euro area will continue and accelerate, driven mostly by domestic demand.

Estonia

It is expected that after the slowdown of 2015 and 2016 Estonia's economic growth will accelerate somewhat (to approx. 2% per year), mostly through a rise in public sector investment and other expenditures. So far the main growth driver has been domestic demand but in subsequent periods, external demand is expected to improve as well. Domestic demand has been fuelled by wage growth which has outpaced the rise in productivity.

Latvia

Economic growth has decelerated: the figure for 2016 was the lowest for the past six years. The main growth drivers have been the manufacturing and the service sector. The contribution of the construction sector is declining and investment is decreasing, partly due to insufficient use of the support available from the European Union's structural funds. Consumer prices which have been relatively stable in recent years are expected to increase. Wage growth will continue and support the rise in private consumption which will remain one of the main drivers of economic growth.

Lithuania

Economic growth is mainly driven by a rise in households' incomes and private consumption. Wages have grown rapidly, partly through a rise in the minimum wage, but productivity has not improved at the same pace. Due to inadequate use of the funding available from the European Union's structural funds, public sector investment has plummeted, triggering a downturn in the construction sector. Unemployment is decreasing but wage growth is expected to slow somewhat. Similarly to Latvia and Estonia, Lithuania's consumer prices are expected to increase.

The key issue for the Baltic region continues to be population decrease, mainly due to emigration.

Legal environment

On 7 July 2015, the Estonian parliament adopted a new Insurance Activities Act which took effect on 1 January 2016. The act is based on directive 2009/138 of the European Union on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II). The act also incorporates the provisions of the EU directives on insurance mediation (IMD I, II) .

Previously, insurers followed the requirements of Solvency I. However, the rules for calculating insurers' liabilities and capital requirements needed reviewing and revising. The purpose of Solvency II is to make sure that insurers can meet their commitments to customers. The Solvency II directive and the new Insurance Activities Act impose a set of important governance, capital, valuation, and reporting requirements for insurance undertakings.

The governance system of an insurance undertaking must ensure its sound and prudent operation. It must incorporate a transparent organisational structure, an effective information exchange system, a clear allocation of responsibilities, identification of the key functions, etc. The system must be documented and updated on a regular basis to make sure that it is effective. The law also establishes new disclosure requirements which improve the transparency of the insurance market and new supervision measures which protect the interests of policyholders.

Although both the Solvency II directive and the new Insurance Activities Act put great emphasis on capital requirements, no amount of capital can substitute for the capacity to understand, assess and manage risk and no formula or model can capture every aspect of the risks an insurer faces. Therefore, the risk management system is an integral part of the governance system and to ensure its effective operation, an insurer must set up a risk management function.

A completely new feature of the new Insurance Activities Act is insurers' own risk and solvency assessment (ORSA). Regular own risk assessment must be embedded in an insurer's business strategy. It must cover an insurer's overall solvency needs as well as consistent compliance with capital requirements and the requirements set for technical provisions.

Solvency II is forward-looking. The new Insurance Activities Act states that an insurance undertaking has to value its assets at amounts for which they could be exchanged and its liabilities (including technical provisions) at amounts for which they could be settled or transferred. The purpose of the quantitative requirements is to make sure that an insurer has sufficient funds to cover its technical provisions, the minimum capital requirement, and the solvency capital requirement.

Before the implementation of Solvency II, insurers provided information about their activities in their annual reports which did not always contain sufficient information about their governance and risk management systems. Under the act which entered into force on 1 January 2016, insurers have to prepare two new reports containing qualitative information: a report on solvency and financial condition (to be disclosed publicly) and a regularly filed report to supervisors (to be submitted to the Financial Supervision Authority).

The report on solvency and financial condition has to be made available on the insurer's website and, if a customer so requests, also on paper. The regular report to supervisors is designed for the Financial Supervision Authority only. It contains everything included in the report on solvency and financial condition as well as information required to determine whether the insurer complies with regulatory requirements, such as the strategies for dealing with each risk category, the fit and proper requirements, etc. In addition to public reporting, an insurer must also submit to the Financial Supervision Authority a so-called quantitative report on its activity.

Compared to previous legislation, the Insurance Activities Act which took effect on 1 January 2016 regulates the activities of insurance intermediaries in greater detail to ensure more uniform service quality and better protection of customers' interests. It sets out the minimum information that an intermediary must disclose to the customer before concluding an insurance contract. Before providing the service, a broker has to sign an insurance brokerage agreement with the customer. The act regulates the information a broker must provide both on signing a brokerage agreement and before concluding any insurance contract. The act also specifies insurance brokers' obligation to inform customers about the basis of their remuneration: the customer must know whether the broker is remunerated by the customer or the insurer that pays for the customer.

An insurance broker may not concurrently broker insurance to several customers wishing to insure the same property against the same risk if it is reasonable to assume that the customers have a conflict of interest in relation to insuring the property. An insurance broker may not enter into agreements with, nor follow the instructions of, an insurer that allow the broker to determine the size of a premium by reference to premiums charged by other insurers.

The obligation to provide more information about themselves as well as the contracts they distribute now also applies to persons for whom acting as an insurance intermediary is not the core business and intermediaries that previously were not subject to insurance regulations such as travel agents. Under the Insurance Activities Act, the remuneration principles, performance targets, and appraisal criteria of natural persons who distribute insurance contracts on behalf of insurance intermediaries must be designed in such a manner that they would not jeopardise the intermediary's obligation to act in the best interests of the customer and would not encourage the intermediary to recommend an insurance contract that does not meet the customer's insurable interest and needs.

The act clarifies the obligation to determine the customer's insurable interest. Namely, every time before concluding and, if there is a clear need, amending an insurance contract, the insurer must establish, based on the information provided by the customer, the customer's insurable interest and requirements regarding the contract. The insurer must recommend from among the contracts it offers the one that best meets the customer's insurable interest and requirements, and provide sufficient explanations so that the customer can make an informed decision.

The act which took effect on 1 January 2016 provides that insurers may, in addition to assessing creditworthiness as provided in section 11(6) of the Personal Data Protection Act, transmit to another insurer, if the latter so requests, for the assessment of underwriting risk and determination of insurance obligations and their extent, data regarding a person that has during preliminary negotiations submitted to the insurer incorrect information about relevant circumstances, has deliberately caused the occurrence of an insured event, or has submitted to the insurer incorrect information about the relevant circumstances of an insured event. This may be done without the consent of the data subject, provided that no more than five years have passed since the violation.

Concurrently with the Insurance Activities Act, legislators revised the Law of Obligations Act. The amendments, which mostly specified the information to be disclosed to the customer before the conclusion and during the term of a contract, took effect on 1 January 2016. Based on the new requirements of the Law of Obligations Act, the Financial Supervision Authority issued a set of guidelines for the information to be disclosed about an insurance contract, which also entered into force on 1 January 2016.

Financial performance of ERGO Insurance SE

ERGO Insurance SE' gross premium income for 2016 was 136.8 million euros. In terms of premium income, ERGO Insurance SE maintained the second position in the Estonian and the third position in the Baltic non-life insurance market. Claims and benefits incurred totalled 84.7 million euros, accounting for 61.9% of gross premium income. Net expense ratio was 34.9% (2015: 36.3%) and net loss ratio was 68.2% (2015: 65.8%). Because of the rise in the loss ratio, the net combined ratio for 2016 rose to 103.1% (2015: 102.2%). ERGO Insurance SE ended 2016 with total comprehensive expense of 0.6 million euros (2015: comprehensive income of 1.2 million euros). The insurance result was a loss of 3.8 million euros, net investment income amounted to 3.6 million euros and other activities generated a profit of 0.8 million euros. The comprehensive result was also influenced by a 1.2 million euro decrease in the value of available-for-sale financial assets.

At the year-end, ERGO Insurance SE had assets of 188.8 million euros (2015: 174.3 million euros). Investments in financial instruments amounted to 121.4 million euros (2015: 107.9 million euros), debt securities accounting for 88.4% (2015: 79.4%), loans for 1.1% (2015: 2.0%) and equities and fund units for 10.5% (2015: 18.6%) of the total. Altogether, investments in financial instruments accounted for 64.3% (2015: 61.9%) of total assets. Insurance provisions totalled 122.1 million euros (2015: 112.1 million euros), accounting for 84.5% (2015: 86.7%) of total liabilities and 64.7% (2015: 64.3%) of total assets. At the reporting date, insurance provisions were backed with investments in financial instruments and reinsurance assets which exceeded insurance provisions by 14.8 million euros (2015: 11.1 million euros), providing the company with an adequate liquidity buffer.

Insurance activities

Gross premium income by insurance class

In euros	2016 Gross premiums written	2016 Share of class, %	2015 Gross premiums written	2015 Share of class, %	Change Gross premiums written	Change Share of class, pp
Motor liability insurance	48,319,189	35.3%	41,738,105	34.5%	6,581,084	0.8
Accident insurance	5,811,753	4.2%	5,092,314	4.2%	719,439	0.0
Travel insurance	3,472,613	2.5%	2,537,444	2.1%	935,169	0.4
Technical risks insurance	4,239,995	3.1%	4,103,932	3.4%	136,063	-0.3
Individuals' property insurance	10,609,064	7.8%	9,853,677	8.1%	755,387	-0.4
Legal persons' property insurance	9,196,273	6.7%	8,986,719	7.4%	209,554	-0.7
Agricultural risks insurance	1,311,800	1.0%	1,040,612	0.9%	271,188	0.1
Motor own damage insurance	38,480,855	28.1%	33,331,336	27.5%	5,149,519	0.6
Liability insurance	5,449,863	4.0%	4,982,994	4.1%	466,869	-0.1
Goods in transit insurance	1,441,258	1.1%	1,381,337	1.1%	59,921	-0.1
Carrier's liability insurance	2,847,232	2.1%	2,675,979	2.2%	171,253	-0.1
Watercraft insurance and watercraft owner's liability insurance	515,316	0.4%	473,030	0.4%	42,286	0.0
Guarantee insurance	1,752,458	1.3%	1,822,105	1.5%	-69,647	-0.2
Railway rolling stock insurance	1,359,892	1.0%	1,383,183	1.1%	-23,291	-0.1
Assistance insurance	1,537,650	1.1%	1,244,025	1.0%	293,625	0.1
Financial risks insurance	471,560	0.3%	385,927	0.3%	85,633	0.0
Loss of employment insurance	17,886	0.0%	6,447	0.0%	11,439	0.0
Total from insurance activities	**136,834,657**	100.0%	**121,039,166**	100.0%	**15,795,491**	
Accident insurance	3,412	0.0%	4,787	0.0%	-1,375	0.0
Legal persons' property insurance	-61,040	0.0%	0	0.0%	-61,040	0.0
Liability insurance	0	0.0%	0	0.0%	0	0.0
Health insurance	0	0.0%	0	0.0%	0	0.0
Total from reinsurance activities	**-57,628**	0.0%	**4,787**	0.0%	**-62,415**	0.0
Total	**136,777,029**	100.0%	**121,043,953**	100.0%	**15,733,076**	

In 2016, ERGO Insurance SE generated premium income of 136.8 million euros, a 13.0% increase on the year before. The largest classes were motor third party liability insurance (hereafter 'motor liability insurance') and motor vehicle insurance (hereafter 'motor own damage insurance'), which generated premium income of 48.3 million euros and 38.5 million euros respectively and accounted for 35.3% and 28.1% of the total portfolio respectively. Individuals' property insurance contributed 10.6 million euros or 7.8% and legal persons' property insurance 9.2 million euros or 6.7%. Premiums written in accident insurance and liability insurance totalled 5.8 million euros and 5.4 million euros respectively and their respective contributions were 4.2% and 4.0%. The total contribution of other insurance classes, which each accounted for less than 4.0%, was 19.0 million euros or 13.9%. Premium income from reinsurance activities amounted to 5.7 million euros.

Compared with year earlier, the share of motor liability insurance increased by 0.8 percentage points and its premium income grew by 6.6 million euros or 15.8%. Strong growth was also achieved in motor own damage insurance where premium income increased by 5.1 million euros or 15.4% and travel insurance where premiums grew by 0.9 million euros or 36.9%.

Claims and benefits paid by insurance class.

In euros	2016		2015		Change	
	Claims and benefits paid	Share of class, %	Claims and benefits paid	Share of class, %	Claims and benefits paid	Share of class, pp
Motor liability insurance	31,430,051	38.7%	25,559,896	38.8%	5,870,155	-0.1
Accident insurance	2,884,611	3.6%	2,525,264	3.8%	359,347	-0.3
Travel insurance	1,537,160	1.9%	1,239,332	1.9%	297,828	0.0
Technical risks insurance	2,725,994	3.4%	1,850,169	2.8%	875,825	0.6
Individuals' property insurance	5,162,491	6.4%	4,172,809	6.3%	989,682	0.0
Legal persons' property insurance	4,947,466	6.1%	4,002,325	6.1%	945,141	0.0
Agricultural risks insurance	411,073	0.5%	254,535	04%	156,538	0.1
Motor own damage insurance	26,276,018	32.4%	21,896,429	33.2%	4,379,589	-0.8
Liability insurance	1,525,136	1.9%	1,207,253	1.8%	317,883	0.0
Goods in transit insurance	298,515	0.4%	290,573	0.4%	7,942	-0.1
Carrier's liability insurance	1,640,186	2.0%	1,363,040	2.1%	277,146	0.0
Watercraft insurance and watercraft owner's liability insurance	412,377	0.5%	447,819	0.7%	-35,442	-0.2
Guarantee insurance	170,610	0.2%	109,785	0.2%	60,825	0.0
Railway rolling stock insurance	349,232	0.4%	89,559	0.1%	259,673	0.3
Assistance insurance	916,845	1.1%	654,286	1.0%	262,559	0.1
Financial risks insurance	423,782	0.5%	210,031	0.3%	213,751	0.2
Loss of employment insurance	2,614	0.0%	331	0.0%	2,283	0.0
Total	**81,114,163**	100.0%	**65,873,436**	100.0%	**15,240,727**	

Claims and benefits paid in 2016 totalled 81.1 million euros (2015: 65.9 million euros). Claims incurrence trends did not change significantly. The largest share of claims was settled in motor liability insurance: 31.4 million euros or 38.7% of claims paid. The next-largest class was motor own damage insurance where claims and benefits paid totalled 26.3 million euros or 32.4%.

Investing activities

Strategic investment management is the responsibility of the company's asset and liability management committee which includes highly qualified specialists from Estonia and Germany. In line with the investment management system, tactical investment management is outsourced to an external service provider. In January 2015, tactical investment management was taken over by the group's asset management company MEAG (MEAG Munich ERGO AssetManagement GmbH), which delivers the service in accordance with the strategic investment management plan and risk profile approved by the management board of ERGO Insurance SE.

In 2016, ERGO maintained a conservative approach to debt securities' interest rate and credit risk. The credit risk profile of the debt securities portfolio was as follows: 54.5% (2015: 33.6%) had an AAA (by Standard & Poor's) or Aaa (by Moody's) credit rating, 21.2% (2015: 34.1%) were rated AA or Aa, 12.8% (2015: 19.7%) had an A rating and 11.5% (2015: 12.6%) were rated BBB or Baa.

At the year-end, the investment portfolio comprised investments in associates of 1.8 million euros (2015: 3.5 million euros), debt securities of 107.3 million euros (2015: 85.7 million euros), loans of 1.4 million euros (2015: 2.1 million euros), and equities and fund units of 12.7 million euros (2015: 20.1 million euros). There were no investments in term deposits.

Income on assets with interest rate risk amounted to 1.13 million euros (2015: 0.94 million euros). Realisation of equities and units resulted in a gain of 1.13 million euros (2015: 0.46 million euros) and realisation of debt securities in a loss of 0.25 million euros (2015: a gain of 0.39 million euros). Dividend income amounted to 0.31 million euros (2015: 0.64 million euros) and income from the sale of an investment in an associate amounted to 1.7 million euros. The fair value reserve decreased by 1.2 million euros (2015: 0.39 million euros). Thus, the overall yield of the investment portfolio was 2.4% (2015: 1.7%). Investment management expenses accounted for 0.3% of the carrying value of managed investments.

Development

SALES AND SERVICE OFFERING

ERGO's strategic focus areas are strong customer relations, a customer-focused approach, innovation, simplicity, and transparency. Based on the customers' willingness to recommend us, ERGO is among the three most popular insurers in the Baltics. We wish to maintain this position.

In 2016, ERGO again participated in the Praise the Service Provider campaign. Service quality is important for ERGO and we are pleased to report that it has been improving year by year. Thanks to customers' recognition, we can proudly use the sign Customers Praise 2016.

Two of our Estonian offices moved to new premises: ERGO's Narva office is now located in the Astri centre and Rakvere office at Laada 29.

On 1 July, we merged our Estonian key customer and corporate customer departments into one loyal customer channel. The goal is to offer business customers comprehensive solutions through one main service channel and to build loyalty through a personal approach.

SERVICES

ERGO is the first insurance company in Estonia which offers its motor own damage policyholders an opportunity to have their vehicle, which has been repaired after an insured event, checked free of charge. This is done in cooperation with reliable workshops, most of which are our long-term business partners. The purpose is to provide the customers with additional assurance.

From February 2016, ERGO's home insurance for apartments includes liability insurance cover. This provides customers with additional assurance and helps mitigate expenses from damages claimed by neighbours.

Customers who have purchased ERGO's full motor own damage insurance for a car or a van which is in normal use are no longer required to pay the deductible when there has been a collision with a wild animal; when a loss has been incurred on avoiding collision, only the basic deductible is charged. In addition, ERGO now also covers the loss which is incurred when a carry cot or safety chair installed in a vehicle is damaged due to an insured event as well as the loss which is incurred when a vehicles' roof rack, roof box or bike carrier is damaged by an unforeseen external mechanical force (including a traffic accident), natural disaster (including hail), vandalism, or fire.

In Estonia, ERGO and its roadside assistance partner realised an idea suggested by a customer. Now policyholders can use ERGO's website not only to request roadside assistance but also to give notice of their location. The positioning link http://greenwave.ee/autoabi/ergo/ can be found on the page for requesting roadside assistance as well as the page for reporting a loss event.

In the third quarter, our Latvian entity signed a cooperation agreement with Citadele bank under which all of the bank's credit card holders are covered by ERGO's travel insurance free of charge.

In Lithuania, we received the highest ranking in a broad-based online survey conducted by the Swiss organisation ICERTIAS (International Certification Association): ERGO is the first choice in the Lithuanian vehicle and property insurance market thanks to our best price and quality ratio.

Our Lithuanian entity and Šiauliu bank signed a cooperation agreement under which all of the bank's gold credit card holders obtain ERGO's travel insurance free of charge.

MARKETING

From 25 February to 17 March, we conducted a travel insurance campaign in Estonia. The purpose was to highlight that ERGO is the only insurer in Estonia which offers travel insurance which does not require the customer who has experienced travel disruption to have spare cash for tickets, transport, or accommodation.

In 2016, our Estonian entity again supported a series of summer running events: Narva Energy Run (11 June, Narva), Night Run (13 August, Rakvere), Jüri Jaanson Two Bridges Run (4 September, Pärnu), SEB Tallinn Marathon (11 September, Tallinn), and Viking Window Paide-Türi Public Race (2 October, Paide-Türi).

In spring, the Estonian entity conducted a motor own damage insurance campaign aimed at introducing ERGO's free roadside assistance, replacement car service and the new 'Request ERGO roadside assistance' function on our website.

We also arranged a recreational sports insurance campaign designed to improve amateur athletes' awareness of the supplementary sports cover which can be added to ERGO's accident insurance. Amateur athlete's insurance is valid 24/7 regardless of whether the insured person is training, participating in a competition, or engaged in everyday activities.

The insurance covers post-accident medical treatment expenses which are not covered by the Health Insurance Fund and the daily allowance covers the portion of salary not paid by the Health Insurance Fund and the employer. This allows the insured persons to maintain the income they are used to. Compensation for permanent disability helps to adjust to the new situation.

During the summer, people could get acquainted with all of ERGO's services at several major fairs such as the rural fair Tartu Maamess and the interior design fair Interjöör in Tallinn.

ERGO is the sponsor of the Estonian Olympic Committee. In connection with the Rio Olympics, we promoted Erika Kirpu, one of the recipients of ERGO's young athlete's grant, with the message: ERGO supports healthy lifestyles and dedicated athletes.

ERGO participated, as an expert, in the Insurance Insights programmes produced by the Estonian Insurance Association and Vikerraadio to improve consumers' awareness of different insurance matters.

Until August, our Latvian entity and Statoil Fuel & Retail conducted a motor liability insurance campaign Purchase Motor Liability Insurance from Statoil and Get a Free Car Wash.

In the third quarter, the Latvian entity carried out a campaign aimed at explaining the relevance of business interruption insurance. The main target group was small and medium-sized enterprises. At the same time, we conducted a cattle insurance campaign aimed at larger farms.

SPONSORING AND SOCIAL RESPONSIBILITY

On 22 February, our Estonian entity recognised the authors of the best ideas submitted to the Insurance 2025 competition at the opening event of the How to Start Up programme, held at Tallinn University of Technology Innovation and Business Centre Mektory. The first place was awarded to Ashish Rana (Start-up Insurance) and Siamak Tebyanian (Playful Insurance Products).

On 23 February, the Estonian entity announced a competition for ERGO's young athlete's grants of 20,000 euros in aggregate. The purpose was to communicate that ERGO supports healthy lifestyles and wishes to improve the health of the Estonian society. Over 160 young athletes applied. The best-represented fields were skiing and track and field, followed by cycling, sailing and riding. We decided to distribute the grant fund among 11 young athletes and support each of them with 1,500 euros. The beneficiaries of 2016 were Ralf Tribuntsov (swimming), Marten Liiv (speed skating), Erika Kirpu (fencing), Kätlin Tammiste and Anna Maria Sepp (sailing), Meril Beilmann (biathlon), Kristjan Ilves (Nordic combined skiing), Kristin Kuuba and Helina Rüütel (badminton), Kreete Verlin (track and field), and Marie Turman (curling).

We support Estonia's participation in the Olympic Games through long-standing cooperation with the Estonian Olympic Committee. ERGO insures athletes' trips to competitions and their vehicles.

In Estonia, we also continue to support the Bully Free School foundation. Every school year, five schools can join the programme.

The German-Baltic Chamber of Commerce grants an Economy Award to recognise small and medium-sized Estonian enterprises which are highly successful or innovative and have business relations with Germany. In 2016, the theme was Our Employees – the Key to Our Success. The winner was Enics Eesti AS. ERGO is a member of the German-Baltic Chamber of Commerce and the main sponsor of the competition.

For 14 years our Latvian entity has been providing scholarships to young orphans that need support to acquire higher education. In February, the entity organised a work shadowing day for students.

To show that ERGO cares about the environment, the staff of our Latvian entity planted 5,000 pine trees. Within the past six years when ERGO has participated in forest planting, we have planted around 21,200 pine and fir trees on an area extending to 10 hectares.

ERGO is an employer that supports healthy lifestyles and encourages its staff to be active: around a hundred people from our Baltic offices participated in the Lattelecom Marathon in Riga.

For the fourth year already, ERGO was the main sponsor of the Latvian beach volleyball competition ERGO Open.

Our Latvian entity set up a bicycle school for up to 14 year-olds, which offered young cyclists an opportunity to improve their cycling skills. All who passed an exam received a certificate.

ERGO continued its cooperation with the Latvian Road Administration. We supported a campaign for safe and environment friendly driving and a campaign for pedestrians' safety. In June, we participated in the Angry but Alive campaign aimed at preventing people from driving under the influence of alcohol. In August, we conducted the Safety Belt campaign, which reminded people of the need to fasten the safety belt also on the back seat. In October and November we conducted the Traffic is not the Place to Prove Yourself campaign aimed at reducing aggressiveness in traffic.

In November, our Latvian entity was the insurance partner of the Staro Rīga Light Festival, which is a major cultural event in Latvia. The festival merges light, music and theatrical arts to turn buildings, squares, bridges and monuments into unique works of art.

In the last two months of 2016, the Latvian entity carried out a life insurance campaign which introduced unit-linked products.

In Lithuania, we signed a cooperation agreement with the Lithuanian Road Administration to improve traffic culture, improve traffic safety and reduce the number of road accidents.

ERGO partnered up with Volvo to support the campaign Stop, Look, Wave which was aimed at minimising traffic accidents involving children.

In September, our Lithuanian entity launched a mobile application Drive Safely which allows people to monitor their driving style.

For four years already, our Lithuanian entity has been the main sponsor of the Vilnius International Film Festival, which is one of the largest cultural events in Lithuania.

In 2016, our Lithuanian entity was also the main sponsor of the cycling event Velomarathon. During the event there was a demonstration of reflective clothes and items called Fashion Which Protects.

In September, ERGO participated in the Vilnius marathon in order to support the United Nations International Children's Emergency Fund (UNICEF).

In Lithuania, we also sponsored the Business 2017 conference which included an insurance forum for insurance intermediaries where participants could discuss economic developments and trends in 2017. Speakers at the conference included Kęstutis Bagdonavičius, the chairman of the management board of ERGO Insurance SE.

In December, our Lithuanian entity arranged a home insurance campaign whose prizes included five smart TVs.

Organisation and management

The roles and responsibilities of the members of the management board are as follows:

- Chairman of the management board Kęstutis Bagdonavičius is responsible for the following departments across the Baltics: communication, corporate strategy, HR and administration, legal and compliance control, regional development, internal audit, business management and innovation.
- Member of the management board and chief financial officer Deniss Sazonovs is responsible for financial management and the following departments: accounting, planning and controlling, actuaries, risk management and IT.
- Member of the management board and ERGO's team leader in Latvia Ingrida Kirse is responsible for life, health and pension insurance in the Baltics as well as property insurance, claims handling, sales and marketing in Latvia.
- Member of the management board and ERGO's team leader in Lithuania Saulius Jokubaitis is responsible for reinsurance and pricing in the Baltics and property insurance, claims handling, sales and marketing in Lithuania.
- Member of the management board and ERGO's team leader in Estonia Tarmo Koll is responsible for bank insurance in the Baltics and property insurance, claims handling, sales and marketing, and customer contract management in Estonia.

Key financial indicators

In thousands of euros, except for ratios *As at 31 December or for the year*	**2016**	2015
For the year		
Gross premiums written	**136,777**	121,044
Gross earned premiums	**130,423**	115,414
Gross claims and benefits incurred	**84,704**	72,563
Gross expenses	**43,877**	39,904
Gross loss ratio	**64.9%**	62.9%
Net loss ratio	**68.2%**	65.8%
Gross expense ratio	**33.6%**	34.6%
Net expense ratio	**34.9%**	36.3%
Gross combined ratio	**98.6%**	97.4%
Net combined ratio	**103.1%**	102.2%
Claims handling ratio	**10.1%**	10.4%
Claims paid ratio	**59.3%**	54.4%
As at the year-end		
Total assets	**188,773**	174,298
Ratio of investments to total assets	**65.3%**	63.9%
Ratio of equity to total assets	**23.5%**	25.8%
Ratio of insurance provisions to total assets	**64.7%**	64.3%
Profitability indicators		
Insurance result (technical result)	**−3,810**	−1,797
Investment result	**2,460**	1,621
Profit for the financial year	**607**	1,556
ROE	**1.4%**	3.4%
ROA	**0.3%**	0.9%
ROI	**2.1%**	1.5%

Explanation of figures and ratios

Gross earned premiums	gross premiums written + change in provision for unearned premiums
Gross claims and benefits incurred	claims and benefits incurred + change in provision for claims outstanding + change in provision for unexpired risks
Gross loss ratio	gross claims and benefits incurred / gross earned premiums
Net loss ratio	net claims and benefits incurred / net earned premiums
Gross expense ratio	(acquisition costs + administrative expenses + membership fee to Traffic Insurance Fund) / gross earned premiums
Net expense ratio	(acquisition costs + administrative expenses – reinsurance commission income + membership fee to Traffic Insurance Fund) / net earned premiums
Gross combined ratio	gross loss ratio + gross expense ratio
Net combined ratio	net loss ratio + net expense ratio
Claims handling ratio	claims handling costs / claims and benefits incurred
Claims paid ratio	claims paid / gross premiums written
Gross expenses	acquisition costs + administrative expenses + membership fee to Traffic Insurance Fund
Insurance result (technical result)	net earned premiums + reinsurance commissions − net claims and benefits incurred – gross expenses
Investment result	investment income and expenses + change in the fair value reserve in equity
Return on equity (ROE)	profit / period's average equity
Return on assets (ROA)	profit / period's average assets
Return on investments (ROI)	investment result / period's average investments

Conclusion

The management board of ERGO Insurance SE is pleased to report that in 2016 the company developed in line with the insurance market and achieved its main business goals and targets.

Kęstutis Bagdonavičius
Chairman of the management board

Financial statements

Income statement

In euros	Note	2016	2015
Income			
Gross premiums written	3	136,777,029	121,043,953
Written premiums ceded to reinsurers	3	-7,462,287	-6,745,769
Change in gross provision for unearned premiums	21	-6,353,881	-5,630,049
Reinsurers' share of change in provision for unearned premiums	15	-452,035	225,568
Net earned premiums		**122,508,826**	**108,893,703**
Reinsurance commission income	4	1,103,449	911,454
Net investment income	5	4,001,382	2,117,269
Other income	6	1,785,038	2,523,651
Total income		**129,398,695**	**114,446,077**
Expenses			
Claims and benefits incurred	7	84,704,208	72,562,931
Reinsurers' share of claims and benefits incurred	7	-1,158,487	-864,410
Net policyholder claims and benefits incurred		**83,545,721**	**71,698,521**
Acquisition costs	8	36,209,014	33,089,326
Administrative expenses	8	6,043,773	5,471,141
Other operating expenses	8	1,623,933	1,343,333
Investment expenses	8	364,804	300,583
Other expenses	8	1,265,135	1,137,951
Total expenses		**129,052,380**	**113,040,855**
Operating profit		**346,315**	**1,405,222**
Share of profit of equity-accounted investees	13	15,691	195,545
Profit before income tax		**362,006**	**1,600,767**
Income tax income/expense	27	**245,148**	**-44,945**
Profit for the year		**607,154**	**1,555,822**

Statement of comprehensive income

In euros	Note	2016	2015
Profit for the year		**607,154**	**1,555,822**
Items of other comprehensive income that may be reclassified subsequently to profit or loss			
Change in value of available-for-sale financial assets	20	-1,176,114	-391,656
Total other comprehensive expense for the year		**-1,176,114**	**-391,656**
Total comprehensive expense/income for the year		**-568,960**	**1,164,166**

The notes on pages 23 to 80 are an integral part of these financial statements.

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Date/kuupäev....27.03.2017....
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Statement of financial position

In euros

As at 31 December	Note	2016	2015
Assets			
Property and equipment	10	9,657,339	9,973,331
Intangible assets			
Deferred acquisition costs	11	5,505,972	4 645 056
Other intangible assets	12	7,170,836	6 479 352
Investments in associates	13	1,855,475	3,496,125
Investments in financial instruments			
Equities and fund units	14	12,726,613	20 071 995
Debt and other fixed-income securities	14	107,325,542	85 682 647
Loans	14	1,384,634	2 106 288
Total investments in financial instruments		121,436,789	107,860,930
Reinsurance assets	15	15,370,195	15,301,714
Insurance and other receivables	16	18,980,895	16,682,675
Deferred tax assets	27	1,176,266	871,848
Cash and cash equivalents	17	7,619,488	8,987,233
Total assets		**188,773,255**	**174,298,264**

Equity and liabilities

As at 31 December	Note	2016	2015
Equity			
Share capital	18	6,391,391	6,391,391
Capital reserve	19	3,072,304	3,072,304
Fair value reserve	20	1,753,440	2,929,554
Retained earnings (prior years)		32,493,445	30,937,623
Profit for the year		607,154	1,555,822
Total equity		**44,317,734**	**44,886,694**
Liabilities			
Insurance contract provisions	21	122,055,304	112,111,376
Reinsurance payables	22	2,178,299	3,011,688
Insurance payables	23	7,146,963	7,509,247
Other payables and accrued expenses	24	7,074,955	6,719,386
Subordinated loan	28	6,000,000	0
Other provisions		0	59,873
Total liabilities		**144,455,521**	**129,411,570**
Total equity and liabilities		**188,773,255**	**174,298,264**

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Date/kuupäev....27.03.2017....
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Statement of cash flows

In euros

(Inflow + , outflow –)	Note	2016	2015
Net cash used in/from operating activities		**-10,308,912**	**3,431,872**
Insurance premiums received		133,735,265	123,729,374
Claims, benefits and handling costs paid		-80,240,245	-65,090,937
Settlements with reinsurers		-6,641,813	-4,033,521
Settlements with holders of reinsurance policies		-11,214	0
Paid in operating expenses		-47,573,403	-44,668,290
Other income and expenses		4,249,533	2,472,717
Acquisition of equities and fund units		-6,750,039	-9,175,298
Disposal of equities and fund units		13,906,642	5,347,716
Acquisition of debt and other fixed-income securities		-56,740,196	-70,769,636
Disposal of debt securities		33,175,173	62,413,508
Interest received		2,476,055	2,874,145
Dividends received		243,202	467,999
Corporate income tax paid		0	-74,732
Paid in investment expenses		-137,872	-61,173
Net cash from/used in investing activities		**8,941,167**	**-1,999,743**
Acquisition of an associate		-419,965	0
Loans provided to group companies		0	-200,000
Repayment of loans to group companies		720,000	0
Interest received from group companies		134,696	132,047
Proceeds from other investments		3,750,000	419,804
Subordinated loan		6,000,000	0
Dividends paid		0	-1,700,000
Paid on acquisition of property and equipment and intangible assets		-1,256,554	-660,614
Proceeds from sale of property and equipment and intangible assets		12,990	9,020
Net cash outflow/inflow		**-1,367,745**	**1,432,129**
Cash and cash equivalents at beginning of year		**8,987,233**	**7,555,104**
Decrease/increase in cash and cash equivalents		-1,367,745	1,432,129
Cash and cash equivalents at end of year	17	**7,619,488**	**8,987,233**

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Date/kuupäev........27.03.2017..........
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Statement of changes in equity

In euros	Share capital	Capital reserve	Fair value reserve	Retained earnings	Total equity
Balance at 31 December 2014	**6,391,391**	**3,072,304**	**3,321,210**	**32,637,623**	**45,422,528**
Dividend distribution	0	0	0	-1,700,000	-1,700,000
Total transactions with owner	**0**	**0**	**0**	**-1,700,000**	**-1,700,000**
Profit for the year	0	0	0	1,555,822	1,555,822
Other comprehensive expense	0	0	-391,656	0	-391,656
Total comprehensive income for the year	**0**	**0**	**-391,656**	**1,555,822**	**1,164,166**
					0
Balance at 31 December 2015	**6,391,391**	**3,072,304**	**2,929,554**	**32,493,445**	**44,886,694**
Dividend distribution	0	0	0	0	0
Total transactions with owner	**0**	**0**	**0**	**0**	**0**
Profit for the year	0	0	0	607,154	**607,154**
Other comprehensive expense	0	0	-1,176,114	0	-1,176,114
Total comprehensive expense for the year	**0**	**0**	**-1,176,114**	**607,154**	**-568,960**
Balance at 31 December 2016	**6,391,391**	**3,072,304**	**1,753,440**	**33,100,599**	**44,317,734**

The notes on pages 23 to 80 are an integral part of these financial statements.

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Date/kuupäev........27.03.2017..........
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Notes to the financial statements

Note 1. Significant accounting policies

ERGO Insurance SE is a non-life insurance company incorporated and domiciled in Estonia. The company's legal address is A. H. Tammsaare tee 47, 11316 Tallinn. The company's main business lines are motor own damage insurance, motor third party liability insurance (hereafter 'motor liability insurance'), and individuals' and legal persons' property insurance.

The financial statements of ERGO Insurance SE for 2016 include the financial statements of ERGO Insurance SE's head office in Estonia and the financial information of its Latvian and Lithuanian branches.

These financial statements were authorised for issue by the management board on 20 March 2017. Under the Estonian Commercial Code, the annual report including the financial statements that has been prepared by the management board and approved by the supervisory board must also be approved by the general meeting. Shareholders may decide not to approve the annual report and may demand that a new annual report be prepared.

(a) Statement of compliance

The financial statements of ERGO Insurance SE have been prepared in accordance with the International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) and their interpretations as adopted by the European Union (IFRS EU) to be effective for the year 2016.

(b) Basis of preparation

The company's functional and presentation currency is the euro.

The financial statements are prepared on the historical cost basis except that the following assets and liabilities are measured at their fair values:

- financial assets at fair value through profit or loss;
- available-for sale financial assets.

Non-current assets held for sale are measured at the lower of their carrying amount and fair value less costs to sell.

Use of significant estimates and judgements

The preparation of financial statements in conformity with IFRSs as adopted by the EU requires management to make judgements, estimates and assumptions that affect the application of policies and the reported amounts of assets and liabilities and income and expenses.

The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making judgements about the carrying amounts of assets and liabilities that are not readily apparent from other sources. Although the estimates are based on management's best judgement and facts, actual results may differ from those estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the year in which the estimate is revised if the revision affects only that year, or in the year of the revision and future years, if the revision affects both the year of revision and future years.

The most significant estimates in the financial statements are related to insurance provisions. The company employs a responsible actuary. Estimation and recognition of insurance provisions and deferred acquisition costs are described in this note, in policies (f) and (l) *(i)* respectively.

Estimates are also used in determining the fair value of financial assets (see accounting policies (l) and (m)).

Information about the main estimation criteria that affect the amounts recognised in the financial statements is presented in the following notes:

- Note 12 Other intangible assets
- Note 14 Investments in financial instruments
- Note 15 Reinsurance assets
- Note 21 Insurance contract provisions

The risks and estimation uncertainties related to insurance contracts and financial instruments are described in note 2.

(c) Branches

A branch is an economic entity established for offering services on behalf of a company. A branch is not an independent legal person. The company is liable for the obligations arising from the activities of a branch. The accounts of foreign branches are maintained separately. Branches prepare their financial information for the same periods and using the same accounting policies. Any balances, income and expenses and gains and losses arising from intra-company transactions are eliminated in full.

(d) Associates

Associates are entities over which the company has significant influence but not control. Significant influence is presumed to exist when the company holds directly or indirectly through subsidiaries 20-50% of an entity's voting power.

Investments in associates are accounted for using the equity method. Upon initial recognition, investments in associates are measured at cost. The cost of an investment includes directly attributable transaction charges. The financial statements include the company's share of an associate's profit or loss from the date the significant influence commences to the date the significant influence ceases to exist.

(e) Classification of insurance contracts

Non-life insurance

Contracts under which the company accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder or other beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder or other beneficiary are classified as insurance contracts. All contracts issued by the company constitute insurance contracts. The company does not issue investment contracts.

Non-life insurance contracts have generally a term of one year. Exceptions include open-ended motor liability insurance contracts under which policies are issued for a maximum term of one year, and travel insurance contracts covering one trip whose term is generally less than one year.

Incoming reinsurance

Reinsurance contracts are contracts under which the reinsurer undertakes to assume the insurance risks of another insurer (the ceding insurer) and to pay that ceding insurer compensation of an agreed amount for losses incurred in connection with an insured event specified in an insurance contract entered into between the ceding insurer and a policyholder. Reinsurance contracts are entered into for a period of one year. Reinsurance contracts fall into two main categories – obligatory non-proportional and obligatory proportional.

Risks that exceed the limits of obligatory reinsurance contracts or fall outside their scope are reinsured under facultative reinsurance contracts. Facultative reinsurance contracts are entered into for covering a particular (single) risk. In its activities as a reinsurer, the company's main objective is to use its capital optimally and disperse its risks by diversifying the locations of the insured property. Reinsurance contracts are entered into with the insurance companies of ERGO group only.

(f) Recognition and measurement of insurance contracts

Insurance premiums

Premium income

At the Estonian entity, the first instalment of a premium payment is recognised at the date of inception of the insurance contract. The following instalment payments are recognised at the earlier of their due date and settlement date. Accordingly, premium income includes both income from contracts concluded in the current financial year and the previous financial year.

At the Latvian and Lithuanian entities, all premiums receivable (the entire premium income) under a contract are recognised immediately regardless of whether the instalment payments relate to the reporting period in part or in full.

Premiums are recognised as income in their gross amount without deducting brokerage fees. Premiums are considered earned when the insurance cover expires. Premiums earned are recognised on a daily basis.

Provision for unearned premiums

The unearned premiums provision is established for covering the costs of insured events of active contracts that occur after the reporting date and for related contract administration expenses. The unearned premiums provision is calculated in all lines of business under the 365-day *pro rata temporis* method. Calculations are made separately for each individual contract. The provision for a contract makes up the same percentage of gross premiums written under the contract as the post-reporting date term of the contract makes up of the entire term of the contract.

The reinsurers' share of the unearned premiums provision is calculated only for those contracts that fall in the scope of a proportional reinsurance contract. Reinsurers' share of the provision for unearned premiums makes up the same percentage of the provision for unearned premiums for contracts with proportionate reinsurance cover as ceded reinsurance premiums make up of relevant gross premiums written.

Claims and provisions for claims outstanding and unexpired risks

Claims and benefits incurred

Claims and benefits incurred from insurance activities consist of claims paid in the financial year, associated claims handling costs and changes in the provision for claims outstanding. Claims paid include claims that have been settled and their handling costs, less salvage and subrogation recoveries.

Subrogation revenue is recognised upon its collection and revenue from salvage recoveries is recognised on the transfer of the asset. The amount recognised as revenue from a salvage recovery is a conservative estimate of probable sales revenue less the costs incurred in connection with the transaction.

Provision for claims outstanding

The provision for claims outstanding is established for covering claims incurred but not settled by the reporting date and corresponding claims handling costs. The provision for claims outstanding includes the provision for claims incurred but not yet reported.

The provision for claims outstanding comprises of the following components:

- claims reported but not completely handled and settled (RBNS);
- claims incurred but not reported (IBNR);
- indirect claims handling costs.

Claims handling experts estimate the outstanding amount of incurred and reported claims separately for each case, taking into account all available information at the date of estimation and estimates of future changes in the claim. A provision for an outstanding claim is recognised immediately when the claim has been reported, the claim file has been opened and preliminary calculations of the loss have been made. Settlements made are deducted and when the last settlement has been made and the file has been closed, the provision is reduced to zero.

Future direct claims handling costs, including the costs of expert opinions and legal assistance, related claims, etc. are also estimated case-by-case.

If an incurred claim is settled in periodic disbursements, a pension annuity provision is established in the provision for claims outstanding.

In calculating the provision for claims outstanding, discounting is applied only to pensions arising from the motor insurance legislation. In other cases, discounting is not applied.

The IBNR component is estimated using various statistical methods. For each year of loss incurrence, the ultimate loss is estimated. The ultimate loss estimate is reduced by claims paid and individual case-based provisions established as at the reporting date. The difference is the basis for determining IBNR.

For covering the costs of future indirect claims handling costs of claims incurred, a provision for indirect claims handling costs is made in the provision for claims outstanding.

Reinsurers' share of the case-based provision for claims outstanding is calculated according to reinsurance contracts precisely. Reinsurers' share of the estimated portions of the claims outstanding provision is determined for only those classes and underwriting years that fall within the scope of a proportional reinsurance contract in force. In the latter case it is assumed that the corresponding part of the provision is split between the reinsurer and the ceding insurer in the same way as the whole liability of the line of business in the underwriting year in question.

Provision for unexpired risks

The provision for unexpired risks is recognised when estimates indicate that the provision for unearned premiums is not sufficient for covering the claims incurred after the reporting date in respect of insurance contracts that entered into force before the reporting date and corresponding contract administration expenses.

Outgoing reinsurance

The company cedes reinsurance in the normal course of business in order to limit its net loss potential by diversifying its risks. Reinsurance arrangements do not relieve the company from its direct obligations to its policyholders.

Premiums ceded and benefits reimbursed are presented in the income statement and statement of financial position on a gross basis. Reinsurance assets comprise of debit balances due from reinsurers for ceded insurance liabilities. Amounts recoverable from reinsurers are measured on the basis of the provision for claims outstanding or the settled claims of policies falling within the scope of a reinsurance contract.

Reinsurance contracts are concluded for a term of one year. The main forms of contract are the obligatory non-proportional and the obligatory proportional reinsurance contract. Risks exceeding the limits of obligatory reinsurance contracts or falling outside their scope are reinsured on a facultative basis. All reinsurance contracts are used to transfer a significant portion of insurance risk. The company does not use financial reinsurance. The deferral calculations of prepaid reinsurance commissions are performed separately for each class of business. The basis for the calculations is relevant data (reinsurance premiums and commissions) for the past six months.

Prepaid reinsurance commissions make up the same proportion of reinsurance commissions as the reinsurers' share of the unearned premiums provision makes up of total reinsurance premiums.

Indemnities receivable under reinsurance contracts are assessed for impairment at reach reporting date. Relevant assets are impaired if, as a result of an event that occurred after their initial recognition, there is objective evidence indicating that the company may not be able to recover all amounts that are due and that the event has had a reliably measurable impact on the amounts the company can recover from the reinsurer.

Liability adequacy test

The insurance portfolio is assessed with the liability adequacy test by estimating the future cash flows under insurance contracts and comparing them against the carrying amounts of liabilities after the deduction of deferred acquisition costs. Liability adequacy is assessed separately for liabilities related to unexpired risks (insurance contracts in force) and liabilities related to expired risks (claims incurred but not yet settled). Liability adequacy is tested by taking into account all cash flows from insurance activities including estimated future claims, claims handling costs and fixed costs.

The liabilities arising from unexpired risks and cash outflows from future claims are estimated by forecasting the amount of claims outstanding for each year of loss incurrence using various mathematical methods. The results are used to find the expected loss ratio, which is used to estimate future cash flows. Expected cash outflows from claims handling activities are estimated by determining the proportion of actual claims handling costs in the amount of claims paid in the previous calendar year and by applying the ratio to the estimated amount of future claims.

Future cash outflows that are necessary for the company's operation are estimated on the basis of the fixed cost ratio for the past calendar year.

Cash inflows comprise estimated future investment income.

Where the liability adequacy test shows a deficiency in the carrying amount of insurance liabilities, first the deferred acquisition costs are reduced. If this does not suffice, an additional unexpired risks provision is recognised. The liability adequacy test is applied to the gross amounts of provisions, i.e. the effect of reinsurance is not taken into account.

(g) Other income

Rental income from investment property is recognised on a straight-line basis over each lease term. Other payments associated with the lease are recognised in profit or loss as an integral part of rental income.

(h) Operating lease expenses

Operating lease payments are recognised as an expense on a straight-line basis over the lease term. Other payments associated with the lease are recognised in profit or loss as an integral part of lease expense.

(i) Income tax

Under the Income Tax Act, in Estonia income tax is not levied on corporate profit but on dividends distributed. The income tax payable on dividends is recognised as the income tax expense of the period in which the dividends are declared irrespective of the period for which the dividends are declared or the period in which they are distributed.

In 2014, the tax payable on dividends distributed in Estonia was calculated as 21/79 of the amount distributed as the net dividend. In 2015, the income tax rate changed and the tax payable on dividends is calculated as 20/80 of the amount distributed as the net dividend. Because of the specific nature of the taxation concept, the term *tax base of assets and liabilities* does not have economic substance and deferred income tax liabilities and assets do not arise.

The maximum income tax liability that could arise on a dividend distribution is disclosed in note 27.

In Latvia and Lithuania corporate profit is subject to income tax. Before taxation, profit is adjusted for permanent and temporary differences as permitted by local tax laws. In the reporting period, the corporate income tax rate in Latvia and Lithuania was 15% (the same as in the previous year).

At foreign entities, deferred tax is recognised using the liability method whereby the deferred tax assets and liabilities arising from temporary differences between the carrying amounts and tax bases of assets and liabilities are recognised in the statement of financial position.

(j) Foreign currency transactions

Transactions in foreign currencies are recorded by applying the exchange rates of the European Central Bank at the dates of the transactions. At the reporting date, assets and liabilities denominated in a foreign currency are retranslated using the exchange rates of the European Central Bank ruling at that date. Exchange gains and losses are recognised in profit or loss in the period in which they arise.

(k) Property and equipment

(i) Owned assets

Items of property and equipment are carried at cost or deemed cost less accumulated depreciation (see below) and impairment losses (see accounting policy (r)). Property that is being constructed or developed for future use as investment property is classified as property and equipment and measured using the cost model until construction or development is complete, at which time it is reclassified to investment property.

Where major identifiable parts of an item of property and equipment have different useful lives, they are accounted for separately.

Assets are recognised as property and equipment if their useful life extends beyond one year.

(ii) Leased assets

Leases that transfer substantially all the risks and rewards incidental to ownership of an asset to the company are classified as finance leases. An asset acquired with a finance lease is carried in the statement of financial position at an amount equal to its fair value or, if lower, the present value of the minimum lease payments, less any accumulated depreciation (see paragraph (iv) below) and any impairment losses (see accounting policy (r)). Lease payments are accounted for as described in policy (h). Property held under operating leases that would otherwise meet the definition of investment property may be classified as investment property on a property-by-property basis.

The company as lessor

Assets subject to operating leases are presented in the statement of financial position according to the nature of the asset. Operating lease payments are recognised as income on a straight-line basis over the lease term.

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The company as a lessee

Finance leases are recognised in the statement of financial position as assets and liabilities at amounts equal to the fair value of the leased property. Lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is recognised over the lease term.

Operating lease payments recognised as an expense on a straight-line basis over the lease term.

(iii) Subsequent costs

The company recognises in the carrying amount of an item of property and equipment the cost of replacing part of such an item when that cost is incurred, if it is probable that future economic benefits embodied within the part will flow to the company and the cost of the part can be measured reliably. All other costs are recognised as an expense as incurred.

(iv) Depreciation

Depreciation is charged to profit or loss on a straight-line basis over the estimated useful life of each part of an item of property and equipment. Land is not depreciated.

The estimated useful lives are as follows:

Computer equipment	3 years
Cars, office and communications equipment	5 years
Furniture	6-7 years
Safes and reinforced cabinets	10 years
Buildings	33 years
Building rights (right of superficies)	50 years

Depreciation is charged on the difference between cost and residual value. If residual value cannot be estimated reliably or is insignificant, it is presumed to be equal to zero.

(l) Intangible assets

(i) Deferred acquisition costs – insurance contracts

Deferred acquisition costs include all direct costs incurred in acquiring insurance contracts. Deferred acquisition costs represent the proportion of direct acquisition costs that corresponds to the proportion of gross premiums written that is unearned at the reporting date. Deferred acquisition cost are direct costs such as agents' fees, brokerage fees, relevant stationery and printed matter costs, the costs of making photos of insured assets and other costs directly attributable to the acquisition of insurance contracts.

The deferral calculations for acquisition costs are performed separately for each class of business. Deferred acquisition costs are recalculated at each reporting date.

(ii) Other intangible assets

Other acquired intangible assets are measured at cost less accumulated amortisation (see below) and impairment losses (see accounting policy (r)). Intangible assets comprise acquired software and licences that are amortised over their useful lives using the straight-line method. The average annual amortisation rate is 25%. As an exception, the useful life assigned to insurance software ALICE is 10 years. Intangible assets are amortised on the assumption that their residual value is zero. Internally generated goodwill and the costs attributable to the development of brands are recognised as an expense as incurred.

(m) Financial assets

Financial assets comprise investments in equity and debt instruments, trade and other receivables, cash and cash equivalents, loans provided and derivative financial instruments.
Financial assets are classified into four categories, depending on the purpose of acquisition:

- financial assets at fair value through profit or loss;
- loans and receivables
- held-to-maturity investments;
- available-for-sale financial assets.

Financial assets at fair value through profit or loss are financial assets which on initial recognition are designated as at fair value through profit or loss.

Derivatives are classified as held for trading and are designated as at fair value through profit or loss unless they are designated and used as effective hedging instruments.

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities which the company intends and is able to hold to maturity.

Loans and receivables are non-derivative financial assets with fixed determinable payments that are not quoted in an active market.

Available-for-sale financial assets are non-derivative financial assets that are either designated to this category or are not classified to any of the other categories.

Purchases of financial assets are recognised at the settlement date. A financial asset is derecognised when contractual rights to receive cash flows from the asset expire, or where the asset, together with substantially all the risks and rewards of ownership, has been transferred.

Financial assets are initially measured at their fair value. After initial recognition, the company measures financial assets at fair value through profit or loss and available-for-sale financial assets at their fair value, without any deduction for the transaction costs it may incur on disposal. The fair value of a quoted financial asset is its quoted bid price at the reporting date.

If the market for a financial asset is not active, the company determines fair value using valuation techniques. These include the use of recent arm's length market transactions, references to another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If the value of equity instruments cannot be measured reliably, they are measured at cost.

Held-to-maturity investments are measured at amortised cost less impairment losses using the effective interest method. Loans and receivables are measured at amortised cost using the effective interest rate method.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or liability.

When calculating the effective interest rate, cash flows are estimated considering all contractual terms of the financial instrument excluding future credit losses. The calculation includes all fees paid or received between parties to the contract, direct transaction costs, and all other premiums or discounts.

Realised gains and losses and unrealised gains and losses arising from changes in the fair value of financial assets at fair value through profit or loss are recognised in profit or loss in the period in which they arise. Unrealised gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised directly in other comprehensive income or expense. When available-for-sale financial assets are sold or become impaired, the cumulative gains or losses previously recognised in other comprehensive income or expense are recognised in profit or loss. Where these investments are interest-bearing, the interest income calculated using the effective interest rate method is recognised in profit or loss.

(n) Derivative financial instruments

The company uses derivative financial instruments to hedge the risk of fluctuations in the value of assets that arise from changes in foreign exchange rates, share prices and interest rates. When a derivate financial instrument is recognised initially, it is measured at its fair value.

After initial recognition, derivative financial instruments are re-measured to fair value at each subsequent reporting date. Derivatives with a positive fair value are classified as assets and derivatives with a negative fair value are classified as liabilities. A gain or loss arising from a change in the fair value of a derivative, except for a gain and loss arising from a derivative that is part of a hedging relationship that qualifies for hedge accounting, is recognised in profit or loss. The company does not have any derivatives that are part of hedging relationships which qualify for hedge accounting. A derivative is derecognised when it matures or is transferred or cancelled.

(o) Receivables

Receivables are measured at their amortised cost and presented in the statement of financial position net of any doubtful and irrecoverable items. Irrecoverable receivables are accounted for off the statement of financial position. Receivables are measured on an individual basis and expensed or deducted from corresponding income when they become doubtful or irrecoverable.

(p) Cash and cash equivalents

Cash and cash equivalents in the statement of financial position comprise cash on hand, demand deposits and overnight deposits. In the statement of cash flows, cash flows are presented using the direct method.

(r) Impairment of assets

(i) Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its fair value.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed for impairment collectively in groups that share similar credit risk characteristics.

All impairment losses are recognised in profit or loss. In the event of impairment, any cumulative loss in respect of an available-for-sale financial asset recognised previously in other comprehensive income or expense is transferred to profit or loss.

When a previously recognised impairment loss decreases and the decrease can be objectively related to an event occurring after the loss was recognised, the impairment loss is reversed. For financial assets measured at amortised cost, the reversal is recognised in profit or loss.

(ii) Non-financial assets

The carrying amounts of non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in profit or loss.

(s) Employee benefits

Termination benefits are payable when the company terminates an employee's employment before the normal retirement date or when an employee decides to accept voluntary redundancy in exchange for those benefits. The company recognises termination benefits when it is demonstrably committed to terminate the employment of an employee or a group of employees under a detailed formal plan for the termination and is without realistic possibility of withdrawal or is demonstrably committed to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Where termination benefits fall due more than 12 months after the reporting date, they are discounted.

(t) Allocation of expenses

Expenses are first allocated on the basis of cost centres that are divided into categories according to their function: administration, sales, investment, and claims handling. If a cost centre is related to more than one function, expenses are re-allocated. Reallocations are made based on expert opinions derived from analyses that are generally valid for at least one year.

(u) Other provisions

Other provisions are recognised when:

- the company has a present legal or constructive obligation as a result of a past event;
- it is probable that an outflow of resources will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the provision.

A provision is recognised by reference to management's best estimates of the expenditure required to settle the obligation and the time the obligation ought to be settled.

(v) Dividends

Dividends are recognised as a liability on an accrual basis in the period in which they are declared.

(w) Events after the reporting period

The annual financial statements reflect all significant events affecting the valuation of assets and liabilities that became evident between the reporting date (31 December 2016) and the date on which the financial statements were authorised for issue but are related to the reporting or prior periods.

Subsequent events that are indicative of conditions that arose after the reporting date but which will have a significant effect on the result of the next financial year are disclosed in the notes to the annual financial statements.

(x) New and revised International Financial Reporting Standards and new interpretations originated by the International Financial Reporting Interpretations Committee (IFRIC)

The following new standards and amendments had to be applied in the reporting period:

- Amendments to IAS 1 *Presentation of Financial Statements*
- Amendments to IFRS 11 *Accounting for Acquisitions of Interests in Joint Operations*
- Amendments to IAS 16 and IAS 38 *Clarification of Acceptable Methods of Depreciation and Amortisation*
- Amendments to IAS 19 *Defined Benefit Plans: Employee Contributions*
- Amendments to IAS 27 *Equity Method in the Separate Financial Statements*

The new standards and amendments did not have a significant impact on the company's financial statements.

The following new and revised standards and interpretations were not yet effective for the year ended 31 December 2016 and have therefore not been applied in preparing these financial statements.

IFRS 9 *Financial Instruments* (2014) is effective for annual periods beginning on or after 1 January 2018.

This standard replaces IAS 39, *Financial Instruments: Recognition and Measurement*, except that the IAS 39 exception for a fair value hedge of an interest rate exposure of a portfolio of financial assets or financial liabilities continues to apply, and entities have an accounting policy choice between applying the hedge accounting requirements of IFRS 9 or continuing to apply the existing hedge accounting requirements in IAS 39 for all hedge accounting.

Although the permissible measurement bases for financial assets – amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL) – are similar to IAS 39, the criteria for classification into the appropriate measurement category are significantly different.

A financial asset is measured at amortised cost if the following two conditions are met:

- the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and,
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding.

In addition, for a non-trading equity instrument, a company may elect to irrevocably present subsequent changes in fair value (including foreign exchange gains and losses) in OCI. These are not reclassified to profit or loss under any circumstances.

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For debt instruments measured at FVOCI, interest revenue, expected credit losses and foreign exchange gains and losses are recognised in profit or loss in the same manner as for amortised cost assets. Other gains and losses are recognised in OCI and are reclassified to profit or loss on derecognition.

The impairment model in IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model, which means that a loss event will no longer need to occur before an impairment allowance is recognised.

It is expected that the new standard, when initially applied, will have a significant impact on the company's financial statements, since the classification and measurement of its financial instruments will change.

At this stage it is still unclear what portion of the company's debt securities will be measured at FVTPL, at FVOCI or amortised cost as this determination will depend on the outcome of the business model test.

It is also possible that a number of equity instruments currently classified as available for sale will be measured at FVTPL under IFRS 9, but this determination will depend on an election to be made by the company at the date of initial application. The company has not yet decided how it will classify these instruments.

Amendments to IFRS 4: Applying IFRS 9 *Financial Instruments* with IFRS 4 *Insurance Contracts* are effective for annual periods beginning on or after 1 January 2021. The amendments are to be applied prospectively (the amendments have not yet been endorsed by the EU).

The amendments address concerns arising from implementing IFRS 9 before implementing the replacement standard that the IASB is developing for IFRS 4. The amendments introduce two optional solutions. One solution is a temporary exemption from IFRS 9, effectively deferring its application for some insurers. The other is an overlay approach to presentation to alleviate the volatility that may arise when applying IFRS 9 before the forthcoming insurance contracts standard.

The company, as an insurance provider, intends to apply the exemption from adopting IFRS 9 and therefore does not expect any material impact on its financial statements.

IFRS 15 *Revenue from Contracts with Customers* is effective for annual periods beginning on or after 1 January 2018. Earlier application is permitted.

The new standard provides a framework that replaces existing revenue recognition guidance in IFRS. Entities will adopt a five-step model to determine when to recognise revenue, and at what amount. The new model specifies that revenue should be recognised when (or as) an entity transfers control of goods or services to a customer at the amount to which the entity expects to be entitled. Depending on whether certain criteria are met, revenue is recognised:

- over time, in a manner that depicts the entity's performance; or

- at a point in time, when control of the goods or services is transferred to the customer.

IFRS 15 also establishes the principles that an entity has to apply to provide qualitative and quantitative disclosures which provide useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows from a contract with a customer.

Although it has not yet fully completed its initial assessment of the potential impact of IFRS 15 on the company's financial statements, management does not expect that the new standard, when initially applied, will have material impact on the company's financial statements. The timing and measurement of the company's revenues are not expected to change under IFRS 15 because of the nature of the company's operations and the types of revenues it earns.

IFRS 16 *Leases* is effective for annual periods beginning on or after 1 January 2019. Earlier application is permitted if the entity also applies IFRS 15 (the standard has not yet been endorsed by the EU).

IFRS 16 supersedes IAS 17 *Leases* and related interpretations. The standard eliminates the current dual accounting model for lessees and instead requires companies to bring most leases on-balance sheet under a single model, eliminating the distinction between operating and finance leases.

Under IFRS 16, a contract is, or contains, a lease if it conveys the right to control the use of an identified asset for a period of time in exchange for consideration. For such contracts, the new model requires a lessee to recognise a right-of-use asset and a lease liability. The right-of-use asset is depreciated and the liability accrues interest. This will result in a front-loaded pattern of expense for most leases, even when the lessee pays constant annual rentals.

The new standard introduces a number of limited scope exceptions for lessees which include:

- leases with a lease term of 12 months or less and containing no purchase options, and
- leases where the underlying asset has a low value ('small-ticket' leases).

Lessor accounting shall remain largely unaffected by the introduction of the new standard and the distinction between operating and finance leases will be retained.

Although it has not yet fully completed its initial assessment of the potential impact of IFRS 16 on the company's financial statements, management expects that the new standard, when initially applied, will have an impact on the company's financial statements since it will require the company to recognise in its statement of financial position assets and liabilities relating to operating leases for which the company acts as a lessee.

Annual improvements to IFRSs 2014-2016 cycle which were issued on 8 December 2016 introduce two amendments to two standards and consequential amendments to other standards and interpretations that result in accounting changes for presentation, recognition or measurement purposes.

The amendments to IFRS 12 *Disclosure of Interests in Other Entities* are effective for annual periods beginning on or after 1 January 2017 and amendments to IAS 28 *Investments in Associates and Joint Ventures* are effective for annual periods beginning on or after 1 January 2018. The amendments are to be applied retrospectively. Earlier application is permitted. None of these amendments is expected to have a significant impact on the company's financial statements.

Note 2. Risk profile

As a part of Munich Re group, ERGO is committed to turning risk into value. ERGO's risk management encompasses all strategies, methods and processes used to identify, analyse, assess, control and monitor both long- and short-term risks to which ERGO is exposed or may become exposed in the future.

To achieve the above goal, risk management has been made an integral part of the company's management. We have set up a risk management function to achieve Munich Re's key strategic risk management objectives:

- to maintain financial strength sufficient for ensuring that all commitments to customers can be met at all times;
- to maintain and increase the value of the shareholders' investment;
- to preserve the reputation of Munich Re and all of its entities and units.

Risk-taking is our business and in order to meet the above objectives, we have to take risks of the right type and the right severity/level. This is the purpose of our risk management. The logic of the business model exposes the company to various risks. Therefore, risk awareness and prudent risk management are our priorities. We put a lot of effort in enhancing our risk management system. Own risk and solvency assessment, which covers all the processes and procedures employed to identify, assess, monitor, manage, and report the short- and long-term risks forms an essential part of ERGO's risk management system. Our own risk and solvency assessment integrates both the current and future periods' business strategy, risk strategy and capital management. The chapters below describe the main risks that ERGO has to face because of its business model

2.1. Insurance risks

The insurance environment is regulated by the law of obligations and insurance activities legislation. In certain areas, motor insurance legislation is applied. As the Baltic countries are members of the EU, all legislation and regulations have to comply with relevant EU directives. Amendment or potential amendment of laws and regulations increases business risk.

Insurance risk management is an integral part of the company's risk management system. To ensure a balanced insurance portfolio, the company has established pricing and underwriting guidelines, which are updated on a regular basis.

The core elements of insurance risk management are continuous monitoring of risk developments and regular review of the actuarial assumptions employed to calculate technical provisions. Insurance premiums and provisions are calculated on the basis of carefully selected actuarial assumptions. The inter-relationship between revision risk and concentration risk may give rise to material losses. Such risks are monitored using scenario analysis and modelling, which provide information about the maximum possible liability. To protect itself against such risks and limit fluctuations in income, the company uses reinsurance.

Policies for mitigating insurance risks

The company's insurance activity assumes the risk that a loss event involving a person or property directly related to an insurance contract will occur. The risk may relate to property, liability, health, accident, financial, or other loss arising from an insured event whose time of occurrence and severity are unknown at the date the insurance contract is concluded.

Through its insurance and investment activities, the company is also exposed to market risks.

The company manages its insurance risk through underwriting limits, approval procedures for transactions that involve new products or exceed set limits, pricing guidelines and centralised management of reinsurance.

The company uses several methods to assess and monitor insurance risk exposures both for individual types of risks insured and general insurance risks. These methods include internal risk measurement models, sensitivity analyses, scenario analyses and stress testing.

The theory of probability is applied to pricing and calculating technical provisions. The principal risk is that the frequency and severity of claims is greater than expected. Insurance events are, by their nature, random, and the actual number and size of events during any year may vary from those estimated using statistical techniques.

The key risks associated with insurance services are underwriting risk and competitive risk. The company is also exposed to the risk of dishonest actions by policyholders.

Underwriting risk is the risk that the company is unable to estimate the probability of an insured event and the size of a potential loss sufficiently accurately and, as a result, insufficient insurance premiums are charged. The risks of a specific contract may be influenced by factors such as the location of the policyholder and the insured property, the safety measures in place, the nature of the policyholder's business, the age of the property, etc. In calculating a premium that is commensurate with the risk insured, the company relies on the loss incurrence statistics for similar risks and the specific features of the risk insured. If insurance risk is systematically underestimated, the company may not be able to indemnify losses and perform its obligations under its insurance contracts.

The risks associated with policyholder claims involve the risk that the insured will make false or invalid claims or will exaggerate the amount claimed following a loss. The category also includes the risk of intentional or unintentional underinsurance.

The process used to determine assumptions is intended to result in neutral estimates of the most likely or expected outcome. The sources of data used as inputs for assumptions are internal and external and based on detailed studies that are carried out annually. Assumptions are checked to ensure that they are consistent with observable market prices or other published information. Special attention is paid to assumptions which change over time. Where there is insufficient information to make a reliable estimate, conservative assumptions are used.

Insurance risk management strategy

The company's underwriting strategy seeks diversity to ensure a balanced portfolio. The company believes that a large portfolio of similar risks ensures a better predictability of the outcomes.

The principles of insurance risk management are described in the company's risk strategy. To enforce appropriate risk selection within the portfolio, the underwriting strategy is cascaded down to individual underwriters through detailed underwriting authorities that set out the limits that any one underwriter can write in terms of line size, class of business and industry. Most non-life insurance contracts are annual in nature and underwriters may refuse to renew the contract or may change contract terms and conditions on renewal.

Insurance services are designed and updated in accordance with the company's internal regulations that provide a framework for insurance services, definitions of insurance risks, and a list of risks or assets that are not to be insured. Adherence to underwriting rights is determined through exception reports which are prepared in respect of insurance classes and services on a quarterly basis.

General insurance contracts

Liability insurance

Liability insurance is considered a long-tail line as handling and settling claims for a given insured event takes relatively long. The speed of claim reporting depends on the insurance cover and the terms and conditions of the insurance contract. The speed of claim handling depends on the speed of reporting, the cover provided, the jurisdiction, and specific policy terms and conditions.

The majority of liability covers are written on a 'claims made' or 'act committed' trigger. The main exception is motor liability insurance that is written on an occurrence basis. Liability contracts provide the scope of the liability also in geographical terms. Generally, the scope of liability is limited to the country where the entity providing the insurance cover is located.

Motor liability insurance is the insurance of the civil liability of a person in possession of a major source of danger. It covers the losses that may be incurred from activities related to ownership or use of a vehicle.

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Motor liability insurance is also valid outside the Baltic countries and covers relevant losses incurred in the EU countries and countries that have joined the Green Card Convention. Losses are indemnified in accordance with the liability rates of the country in which the traffic accident occurs. In some countries liability is unlimited. Therefore, in principle, motor liability insurance contracts are contracts with unlimited liability. This means that policies are written without a limit although tariffs are set taking into account the actual value of the largest possible claim.

Motor liability insurance covers property damages and personal injuries inflicted on third persons and, locally, also the medical treatment expenses of the driver that caused the insured event. This means that the nature of losses differs. Property losses are handled quickly but the handling of personal injury claims may take years. In the case of personal injuries that have to be indemnified with periodic payments (pensions) the insurer may not indemnify the damages in an agreed lump sum. In the case of traffic accidents that occur in the Baltic countries, motor liability insurance does not cover unearned income. Due to a longer handling period and also because personal injuries are directly related to many other socio-economic factors, the proportion of personal injury claims is increasing rapidly.

Motor liability insurance contracts are entered into for an unspecified term. The maximum term of a policy is twelve months. A specific feature of the product is that when the policy expires, the insurer's liability does not expire unless the policyholder has concluded a new insurance contract. An insurer may not refuse to conclude a contract. This increases the importance of risk assessment.

Liability insurance is typically the greatest source of uncertainty regarding claim provisions. Claims with long reporting lags result in greater inherent risk. Claims with long latency also increase the potential recognition lag, i.e. the lag between writing a type of policy in a certain market and the recognition that such policies have potential mass tort or latent claim exposure. As a rule, liability insurance services have long reporting lags and involve several parties, claims may be filed by several persons and claim amounts may be large. Therefore, estimation of provisions in liability insurance is somewhat more difficult than in other classes that do not have such features.

Property insurance

The company offers property insurance to owners of property located in the Baltic countries. Property insurance protects, subject to the limits and restrictions of the insured amounts and insurance conditions, policyholders against financial loss caused by damage to their physical property or financial loss arising from business interruption caused by damage to property.

The event (e.g. a fire or burglary) giving rise to a claim for compensating damage to buildings or property located therein usually occurs suddenly and the cause and time are generally easily determinable. The claim is generally notified promptly and can be settled without delay. Delays may result from the determination of the cause of the insured event, restoring the property and making relevant preparations.

Property business is therefore classified as 'short-tailed' meaning that the increase in costs over time and investment return are of negligible importance. This contrasts with the 'long-tailed' classes (e.g. liability insurance) where the ultimate cost of a claim takes longer to determine, making costs and investment return considerably more important.

Marine and transport insurance

This category comprises the insurance of watercraft and the transport of goods such as goods in transit insurance, carrier's liability insurance and forwarding agent's liability insurance. The classes incorporate the features of both property insurance and liability insurance. Similarly to liability insurance, reporting and handling are long-term processes.

Product-specific risks include claims related to violation of customs regulations. The risks related to property insurance are more indeterminate because insurance cover is valid also outside the Baltic countries.

Pricing risks

The premium rates and tariffs applied by the company are usually calculated for a year and their adequacy is checked on a regular basis. Premium rates and tariffs may be changed due to changes in claim incurrence statistics, market trends and the broadening or limitation of insurance cover. The company has a routine procedure for changing premium rates and tariffs. Tariffs are calculated based on mathematical assumptions.

Therefore, there exists the risk that the frequency and severity of losses will surpass the assumptions. This risk is mitigated by checking the validity of assumptions applied in routine reporting.

Another pricing risk is related to the sales process. The ultimate price of an insurance service depends on various risk factors, some of which are subjective. Therefore, there exists the risk that risk factors are intentionally or unintentionally altered. The company has mitigated the risk by excluding the possibility of price manipulations on the sale of mass products. In classes where each item of insured property has to be assessed on an individual basis, the underwriting process entails risk assessment and supervision by the company's insurance department.

Claims handling risks

The overriding principles of the company's claims handling operations are transparency and prudence. Transparency assumes the clarity of the handling process and its compliance with established guidelines. On the one hand this is in the customer's best interests and on the other allows monitoring and checking the handling process. The risks inherent in the process are mitigated by the absence of cash risk and applying proper quality controls, separating the process into stages, and observing signature rules.

In line with the principle of prudence each reported claim is evaluated on an individual basis taking into account the circumstances surrounding the claim, the information obtained during the handling process and historical evidence about the size of similar claims. The nature of the business makes it very difficult to predict with certainty the likely outcome of any particular claim and the ultimate cost of reported claims. Therefore, case estimates are reviewed regularly and updated as and when new information becomes available. However, the ultimate liabilities may vary as a result of subsequent developments. The impact of many factors affecting the ultimate loss is difficult to estimate. Provision estimation difficulties, which differ by class of business, depend also on the terms of the underlying insurance contract, claim complexity and size, determination of the date of occurrence, and reporting lag.

Provisioning risks

The company's exposure to latent bodily injury claims arises mainly from motor liability insurance contracts and, to a lesser extent, accident insurance contracts. The company's estimate of its ultimate liability for such exposures includes case-based provisions and a provision for liabilities incurred but not reported (IBNR).

The IBNR provision is estimated using statistical methods, such as the chain ladder and Bornhuetter Ferguson methods, and taking into account claims development, frequency and severity. Such methods extrapolate the development of paid and incurred claims, average cost per claim and ultimate number of claims for each year based upon observed developments of earlier years and expected loss ratios.

The key methods that are used and have remained unchanged from prior years are:

- chain ladder methods, which use historical data to estimate the ratio of paid and incurred claims to forecasted ultimate claims cost;
- expected loss ratio methods, which use the company's expectation of the loss ratio for a class of insurance.

The actual method or blend of methods used varies by the year of incurrence, the class of business and observed historical claims development.

The methods rely on historical claims development information and assume that the historical pattern will occur again in the future. There are reasons why this may not be the case and which are considered, where possible, by modifying the methods. Such reasons include:

- changes in the processes that affect the development or recording of claims paid and forecasted (such as changes in claims provisioning procedures);
- economic, legal, political and social trends that cause the rate of inflation differ from the forecast;
- changes in the mix of business;
- random fluctuations, including the impact of large losses.

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IBNR provisions are initially estimated at a gross level and separate calculations are made to estimate the size of reinsurance recoveries.

ERGO calculates its insurance provisions using the principle of best actuarial estimates, i.e. an insurance provision is recognised in an amount that best reflects the expected future net cash outflows. In addition to direct claim and benefit payments, the expected future cash outflows comprise claims handling and other potential costs as well as expected future income from salvage and subrogation recoveries.

Concentration risks

Within the insurance process, concentration risk may arise where a particular event or series of events has a strong impact on the company's liabilities. Such concentration may arise from a single insurance contract or through a large number of related contracts.

Recognition of losses due to such events will accurately reflect the events that have taken place. The company's cash flows resulting from a high-severity risk such as a flood may differ significantly from the cash flows resulting from an ordinary insured event.

The company is engaged in non-life insurance, providing cover for various risks. In property insurance, the company needs to monitor the geographical concentration of risks because external factors such as adverse weather conditions may have an adverse impact on a large proportion of insured property in a particular geographical area. Claim-triggering perils such as storms, floods, fires, explosions, and growth in crime may occur on a regional basis, meaning that the company has to manage its geographical risk dispersion very carefully. The company assesses and mitigates the geographical concentration of risks by using contemporary tools for analysing geographical information.

In geographical terms, the company's insurance contract liabilities break down as follows.

In euros	2016			2015		
	Gross provisions	Reinsurers' share	Net provisions	Gross provisions	Reinsurers' share	Net provisions
Estonia	34,341,152	2,702,781	31,638,371	32,837,306	2,859,660	29,977,646
Latvia	30,191,809	6,659,442	23,532,367	28,738,957	7,549,087	21,378,729
Lithuania	57,522,343	6,007,972	51,514,371	50,535,113	4,892,967	45,453,287
Total	122,055,304	15,370,195	106,685,109	112,111,376	15,301,714	96,809,662

Impact of catastrophic events

Probable events that could have the strongest impact on the insurance portfolio are natural disasters such as floods and storms. In Estonia, the probable frequency of a severe natural disaster comparable to the storm on 9 January 2005 is once in twenty years.

In order to limit the impact of a potential catastrophe, the company has bought natural catastrophe reinsurance with an insured amount of 26 million euros and retention of 3.0 million euros. In addition, the company constantly limits its risk concentration by spreading its insurance risks across Estonia and limiting its contractual exposure to any single peril in the event of a natural disaster.

The biggest possible losses resulting from single events relate to motor liability insurance and property insurance. The company has bought non-proportional peril-based reinsurance cover, limiting its net liability to 1.5 million euros per insurance contract in property insurance and to 1.0 million euros per insured event in motor liability insurance.

Reinsurance strategy

The company reinsures a certain part of the risks for which it provides insurance cover under insurance contracts. The purpose of reinsurance is to reduce the company's share of losses and to limit the potential net loss through the diversification of risks. The main contract forms in reinsurance are peril-based obligatory non-proportional and peril-based obligatory proportional reinsurance, accompanied by catastrophe reinsurance for aggregated risks related to the whole portfolio. Risks exceeding the limits of obligatory reinsurance contracts or falling outside their scope are reinsured on a facultative basis.

Reinsurance is acquired on the guiding principle that the net loss should not exceed 1.5 million euros for each individual insured item and/or each individual event. Retention for additional natural catastrophe reinsurance is 3.0 million euros. Standard exclusions from reinsurance contracts are losses arising from nuclear energy and terrorism.

Breakdown of reinsurance retention by insurance class as at 31 December 2016 (on a forward-looking basis):

Class of insurance	Retention in euros
Property and technical risks insurance	1,500,000
Motor liability insurance	1,000,000
Liability insurance, additional 'stop loss' reinsurance contract for covering retention in property, technical risks, and motor liability insurance	500,000
Goods in transit, watercraft, accident, travel, carrier's liability, and animal insurance	300,000
Motor own damage insurance and guarantee insurance	250,000

To protect the company against the impacts of major losses, ERGO Insurance SE signed an additional reinsurance contract for 2016 to cover its risk retention in property insurance, technical risks insurance and motor liability insurance.

Claims development

The claims development table allows comparing the claims outstanding estimates included in the financial statements with the claims incurred in previous years and reflects the company's ability to estimate the total value of claims.

The table provides an overview of current estimates of cumulative claims (including claims paid and case-based provisions and IBNR, but excluding claims handling costs and the provision for claims handling costs) and demonstrates how claims estimates have changed at subsequent year-ends. An estimate is increased or reduced as claims are paid and more information becomes available about the frequency and severity of claims outstanding.

Various factors may distort current estimates of provisions and cumulative prior year provisions. While the information in the table provides a historical perspective of the adequacy of claims outstanding estimates, it does not provide a basis for extrapolating surpluses or shortfalls of the past on current claims outstanding balances. The company believes that the estimates of claims outstanding as at the end of 2016 are adequate. However, due to the inherent uncertainties of the provisioning process, it cannot be guaranteed that the balances will prove adequate.

Analysis of claims development – gross (as at 31 December 2016)

In euros			*Year of loss incurrence*			
Estimate of cumulative claims	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
At end of year of incurrence	68,364,655	69,438,065	77,091,746	64,433,543	72,990,244	85,557,818
One year later	65,590,736	65,021,928	75,950,590	64,306,855	64,193,882	
Two years later	63,447,380	64,122,775	75,873,325	61,875,565		
Three years later	62,400,489	62,954,651	71,225,429			
Four years later	61,902,737	60,224,310				
Five years later	59,449,939					
Cumulative payments until 31 December 2016	58,959,782	58,254,228	57,545,555	56,202,289	60,891,819	55,016,237
Provision for claims outstanding (incl. IBNR) at 31 December 2016	490,157	1,970,082	13,679,874	5,673,276	3,302,063	30,541,581

At 31 December 2016, the provision for claims outstanding for earlier years of loss incurrence amounted 9,258,338 euros (2015: 11,504,188 euros).

The following sensitivity analysis reflects the effect of a 5% change in the provisions for claims outstanding on the company's net loss ratio, profit or loss for the year, and equity.

Results of sensitivity analysis for claims

	As at 31 December 2016		**As at 31 December 2015**	
	Change in net loss ratio in percentage points	Impact on profit or loss and equity in euros	Change in net loss ratio in percentage points	Impact on profit or loss and equity in euros
Motor liability insurance	4.1	-1,826,990	4.2	-1,608,370
Motor own damage insurance	0.7	-249,244	0.8	-257,528
Individuals' property insurance	0.9	–89,631	0.8	-78,953
Legal persons' property insurance	4.1	-274,577	4.2	-288,460
Other classes of insurance	3.8	-963,938	4.4	-1,001,010

Sensitivity analysis involves applying various methods to assess the volatility of estimates used for creating provisions for claims and its impact on the net loss ratio and net profit or loss.

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A 5% decrease in premium income for 2016 would have had a -0.8 million euro impact on the company's insurance result.

Liability adequacy test

The company has assessed the insurance liabilities recognised in the statement of financial position as at 31 December 2016 using the liability adequacy test.

The test indicated that in some classes of insurance contractual liabilities may exceed the insurance provisions recognised by a total of 690,456 euros (2015: 697,366 euros). As a result, the company reduced the deferred acquisition costs of the affected classes of insurance. No additional unexpired risks provision was recognised. Detailed information on insurance provisions is provided in note 21.

In euros

	As at 31 December 2016		As at 31 December 2015	
Class of insurance	Reduction of deferred acquisition costs after liability adequacy test	Additional unexpired risks provision	Reduction of deferred acquisition costs after liability adequacy test	Additional unexpired risks provision
Motor liability insurance	487,160	0	468,118	0
Legal persons' property insurance	0	0	80,123	0
Motor own damage insurance	203,296	0	135,102	0
Other property insurance	0	0	14,023	0
Total	**690,456**	**0**	**697,366**	**0**

In respect of other classes of insurance, the liability adequacy test indicated that the liabilities recognised in the statement of financial position exceeded the present value of the expected future net cash flows. Therefore, no additional provisions were recognised.

2.2. Market, credit and liquidity risk management

The principles of managing the risks related to financial assets are embedded in the company's risk management policy and observed in adhering to the predetermined risk appetite, strategic investment of assets, and specific risk management processes.

The company manages its asset risk by preparing a new investment policy on an annual basis. The policy sets out both the short- and long-term investment strategy. Implementation of the strategy and adherence to limits and restrictions is monitored by a multi-level structure. Tactical decisions are made and implemented by MEAG, an investment management company hired by ERGO in 2015. The compliance of investments with the adopted strategy is monitored by the asset and liability management (ALM) team and the team of the risk management function. If problems arise, they are reviewed by the ALM committee, which includes qualified members from Estonia and Germany, and the management board. Many ERGO group entities are also involved in planning, monitoring and managing investment risks.

Credit risk

The credit risk of investments is the risk that the issuer of a security will not discharge its obligations. The risk is mitigated by acquiring securities from issuers with a high credit rating. The following table describes the company's debt securities portfolio by the issuer's credit rating. At the year-end, the weighted average rating of fixed-income securities was AA- (2015: A+). The company believes that its credit risk exposure to other financial assets is low due to their small proportion.

In its insurance activities, the company's main credit risk is payment default by a broker or reinsurer. The company's credit risk arises principally from its insurance and reinsurance receivables. In each business line, risk management measures are applied to protect the company's financial position. The company has rules in place for consistently monitoring and managing overdue receivables. Receivables that are more than 60 days overdue are written down.

To mitigate the risk arising from reinsurance, the company enters into obligatory reinsurance contracts with such reinsurers only whose equity amounts to at least 250 million euros and rating is above A– (according to Standard & Poor's). Facultative reinsurance contracts are concluded with such reinsurers only that have been included in a list approved by the relevant department of ERGO group. In addition, premiums ceded to any one reinsurer may not exceed 10% of ERGO's annual gross premium income.

The assets presented in the table below have at least one rating of the respective rating group provided by one of the named rating agencies.

2016	**Standard & Poor's**	**AAA**	**AA**	**A**	**BBB**	**Without rating**	**Total**
	Moody's	**Aaa**	**Aa**	**A**	**Baa**	**Without rating**	
Debt securities at fair value		58,515,065	22,797,573	13,684,438	12,328,466	0	**107,325,542**
Proportion of debt securities		54.52%	21.24%	12.75%	11.49%	0.00%	**100.00%**
Reinsurance assets		1,968,074	10,355,109	1,012,920	3,644	2,030,448	**15,370,195**
Proportion of reinsurance assets		12.81%	67.37%	6.59%	0.02%	13.21%	**100.00%**

2015	**Standard & Poor's**	**AAA**	**AA**	**A**	**BBB**	**Without rating**	**Total**
	Moody's	**Aaa**	**Aa**	**A**	**Baa**	**Without rating**	
Debt securities at fair value		28,801,245	29,191,512	16,900,681	10,789,209	0	**85,682,647**
Proportion of debt securities		33.61%	34.07%	19.72%	12.59%	0.00%	**100.00%**
Reinsurance assets		266,058	8,715,790	1,927,219	0	4,392,647	**15,301,714**
Proportion of reinsurance assets		1.74%	56.96%	12.59%	0.00%	28.71%	**100.00%**

Other financial assets are also exposed to credit risk. The table below analyses financial assets' maturity structure, which reflects their credit quality. Receivables that are more than 180 days past due are written down in full.

As at 31 December 2016 *In euros*	Not past due	Less than 30 days past due	30 to 60 days past due	60 to 180 days past due	Total
Receivables from policyholders	9,152,622	4,316,090	61,526	106,508	**13,636,746**
Receivables from intermediaries	503,436	626,358	2,259	168,029	**1,300,082**
Receivables from reinsurers	28,794	98,636	499,334	260,293	**887,057**
Other receivables	1,352,520	361,271	88,132	237,123	**2,039,046**
Loan receivables	1,384,634	0	0	0	**1,384,634**
Accrued income – interest receivable	5,032	0	0	0	**5,032**
Total	**12,427,038**	**5,402,355**	**651,251**	**771,953**	**19,252,597**

As at 31 December 2015 *In euros*	Not past due	Less than 30 days past due	30 to 60 days past due	60 to 180 days past due	Total
Receivables from policyholders	6,403,784	4,646,219	132,183	165,170	**11,347,356**
Receivables from intermediaries	569,146	560,172	87,143	187,240	**1,403,701**
Receivables from reinsurers	5,490	366,043	41,682	241,006	**654,221**
Other receivables	197,046	504,100	976,799	542,532	**2,220,477**
Loan receivables	2,106,288	0	0	0	**2,106,288**
Accrued income – interest receivable	5,352	0	0	0	**5,352**
Total	**9,287,106**	**6,076,534**	**1,237,807**	**1,135,948**	**17,737,395**

Market risk

The most important risk related to financial assets is a decrease in the value of the investment portfolio, caused by the volatility of market prices.

Exposure to fluctuations in market value is assessed on an ongoing basis using four models. The first, Net Loss Limit (NLL), monitors the probability of achieving a result that surpasses the minimum investment result fixed by the actuaries. The second, Credit Value at Risk (CVaR) measures the potential loss that a portfolio of assets exposed to credit risk could suffer due to a weakening of the issuer's credit rating. The third, Market Value at Risk (MVaR), measures the potential decrease in the value of the current investment portfolio during one year. The fourth, Investment Asset/Liability Mismatch (InvALM) combines two of the above models (CVaR and MVaR) and the company's liabilities side and views how market events could influence the company when the risks taken on the asset side exceed the risk-neutral position resulting from liabilities. Clearly defined processes ensure that the company can respond timely to any significant capital market developments.

Market risk encompasses also potential inflation-triggered growth in future liabilities, particularly long-term liabilities such as motor liability insurance pensions. The risk is mitigated by estimating pension provisions by applying the expected rate of inflation and not discounting other kinds of case-based claims provisions. In view of the nature of its business and the small proportion of its long-term liabilities, the company believes that the impacts of market risk are moderately low.

(a) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in interest rates.

The company's investments comprise mostly fixed-income securities whose market value is influenced by changes in interest rates. At 31 December 2016, the weighted average yield to maturity of fixed-income available-for-sale debt securities was -0.13% (31 December 2015: 0.13%).

Assets exposed to interest rate risk, by interest rate.

In euros	As at 31 December 2016		As at 31 December 2015	
	Cost	Fair value	Cost	Fair value
Fixed-income debt securities				
Interest rate 0.00–2.50%	65,982,876	66,402,850	30,179,782	30,236,107
Interest rate 2.51–3.50%	7,085,902	11,229,228	11,158,008	11,177,146
Interest rate 3.51–4.50%	14,721,967	15,010,543	23,991,465	24,280,329
Interest rate 4.51–5.50%	8,938,600	9,288,264	14,427,080	14,877,690
Interest rate 5.51–6.50%	468,672	472,279	0	0
Total fixed-income debt securities	**97,198,017**	**102,403,164**	**79,756,335**	**80,571,272**
Floating rate debt securities	4,529,391	4,922,378	4,529,442	5,111,375
Total	**101,727,408**	**107,325,542**	**84,285,777**	**85,682,647**

If at 31 December 2016 the yield curve had shifted evenly 100 basis points upward/downward across all maturities, the company's equity would have decreased/increased by 2.1 million euros (2015: 1.7 million euros). Higher risk results from growth in the volume of the debt securities portfolio. There would be no impact on profit or loss because the securities, which are measured at fair value, have been classified as available-for-sale financial assets and changes in their fair value are recognised in other comprehensive income or expense.

(b) Other price risk

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk and currency risk) whether those changes are caused by factors specific to the individual financial instrument or its issuer or factors affecting all similar financial instruments traded in the market.

If at 31 December 2016 the value of investments in equity and debt securities funds had increased/decreased by 10%, the company's equity would have increased/decreased by 1.3 million euros (2015: 2 million euros). The decrease in risk is attributable to disposal of units in debt and equity funds during the year.

Changes in the economies of different geographical areas may also affect the fair values of financial assets connected with those areas.

Investments in financial instruments by issuer's domicile.

In euros **As at 31 December**	**2016**	**2015**
Debt and other fixed-income securities		
Australia	507,428	0
USA	0	4,598,566
Austria	2,268,177	518,068
Belgium	2,028,631	2,997,782
Spain	8,985,143	4,687,757
Netherlands	3,634,415	363,747
Ireland	2,650,206	5,189,260
Italy	3,554,801	4,475,097
Canada	5,236,891	0
Korea	505,665	0
Lithuania	5,371,376	6,858,306
Luxembourg	502,052	0
Latvia	776,523	1,128,267
Mexico	0	1,941,174
Norway	2,929,446	1,650,249
Poland	1,050,501	2,654,521
France	24,274,848	19,569,770
Sweden	358,430	840,402
Germany	24,361,059	12,594,620
Slovenia	650,852	1,390,984
Finland	1,054,930	0
Great Britain	5,942,075	6,094,312
Switzerland	2,290,775	0
Denmark	1,073,537	1,104,318
Czech Republic	1,930,364	2,227,985
Hungary	919,296	0
New Zealand	3,716,257	4,069,822
European Investment Bank	751,864	727,640
Total debt and other fixed-income securities	***107,325,542***	***85,682,647***
Equities and fund units		
Estonia	0	0
Ireland	8,229,274	13,706,493
Lithuania	43,443	43,443
Luxembourg	4,453,896	5,749,865
Germany	0	572,194
Total equities and fund units	***12,726,613***	***20,071,995***
Loans		
Lithuania	4,634	6,288
Latvia	0	600,000
Belarus	1,380,000	1,500,000
Total loans	***1,384,634***	***2,106,288***
Total investments in financial instruments	**121,436,789**	**107,860,930**

(c) Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

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The company's liabilities in different currencies are covered with assets denominated in the same currencies. Currency risk is countered by monitoring that no uncovered currency exposure would exceed 5% of assets. The following assets and liabilities are exposed to currency risk.

In euros	**As at 31 December 2016 USD**	**As at 31 December 2015 USD**
Insurance and other receivables	29,483	17,304
Reinsurance assets	40159	0
Investments in financial instruments – available-for-sale debt securities	4,436,556	3,276,025
Other liabilities from direct insurance business	1,918	5,076
Other liabilities and accrued expenses	0	1,633
Reinsurance payables	8,011	26,488
Total	**4,516,127**	**3,326,526**

Liquidity risk

The company has to be able to discharge its payment obligations at any time. This is ensured by liquidity planning that is embedded in the asset and liability management (ALM) model.

To be able meet its settlement commitments at any time, the company needs to know its liabilities and has to acquire a suitable investment portfolio. This is achieved by close cooperation between actuaries, the investment manager and the ALM Team.

The debt securities portfolio is composed by taking into account the average duration of liabilities and modifying the duration of assets and liabilities with duration matching. In addition, a large share of the company's assets is invested in highly liquid securities, which should ensure the availability of sufficient cash even under stressed circumstances. At the year-end, the company's liquid funds totalled 129 million euros (2015: 116.9 million euros) including available-for-sale debt securities of 107.3 million euros (2015: 85.7 million euros), equities and fund units of 12.7 million euros (2015: 20.1 million euros), loans of 1.4 million euros (2015: 2.1 million euros) and cash and cash equivalents of 7.6 million euros (2015: 9.0 million euros).

At the year-end, the weighted average duration to maturity of the available-for-sale debt securities portfolio and units in debt securities funds was 2.1 years (2015: 2.2 years). There were no non-cash movements in the portfolio.

All of the company's receivables and liabilities except for liabilities arising from insurance contracts are current, i.e. with a maturity of up to one year.

Financial assets and liabilities exposed to liquidity risk by maturity

As at 31 December 2016	Note	Without term	Less than 1 year	1-2 years	2-5 years	5-10 years	Over 10 years	Total
Net future payment obligations resulting from provisions for claims outstanding	21	0	20,781,229	12,688,885	6,226,454	4,710,156	9,418,653	**53,825,377**
Of which net insurance pension payments	21	0	602,527	706,695	1,105,034	1,499,081	2,104,438	**6,017,775**
Financial assets (investments in financial instruments and cash and cash equivalents)	14, 15	20,346,101	3,544,037	34,836,023	67,428,943	2,901,173	0	**129,056,277**
Other financial assets	16	0	17,881,516	0	0	0	0	**17,881,516**
Other financial liabilities	24	0	6,107,148	0	0	6,000,000	0	**12,107,148**
Net exposure (assets less liabilities)		20,346,101	-5,462,824	22,147,138	61,202,489	-7,808,983	-9,418,653	**81,005,268**

As at 31 December 2015	Note	Without term	Less than 1 year	1-2 years	2-5 years	5-10 years	Over 10 years	Total
Net future payment obligations resulting from provisions for claims outstanding	21	0	24,660,156	6,033,561	6,403,178	4,638,493	9,020,463	**50,755,851**
Of which net insurance pension payments	21	0	214,047	240,239	699,017	1,098,196	3,209,634	**5,461,133**
Financial assets (investments in financial instruments and cash and cash equivalents)	14, 15	29,059,228	8,613,999	23,277,198	52,682,651	3,215,087	0	**116,848,163**
Other financial assets	16	0	15,631,107	0	0	0	0	**15,631,107**
Other financial liabilities	24	0	5,709,330	0	0	0	0	**5,709,330**
Net exposure (assets less liabilities)		29,059,228	-6,124,380	17,243,637	46,279,473	-1,423,406	-9,020,463	**76,014,089**

2.3. Capital management

Management's policy is to maintain a strong capital base so as to protect the interests of investors, creditors and policyholders and to sustain future development of the business. Management monitors return on equity (the ratio of profit to the period's average equity) on an ongoing basis. The return for 2016 was 1.4% (2015: 3.4%).

Thorough capital planning, regular monitoring and a system of risk limits and warnings enable the company to identify a decrease in the capital buffer and potential shortfalls sufficiently early. The capital management plan includes the financial and solvency forecasts made during the planning process, which in turn are part of the company's own risk and solvency assessment report. The capital management plan takes into account the changes planned in the company's own funds. Assessment of the overall solvency needs represents the company's own view of its risk profile and the capital and other funds needed to address these risks.

The Insurance Activities Act which took effect on 1 January 2016 introduced significant changes to insurers' capital requirements accounting. In the Insurance Activities Act, which was in force at 31 December 2016, insurers' capital requirements were set out in division 4 of chapter 3 and the minimum capital requirement was described in subdivision 4 of division 4, chapter 3. The new version of the act did not change the minimum share capital requirement. At 31 December 2016, the company's consolidated own funds exceeded the solvency capital requirement 1.29 times.

The company calculates its solvency capital requirement using the standard formula (Insurance Activities Act, chapter 3, division 4, subdivision 2).

2.4. Strategic risks

Strategic risk is the risk of loss from wrong business decisions, poor implementation of decisions or failure to adapt to changes in the operating environment. The company's current and future operations involve strategic risks, which generally evolve over an extended period and occur in combination with other risks. Strategic risk factors are divided into two major categories: external (insurance market, competitors, customers and services) and internal (business strategy, achievement of strategic objectives). Adopting strategic decisions, particularly planning business activities, is closely related to risk management. As part of strategic risk management, the company identifies significant risks, which are assessed and reviewed by the management board. Where necessary, the management board determines appropriate risk mitigation measures and the person responsible for implementing the measures.

2.5. Operational risks

Operational risks are an inevitable part of the company's business operations. They have to be mitigated or, where possible, avoided if it is economically reasonable. Operational risks result from inadequate processes, failures in communication or information technology, and external factors such as natural disasters and legal risks.

In operational risk management, ERGO focuses on the following elements:

- resources, particularly information technology and infrastructure;
- personnel and processes;
- projects.

Operational risk management is underpinned by qualitative and quantitative assessment. Risks related to business processes are managed through relevant processes and adequate control of IT applications which have been implemented. Compliance with legal and regulatory requirements is also ensured through external control.

Through the internal control system, the company has identified, analysed and assessed both external risks and the risks inherent in its key processes, including IT risks. There are measures in place for improving risk control and mitigating risks. The company's internal control and risk management systems deal with both risks arising from everyday operations as well as compliance and financial reporting risks.

The model adopted allows identifying risks that are common to different departments and processes. Operational risks are identified, analysed and assessed on a regular basis.

To mitigate personnel risk, the company has established guidelines for avoiding conflicts of interest. Corporate misconduct is counteracted by a system of powers and authorities, segregation of duties, internal regulations and sample testing of business transactions.

Due to extensive reliance on the IT systems, the company is threatened by many IT risks such as system malfunctions and failures, loss of data and external system attacks. IT risks are mitigated by preventive measures, emergency planning, backup solutions and access controls.

To mitigate the risks resulting from business interruption, the company has adopted business continuity plans which include instructions on how to act as well as alternative and recovery procedures for emergency and crisis situations.

Although operational risks are mainly managed through the above processes, some risks (either individually or in combination with others) may have such an extensive impact on a specific process and the company as a whole that the company's ability to carry on its regular business activities is put at risk (business interruption). Therefore, significant risk events are evaluated separately to increase awareness of such incidents and highlight their potential impact,

2.6. Reputational risk

Reputational risk is the risk of loss resulting from damage to the company's public image or reputation in the eyes of its customers, shareholders, employees, partners or supervision authorities. Reputational risk may arise as a result of some other risk (e.g. operational risk, strategic risk, or concentration risk) or together with other risks. Thus, reputational risks are controlled indirectly, through the control of other risks.

Reputational risks are identified by three methods:

- preparation of extraordinary reports;
- regular quarterly communication between the risk management team and the compliance control, internal audit, and communication teams;
- internal control where the evaluation of any operational risk is always accompanied by the assessment of potential damage to reputation.

Sometimes reputational risks are difficult to identify and their financial impacts may be hard to assess. The company's strategy is to avoid reputational risk. Risk exposure is limited by assessing, analysing and reporting reputational risks on a regular basis. The compliance control team and the internal audit team assess reputational risks and report any identified reputational risks to the risk management team and other relevant parties.

Note 3. Premium income

The following table outlines gross and net premiums for 2016 and 2015 by insurance class.

In euros	2016			2015		
	Gross premiums written	Reinsurers' share	Net earned premiums[1]	Gross premiums written	Reinsurers' share	Net earned premiums[1]
Motor liability insurance	48,319,189	1,359,626	44,348,338	41,738,105	596,397	38,740,281
Accident insurance	5,811,753	19,088	5,489,561	5,092,314	24,722	4,905,215
Travel insurance	3,472,613	268,399	2,891,378	2,537,444	47,369	2,484,174
Technical risks insurance	4,239,995	102,681	3,998,818	4,103,932	304,000	3,749,210
Individuals' property insurance	10,609,064	341,482	9,970,519	9,853,677	177,597	9,439,662
Legal persons' property insurance	9,196,273	2,684,259	6,425,511	8,986,719	2,265,808	6,495,954
Agricultural risks insurance	1,311,800	279,967	923,863	1,040,612	279,596	922,203
Motor own damage insurance	38,480,855	27,212	36,334,264	33,331,336	47,756	31,358,928
Liability insurance	5,449,863	923,495	4,132,901	4,982,994	1,363,053	3,229,922
Goods in transit insurance	1,441,258	154,539	1,320,325	1,381,337	130,301	1,260,936
Carrier's liability insurance	2,847,232	0	2,711,297	2,675,979	22	2,641,478
Watercraft insurance and watercraft owner's liability insurance	515,316	36,391	468,209	473,030	30,013	427,943
Guarantee insurance	1,752,458	859,827	817,266	1,822,105	1,071,568	687,425
Railway rolling stock insurance	1,359,892	320,165	970,502	1,383,183	285,800	1,071,068
Assistance insurance	1,537,650	0	1,448,481	1,244,025	196	1,179,553
Financial risks insurance	471,560	85,156	295,434	385,927	121,571	289,002
Loss of employment insurance	17,886	0	17,364	6,447	0	5,983
Total from insurance activities	**136,834,657**	**7,462,287**	**122,564,032**	**121,039,166**	**6,745,769**	**108,888,937**
Accident insurance	3,412	0	5,582	4,787	0	4,766
Technical risks insurance	0	0	252	0	0	0
Legal persons' property insurance	-61040	0	-61040	0	0	0
Financial risks insurance	0	0	0	0	0	0
Total from reinsurance activities	**-57,628**	**0**	**-55,206**	**4,787**	**0**	**4,766**
Total	**136,777,029**	**7,462,287**	**122,508,826**	**121,043,953**	**6,745,769**	**108,893,703**

[1] Net earned premiums = gross premiums written – reinsurers' share – net change in the provision for unearned premiums and change in unexpired risks provision.

Gross and net changes in the provision for unearned premiums are presented in note 21.

Breakdown of gross premiums written by currency

In euros	2016	2015
EUR	136,591,628	120,821,165
USD	185,401	222,788
Total	**136,777,029**	**121,043,953**

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Breakdown of gross premiums written by country

In euros	**2016**	**2015**
Estonia	49,992,835	45,925,204
Latvia	25,552,523	22,844,279
Lithuania	61,289,299	52,269,683
Total from insurance activities	**136,834,657**	**121,039,166**
Estonia	0	2,177
Latvia	0	2,610
Lithuania	3,412	0
Romania	-61,040	0
Total from reinsurance activities	**-57,628**	**4,787**
Total	**136,777,029**	**121,043,953**

Note 4. Commission income

In euros	**2016**	**2015**
Reinsurance commissions	702,595	856,316
Participation in reinsurers' profit	306,307	117,367
Reinsurers' share of deferred acquisition costs	94,547	-62,229
Total	**1,103,449**	**911,454**

Note 5. Investment income

In euros	2016	2015
Interest income on		
Loans	157,488	170,196
Term deposits	664	416
Available-for-sale debt securities	970,321	766,291
Total interest income	**1,128,473**	**936,903**
Dividend income	310,380	637,386
Net realised gains on		
Equities and fund units	1,134,648	458,742
Available-for-sale debt securities	-245,812	386,210
Investments in associates	1,673,693	0
Total net realised gains	**2,562,529**	**844,952**
Impairment loss	**0**	**-301,972**
Total	**4,001,382**	**2,117,269**

Note 6. Other income

In euros	2016	2015
Gain on disposal of property and equipment	41,219	31,125
Fees, commissions and charges received	641,781	657,441
Insurance brokerage income	366,121	320,130
Foreign exchange gain	200,151	461,614
Rental income	134,294	371,626
Miscellaneous income	401,472	681,715
Total	**1,785,038**	**2,523,651**

Note 7. Claims and benefits

The following table shows claims paid and incurred in 2016 and 2015 by insurance class.

In euros	2016				2015			
	Claims paid[1]	Change in provision for claims outstanding	Reinsurers' share of claims	Net claims incurred	Claims paid[1]	Change in provision for claims outstanding	Reinsurers' share of claims	Net claims incurred
Motor liability insurance	31,430,051	4,260,911	-1,232,203	34,458,759	25,559,896	5,022,725	-771,001	29,811,620
Accident insurance	2,884,611	116,812	0	3,001,423	2,525,264	-58,336	0	2,466,930
Travel insurance	1,537,160	224,546	-233,956	1,527,750	1,239,332	-75,116	-771	1,163,445
Technical risks insurance	2,725,995	-194,562	6,192	2,537,625	1,850,169	786,888	-30,581	2,606,476
Individuals' property insurance	5,162,491	213,568	0	5,376,059	4,172,809	-731,523	0	3,441,284
Legal persons' property insurance	4,947,466	-275,767	-125,009	4,546,690	4,002,325	1,248,560	12,368	5,263,254
Agricultural risks insurance	411,073	3,466	0	414,539	254,535	45,705	0	300,239
Motor own damage insurance	26,276,018	-165,894	3,789	26,113,913	21,896,429	-582,954	5,348	21,318,825
Liability insurance	1,525,136	-265,993	495,349	1,754,491	1,207,253	396,761	-31,428	1,572,585
Goods in transit insurance	298,515	70,525	0	369,041	290,573	-4,288	769	287,055
Carrier's liability insurance	1,640,186	-226,044	-1,776	1,412,366	1,363,040	324,420	-1,450	1,686,010
Watercraft insurance and watercraft owner's liability insurance	412,377	-42,826	0	369,551	447,819	-190,849	0	256,971
Guarantee insurance	170,610	26,907	-70,873	126,644	109,785	-35,004	-30,744	44,035
Railway rolling stock insurance	349,232	-215,891	0	133,342	89,559	426,176	0	515,735
Assistance insurance	916,845	56,456	0	973,300	654,286	-87,651	0	566,636
Financial risks insurance	423,782	3,306	0	427,088	210,031	203,981	-16,920	397,090
Loss of employment insurance	2614	526	0	3,140	331	0	0	331
Total	**81,114,162**	**3,590,046**	**-1,158,487**	**83,545,721**	**65,873,436**	**6,689,495**	**-864,410**	**71,698,521**

[1] Claims paid include insurance indemnities and benefits paid, claims handling costs and income from salvage and subrogation recoveries.

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Claims handling costs

In euros	2016	2015
Salaries	3,084,565	2,710,551
Social security charges	935,198	828,225
Depreciation and amortisation	225,465	177,468
Services purchased	2,377,543	1,910,447
Other labour costs	57,414	48,755
Business travel expenses	35,736	23,812
Costs of company cars	71,242	70,441
Training and other staff costs	42,979	33,650
Rental and utilities charges	140,940	134,413
Office expenses	191,454	161,718
Communication expenses including mobile phone charges	96,856	58,800
IT costs	382,866	284,032
Miscellaneous costs	552,570	438,015
Total	**8,194,828**	**6,880,325**

The following table provides an overview of income from subrogation and salvage recoveries in 2016 and 2015.

In euros	2016	2015
Motor liability insurance	1,634,228	1,472,371
Accident insurance	5,704	8104
Travel insurance	22644	844
Technical risks insurance	13,235	91,044
Individuals' property insurance	415,400	482,023
Legal persons' property insurance	214,691	181,204
Motor own damage insurance	3,287,074	3,046,228
Liability insurance	78,547	22,667
Goods in transit insurance	223,291	176,016
Carrier's liability insurance	53,019	6,301
Watercraft insurance and watercraft owner's liability insurance	0	17,260
Guarantee insurance	7,554	62,110
Assistance insurance	5978	156
Railway rolling stock insurance	2,569	21,003
Total	**5,963,934**	**5,587,331**

Catastrophes and major losses in 2016

In 2016, there were no extraordinary loss events, nor were there any natural disasters. The amounts of all claims reported to the company were below 1.0 million euros. The amounts of claims incurred in connection with the collapse of a shopping centre in the Zolitude district of Riga, Latvia, in December 2013 were not significantly adjusted in 2016.

Note 8. Expenses

In euros	Note	2016	2015
Acquisition costs		**36,209,014**	**33,089,326**
Salaries		8,883,339	8,573,469
Social security charges		3,370,283	3,240,977
Depreciation and amortisation		1,490,732	1,371,943
Service fees and commissions		15,767,794	13,606,817
Change in deferred acquisition costs		-860,912	-905 976
Other labour costs		293 528	239 275
Business travel expenses		104,343	104,888
Costs of company cars		327,401	320,850
Training and other staff costs		137,246	167,970
Rental and utilities charges		1,866,795	1,956,545
Office expenses		784,217	715,897
Communication expenses including mobile phone charges		347,801	356,989
IT costs		1,420,871	1,222,179
Marketing expenses		1,416,104	1,283,733
Miscellaneous expenses		859,472	833,771
Administrative expenses		**6 043 773**	**5,471,141**
Salaries		2,945,814	2,844,156
Social security charges		848,655	752,773
Depreciation and amortisation		360,148	329,945
Other labour costs		96,558	14,840
Business travel expenses		108,147	112,307
Costs of company cars		53,000	65,693
Training and other staff costs		72,501	75,847
Rental and utilities charges		849,069	833,193
Office expenses		129,402	125,536
Communication expenses including mobile phone charges		47,165	46,371
IT costs		422,639	461,763
Miscellaneous expenses		110,675	−191,282
Other operating expenses		**1,623,933**	**1,343,333**
Membership fee to Estonian Traffic Insurance Fund		1,623,933	1,343,333
Investment expenses		**364,804**	**300,583**
Salaries		129,181	94,717
Social security charges		30,207	19,360
Services purchased		118,382	71,819
Other labour costs		6,223	3,503
Business travel expenses		20,579	18,855
Training and other staff costs		1,517	1382
Rental and utilities charges		13,277	14,873
Office expenses		1,207	511
Communication expenses including mobile phone charges		3,604	3,095
Other services		31,464	22,902
Miscellaneous expenses		9,163	49,566

In euros	Note	2016	2015
Other expenses		**1,265,135**	**1,137,951**
Membership fees to Financial Supervision Authority and professional associations		283,408	320,178
Insurance brokerage expenses		100,389	72,679
Audit and legal fees		123,656	86,720
Loss on sale of property and equipment		119	17,706
Write-off of property and equipment	10	237,660	0
Interest paid		5,055	0
Expenses related to leasing out premises		30,061	32,775
State fees, stamp duties and late payment interest		32,116	48,469
Foreign exchange loss		194,890	234,207
Miscellaneous expenses		257,781	325,217

Note 9. Foreign exchange differences

In the reporting period, the net amount of foreign exchange differences recognised in profit or loss, excluding those arising on financial instruments at fair value through profit or loss, was 5,260 euros (2015: 292,177 euros).

Note 10. Property and equipment

Property and equipment comprises tangible assets employed in the company's activity whose useful life exceeds one year and land and buildings that are in the company's own use. Items of property and equipment are depreciated using the straight-line method.

At 31 December 2016, the cost of fully depreciated items still in use was 3,148,549 euros (31 December 2015: 4,399,468 euros). ERGO Insurance SE has only such items of property and equipment that are in the company's own use.

In euros

Asset class	Land	Buildings	Improvements to leased premises	Equipment and other items	Total
Cost					
As at 31 December 2014	**1,247,262**	**9,932,053**	**638,913**	**5,225,821**	**17,044,049**
Value adjustment	0	159,826	0	-7	159,819
Additions	0	0	4,964	673,795	678,759
Sales	0	-17,647	0	-88,055	-105,702
Write-off	0	0	-81,741	-557,904	-639,645
As at 31 December 2015	**1,247,262**	**10,074,232**	**562,136**	**5,253,650**	**17,137,280**
Additions	0	0	208,655	501,117	709,772
Sales	-4,344	-60,820	0	-266,771	-331,935
Write-off	0	0	0	-225,425	-225,425
As at 31 December 2016	**1,242,918**	**10,013,412**	**770,791**	**5,262,571**	**17,289,692**
Accumulated depreciation					
As at 31 December 2014	**0**	**2,560,823**	**459,757**	**4,142,731**	**7,163,311**
Value adjustment	0	12,052	0	-7	12,045
Depreciation for the year	0	235,905	38,454	415,203	689,562
Sales	0	-4,581	0	-74,669	-79,250
Write-off	0	0	-64,237	-557,482	-621,719
As at 31 December 2015	**0**	**2,804,199**	**433,974**	**3,925,776**	**7,163,949**
Depreciation for the year	0	467,784	39,444	461,491	968,719
Sales	0	-16,080	0	-259,991	-276,071
Write-off	0	0	0	-224,244	-224,244
As at 31 December 2016	**0**	**3,255,903**	**473,418**	**3,903,032**	**7,632,353**
Carrying amount					
As at 31 December 2015	**1,247,262**	**7,270,033**	**128,162**	**1,327,874**	**9,973,331**
As at 31 December 2016	**1,242,918**	**6,757,509**	**297,373**	**1,359,539**	**9,657,339**

Note 11. Deferred acquisition costs

In euros	**2016**	**2015**
Balance as at 1 January	**4,645,056**	**3,739,080**
Amortised portion	-4,470,439	-3,728,060
Addition from new contracts	6,021,811	5,331,402
Reduction after liability adequacy test	-690,456	-697,366
Balance as at 31 December	**5,505,972**	**4,645,056**

Note 12. Other intangible assets

In euros	Software and licences
Cost	
As at 31 December 2014	**13,191,569**
Addition through purchase of software and licences	781,998
Addition through internally generated IT projects	520,285
Write-off of software and licences	-85717
As at 31 December 2015	**14,408,135**
Addition through purchase of software and licences	1,717,474
Addition through internally generated IT projects	371,967
Write-off of software and licences	-93412
As at 31 December 2016	**16,404,164**
Accumulated amortisation	
As at 31 December 2014	**6,793,645**
Amortisation for the year	1,220,854
Write-off	-85716
As at 31 December 2015	**7,928,783**
Amortisation for the year	1,397,957
Write-off	-93412
As at 31 December 2015	**9,233,328**
Carrying amount	
As at 31 December 2015	**6,479,352**
As at 31 December 2016	**7,170,836**

Internally generated IT project ALICE

	Carrying amount
As at 31 December 2016	5,068,722
As at 31 December 2015	4,837,053

The estimated useful life of insurance software ALICE is 10 years.

ALICE is insurance software that is developed by ERGO group. The costs that are capitalised comprise consulting and development services purchased from external partners and direct labour costs.

In the income statement, amortisation expense is allocated to acquisition costs, administrative expenses and claims handling costs depending on the purpose of use of the asset. Intangible assets comprise various items of software and their licences. In the reporting period, the company did not make any significant investments in insurance software ALICE. ALICE has been implemented at the Estonian entity in motor liability, motor own damage, individuals' property, legal persons' property, liability, accident, and travel insurance. In other classes, the software will be implemented in 2017.

No intangible assets were sold in the reporting period. At 31 December 2016, the cost of fully amortised assets still in use was 4,511,231 euros (31 December 2015: 3,064,939 euros).

Note 13. Investments in associates

On the acquisition of interests in ERGO Latvija Invest SIA and CJSC ERGO Ins. Co, ERGO Insurance SE acquired significant influence but not control over the entities. Accordingly, the investments are accounted for as investments in associates.

In euros	2016	2015	2016	2015
	ERGO Latvija Invest SIA		CJSC ERGO Ins. Co.	
Ownership interest, %	0	38	35	35
Number of shares held	0	1,254	6,591	6,591
Nominal value of a share	0 euros	1,4 euros	237 rubles	1,145,370 rubles
Nominal value of investment	0 euros	1,784 euros	1,562,067 rubles	7,549,133,670 rubles
Share capital	0 euros	4,696 euros	4,463,421 rubles	21,570,753,210 rubles
Total number of shares	0	3,300	18,833	18,833
Cost of investment	0	488,106	1,493,774	1,073,809
Company's share of investee's equity	0	2,248,614	1,296,629	895,274
Carrying amount	0	2,076,307	1,855,475	1,419,818
Company's share of investee's profit	0	46,211	15,691	149,334
Assets	0	7,578,737	11,389,480	9,166,642
Liabilities	0	1,661,332	7,684,518	6,608,504
Equity	0	5,917,404	3,704,961	2,558,139
Income	0	914,394	10,716,517	7,772,281
Expenses	0	−775,992	-10,632,246	−7,211,984
Profit	0	121,607	44,834	426,704

On 22 June 2016, the management board approved the decision to dispose of the investment in ERGO Latvija Invest SIA. The transaction was completed on 29 June 2016.

Note 14. Investments in financial instruments

In euros **As at 31 December**	Note	2016	2015
Available-for-sale financial assets			
Equities and fund units	14.1	12,726,613	20,071,995
Debt and other fixed-income securities	14.2	107,325,542	85,682,647
Total available-for-sale financial assets		**120,052,155**	**105,754,642**
Loans and receivables			
Loans	14.3	1,384,634	2,106,288
Total loans and receivables		**1,384,634**	**2,106,288**
Total		**121,436,789**	**107,860,930**

IFRS 13 establishes the following three-level fair value hierarchy:

- Level I: financial instruments whose fair value is measured using quoted prices in active markets;
- Level II: financial instruments whose all significant fair value measurement inputs are observable;

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- Level III: financial instruments whose fair value is measured using unobservable inputs.

According to the hierarchy, at 31 December 2016 the company's available-for-sale debt securities and listed equities and fund units of 120 million euros (2015: 105.7 million euros) fell into Level 1. The fair value of unlisted securities (carrying amount at 31 December 2016 43,443 euros and at 31 December 2015 43,443 euros) cannot be measured reliably. Therefore, their level has not been determined. More detailed information on the breakdown of assets between the different levels of the fair value hierarchy is provided in note 25 *Fair value of financial instruments*

The fair value of Level 1 financial assets is measured by reference to quoted prices in active markets. The fair value of instruments traded in active markets is based on their listed market price at the end of the reporting period. A market is considered active when listed prices are easily and regularly available from a stock exchange, a dealer, a broker, an industry group, a pricing service or a regulatory authority and the prices represent actual and regularly occurring arm's length transactions. The listed market price of the company's financial assets is their current bid price.

The fair value of financial instruments not traded in an active market is determined using valuation techniques. Valuation techniques are applied using as much as possible observable market data, if available, and relying as little as possible on the company's own estimates. An instrument is classified to the Level 2 category when all important inputs that are required for determining fair value are observable.

14.1. Equities and fund units

In euros	**As at 31 December 2016**		**As at 31 December 2015**	
	Cost	Fair value	Cost	Fair value
Units in listed equity funds	3,802,222	3,828,737	6,018,593	7,642,171
Units in listed debt funds	8,656,480	8,854,433	12,678,963	12,386,381
Unlisted equities	43,443	43,443	43,443	43,443
Total	**12,502,145**	**12,726,613**	**18,740,999**	**20,071,995**

Equities not listed on a public stock exchange comprise other equities of 43,443 euros (2015: 43,443 euros).

Equities and fund units have been classified as available-for-sale financial assets. Unrealised gains and losses on equities and fund units are recognised in other comprehensive income or expense. Sales, interest and dividend income is recognised in profit or loss.

Cash movements related to equities and fund units are presented in the statement of cash flows. In the reporting period, there were no non-cash movements related to investments.

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14.2. Available-for-sale debt and other fixed income securities

Debt and other fixed income securities have been classified as available-for-sale financial assets. Changes in the fair value of available-for-sale financial assets are recognised in other comprehensive income or expense. Interest income is recognised using the effective interest rate method.

In euros	As at 31 December 2016		As at 31 December 2015	
	Cost	Fair value	Cost	Fair value
Fixed-income debt securities				
Government bonds	35,915,524	36,951,495	37,571,663	38,320,953
Financial institutions' bonds	65,410,492	65,451,669	42,184,672	42,250,319
Total fixed-income debt securities	**101,326,016**	**102,403,164**	**79,756,335**	**80,571,272**
Floating rate debt securities				
Financial institutions' bonds	4,529,391	4,922,378	4,529,442	5111375
Total floating rate debt securities	**4,529,391**	**4,922,378**	**4,529,442**	**5,111,375**
Total	**105,855,407**	**107,325,542**	**84,285,777**	**85,682,647**

Available-for-sale debt securities comprise government bonds and debt securities issued by financial institutions.

The fair value of debt securities is determined by reference to the Bloomberg Generic (BGN) Prices available on the information systems of Bloomberg. Where BGN prices are not available, fair value is determined by reference to quoted market prices. If there is a broker on the market whose price quotation includes the quantity purchased, that quotation is relied on. If a quotation including the quantity purchased is not available, one without quantity is used. If a debt security does not have a listed price, valuation models are applied. If the models cannot be used or it would be impracticable, the security is measured at cost. At 31 December 2016, the portfolio did not include any debt securities measured at cost or using valuation models.

Cash movements related to available-for-sale debt securities are presented in the statement of cash flows. In the reporting period, there were no non-cash movements related to available-for-sale debt securities.

14.3. Loans

Other loans by maturity

In euros **As at 31 December**	**2016**	**2015**
One to six months	4,634	6,288
Total	**4,634**	**6,288**

Mortgage loans by maturity

In euros **As at 31 December**	**2016**	**2015**
Six months to one year	0	600,000
Over five years	1,380,000	1,500,000
Total	**1,380,000**	**2,100,000**

At 31 December 2016, ERGO Insurance SE's statement of financial position included a mortgage loan of 1,380,000 euros (31 December 2015: 1,500,000 euros) provided to CJSC ERGO Ins. Co. The interest rate of the loan is 9.67% per year.

Note 15. Reinsurance assets

At the reporting date, reinsurers' share of insurance provisions was as follows:

In euros **As at 31 December**	**2016**	**2015**
Provision for unearned premiums	1,107,953	1,559,989
Provision for claims outstanding – claims incurred and reported	*12,524,321*	*12,007,463*
Provision for claims outstanding – IBNR	*39,898*	*26,990*
Provision for insurance pension annuities	*1,698,023*	*1,707,272*
Total provision for claims outstanding	14,262,242	13,741,725
Total	**15,370,195**	**15,301,714**

Information on reinsurance assets is provided also in note 21.

Other reinsurance receivables are reported within insurance receivables (see note 16).

Reinsurance result

In euros	Note	2016	2015
Premiums paid to reinsurers	3	-7,462,287	-6,745,769
Reinsurers' share of change in provision for unearned premiums		-452,035	225,568
Commissions and profit participation paid by reinsurers	4	1,008,902	973,683
Reinsurers' share of claims paid	7	637,971	423,256
Reinsurers' share of change in provision for claims outstanding	7	520,516	441,154
Reinsurers' share of deferred acquisition costs	4	94,547	-62,229
Total		**-5,652,386**	**-4,744,337**

Note 16. Insurance and other receivables

In euros **As at 31 December**	2016	2015
Receivables from policyholders	13,636,746	11,347,356
Receivables from brokers and other intermediaries	1,300,082	1,403,701
Receivables from reinsurers	887,057	654,221
Subrogation and salvage receivables	13,553	0
Total insurance receivables	***15,837,438***	***13,405,278***
Other receivables	2,039,046	2,220,477
Accrued income – interest receivable	5,032	5,352
Total other financial assets	***17,881,516***	***15,631,107***
Prepaid taxes	47,960	36,569
Prepaid expenses	1,051,419	1,014,999
Total non-financial assets	***1,099,379***	***1,051,568***
Total	**18,980,895**	**16,682,675**

Note 17. Cash and cash equivalents

The balance of cash and cash equivalents consists of demand deposits with banks.

In euros **As at 31 December**	2016	2015
Demand deposits	7,619,488	8,987,233
Total	**7,619,488**	**8,987,233**

Cash and cash equivalents by original currency

As at 31 December	2016	2015
EUR	7,514,538	8,794,561
USD	110,628	192,672

Note 18. Shareholders and share capital

	Ordinary shares without par value		Total share capital
	Number of shares	Value in euros	In euros
As at 31 December 2016	384,629	6,391,391	6,391,391
As at 31 December 2015	384,629	6,391,391	6,391,391

Ordinary shares carry all the rights provided for under the Estonian Commercial Code – the right to participate in the general meeting, distribution of profits and distribution of residual assets upon the dissolution of the company; the right to receive information from the management board about the activities of the company; a pre-emptive right to subscribe for new shares in proportion to the proportionate value of the shares already held when share capital is increased, etc. The company's articles of association provide that upon the transfer of shares, other shareholders have a pre-emptive right before third parties. According to the articles of association, shares may be pledged only subject to the consent of the management board.

Adoption of shares without par value allowed the company to convert share capital into euros without changing the size of share capital. Upon conversion of share capital into euros, share capital would have had to be increased or reduced in order to arrive at a whole number. By adopting shares without par value, the company did not have to do this. Adoption of shares without par value also simplifies accounting for capital and allocation of profits. The third advantage of shares without par value is that it is easier to make changes to share capital – articles of association determine only the size of share capital and the number of shares.

The sole shareholder of ERGO Insurance SE is ERGO International AG (registry number HRB 40871, address Victoriaplatz 2, 40198 Dusseldorf, Germany). The shareholder of ERGO International AG is ERGO Group AG. The consolidated financial statements of ERGO Group AG, prepared in accordance with International Financial Reporting Standards, are available at www.ergo.de. The parent of ERGO Versicherungsgruppe AG group is Münchener Rückversicherungs-Gesellschaft AG whose shares are listed on German stock exchanges.

The entire share capital has been paid in.

Dividends

Based on the decision of the sole shareholder, in 2016 no dividend was declared (2015: 1,700,000 euros).

Note 19. Capital reserve

The capital reserve is created with annual net profit transfers made based on the resolution of the general meeting. Under the articles of association that have been in effect since 7 December 2007, the capital reserve has to amount to one tenth of share capital and pursuant to section 336(2) of the Estonian Commercial Code every year at least one twentieth of net profit for the year has to be transferred to the capital reserve. When the level outlined in the articles of association has been achieved, transfers may be discontinued. At 31 December 2016, the capital reserve of ERGO Insurance SE exceeded the level required by the articles of association.

Under section 337 of the Estonian Commercial Code, subject to a resolution of the general meeting, the capital reserve may be used to cover losses if the latter cannot be covered with unrestricted equity, or to increase share capital. The capital reserve may not be distributed to shareholders.

At 31 December 2016, the capital reserve amounted to 3,072,304 euros (31 December 2015: 3,072,304 euros).

Note 20. Fair value reserve

The fair value reserve comprises the net change in the fair value of available-for-sale financial assets. When a financial asset is derecognised, the cumulative gain or loss previously recognised in equity is recognised in profit or loss.

In euros	**2016**	**2015**
At 1 January	**2,929,554**	**3,321,210**
Derecognised from equity and recognised in profit or loss in connection with sale and impairment	-1,540,237	-1,119,716
Derecognised from equity and recognised in profit or loss in connection with arrival of maturity date	401	-7,270
Net change in fair value recognised in other comprehensive income or expense during the year	363,722	735,330
At 31 December	**1,753,440**	**2,929,554**

Note 21. Insurance contract provisions and reinsurance assets

In euros **As at 31 December**	Note	**2016**	**2015**
Gross provisions			
Provision for unearned premiums		53,967,682	47,613,800
Provision for claims outstanding – claims incurred and reported		*49,000,589*	*47,652,540*
Provision for claims outstanding – IBNR		*8,124,878*	*6,803,356*
Provision for claims outstanding – indirect claims handling costs		*3,246,358*	*2,873,276*
Provision for insurance pension annuities		*7,715,797*	*7,168,404*
Total provision for claims outstanding		68,087,622	64,497,576
Total gross provisions		**122,055,304**	**112,111,376**
Reinsurers' share of provisions			
Provision for unearned premiums		1,107,953	1,559,989
Provision for claims outstanding – claims incurred and reported		*12,524,321*	*12,007,463*
Provision for claims outstanding – IBNR		*39,898*	*26,990*
Provision for insurance pension annuities		*1,698,023*	*1,707,272*
Total provision for claims outstanding		14,262,242	13,741,725
Total reinsurers' share of provisions	15	**15,370,195**	**15 301 714**
Net provisions			
Provision for unearned premiums		52,859,729	46,053,811
Provision for claims outstanding – claims incurred and reported		*36,476,268*	*35,645,077*
Provision for claims outstanding – IBNR		*8,084,980*	*6,776,366*
Provision for claims outstanding – indirect claims handling costs		*3,246,358*	*2,873,276*
Provision for insurance pension annuities		*6,017,774*	*5,461,132*
Total provision for claims outstanding		53,825,380	50,755,851
Total net provisions		**106,685,109**	**96,809,662**

Movements in provisions for unearned premiums

In euros	**2016**			**2015**		
	Gross provision for unearned premiums	**Reinsurers' share**	**Net provision for unearned premiums**	**Gross provision for unearned premiums**	**Reinsurers' share**	**Net provision for unearned premiums**
At 1 January	47,613,800	1,559,989	46,053,811	41,938,986	1,334,423	40,604,563
Premiums written	136,777,029	7,462,287	129,314,742	121,043,953	6,745,769	114,298,184
Premiums earned	-130,423,147	-7,914,323	-122,508,824	-115,369,139	-6,520,203	-108,848,936
At 31 December	**53,967,682**	**1,107,953**	**52,859,729**	**47,613,800**	**1,559,989**	**46,053,811**

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Movements in provisions for claims outstanding

In euros	2016			2015		
	Gross provision for claims outstanding	**Reinsurers' share**	**Net provision for claims outstanding**	**Gross provision for claims outstanding**	**Reinsurers' share**	**Net provision for claims outstanding**
At 1 January	64,497,576	13,741,725	50,755,851	57,808,092	13,300,569	44,507,523
Claims incurred in the reporting period	91,229,104	547,478	90,681,626	76,108,750	223,079	75,885,671
Change in claims incurred in prior periods	-6,524,896	611,010	-7,135,906	-3,545,830	1,082,487	-4,628,317
Claims paid	-81,114,162	-637,971	-80,476,191	-65,873,436	-864,410	-65,009,026
At 31 December	**68,087,622**	**14,262,242**	**53,825,380**	**64,497,576**	**13,741,725**	**50,755,851**

Provisions for unearned premiums by insurance class

In euros

Insurance class	**Gross provision for unearned premiums 31 Dec 2016**	**Gross provision for unearned premiums 31 Dec 2015**	**Net provision for unearned premiums 31 Dec 2016**	**Net provision for unearned premiums 31 Dec 2015**
Motor liability insurance	17,823,848	15,212,625	17,823,848	15,212,624
Accident insurance	2,345,063	2,045,260	2,343,922	2,042,988
Travel insurance	856,364	527,592	835,064	522,227
Technical risks insurance	1,753,138	1,677,844	1,753,138	1,614,892
Individuals' property insurance	4,627,761	4,330,781	4,627,761	4,330,699
Legal persons' property insurance	3,674,472	3,659,587	3,444,913	3,301,603
Other property insurance	567,252	459,281	567,253	459,282
Motor own damage insurance	15,733,760	13,614,382	15,733,760	13,614,381
Liability insurance	2,344,024	2,132,685	2,021,284	1,627,818
Goods in transit insurance	375,261	408,859	374,630	408,236
Carrier's liability insurance	1,026,328	890,393	1,026,327	890,392
Watercraft insurance and watercraft owner's liability insurance	142,195	131,477	142,195	131,477
Guarantee insurance	955,430	965,952	499,287	423,923
Railway rolling stock insurance	1,081,978	1,011,456	1,018,680	949,456
Assistance insurance	481,409	392,260	481,408	392,238
Financial risks insurance	178,412	152,902	165,272	131,111
Loss of employment insurance	987	464	987	464
Total	**53,967,682**	**47,613,800**	**52,859,729**	**46,053,811**

Provisions for claims outstanding by insurance class

In euros

Insurance class	Gross provision for claims outstanding 31 Dec 2016	Gross provision for claims outstanding 31 Dec 2015	Net provision for claims outstanding 31 Dec 2016	Net provision for claims outstanding 31 Dec 2015
Motor liability insurance	37,874,011	33,620,676	31,701,382	28,478,388
Accident insurance	1,064,241	947,430	1,064,241	947,430
Travel insurance	609,200	385,317	547,275	384,306
Technical risks insurance	6,376,986	6,571,546	1,744,674	1,933,043
Individuals' property insurance	1,792,629	1,579,062	1,792,629	1,579,062
Legal persons' property insurance	5,320,041	5,596,408	3,869,640	4,137,432
Other property insurance	112,245	108,780	112,245	108,779
Motor own damage insurance	4,984,870	5,150,566	4,984,868	5,150,566
Liability insurance	6,159,453	6,425,445	4,621,243	4,316,980
Goods in transit insurance	582,723	512,197	569,347	498,821
Carrier's liability insurance	1,899,804	2,125,849	1,884,112	2,109,124
Watercraft insurance and watercraft owner's liability insurance	83,968	126,796	83,968	126,796
Guarantee insurance	630,145	603,237	253,048	232,813
Railway rolling stock insurance	219,506	435,397	219,506	435,397
Assistance insurance	164,762	108,305	164,762	108,305
Financial risks insurance	212,512	208,609	211,914	208,609
Loss of employment insurance	526	0	526	0
Total	**68,087,622**	**64,505,620**	**53,825,380**	**50,755,851**

In motor liability insurance, the provision for claims outstanding also includes the provision for insurance pension annuities. At 31 December 2016, annuity claim files were open for 226 persons: 113 in Estonia, 80 in Latvia and 33 in Lithuania.

The following table shows pension annuity provisions by years of claim incurrence.

In euros	Year of incurrence						
	2016	**2015**	**2014**	**2013**	**2012**	**2011 and earlier**	**Total**
Gross provision for pension annuities	193,240	212,829	621,736	314,944	971,607	5,401,441	7,715,797
Net provision for pension annuities	193,240	212,829	621,736	314,944	971,607	3,703,418	6,017,774

Unexpired risks provision

In accordance with the company's accounting policies, the adequacy of insurance provisions has to be tested with a liability adequacy test. Where the test indicates a shortfall in provisions, the company has to first reduce deferred acquisition costs and then, if necessary, recognise an additional provision for unexpired risks. The liability adequacy test performed as at 31 December 2016 indicated that the provisions made for some classes of insurance were not adequate to cover ERGO Insurance SE's obligations in these classes. Based on the test results, deferred acquisition costs were reduced by 690,456 euros (2015: 697,366). No additional unexpired risks provision was recognised (see note 2.1). The company's action plan foresees increasing the proportion of property insurance classes in order to balance the portfolio structure and reduce reliance on a single insurance class. The company also reviews its expense structure on a regular basis and has set itself the target to consistently lower the expense ratio in the next few years.

Note 22. Reinsurance payables

In euros **As at 31 December**	**2016**	**2015**
Payables to reinsurers	1,905,894	2,644,736
Reinsurers' share of deferred acquisition costs	272,405	366,952
Total	**2,178,299**	**3,011,688**

Note 23. Insurance payables

In euros **As at 31 December**	**2016**	**2015**
Payables to policyholders	4,229,904	5,098,317
Payables to brokers and other intermediaries	2,848,375	2,349,888
Other payables	68,684	61,042
Total	**7,146,963**	**7,509,247**

Note 24. Other payables and accrued expenses

In euros **As at 31 December**	**2016**	**2015**
Dividends payable	171	171
Other payables	344,951	415,179
Payables to suppliers	1,133,968	1,760,548
Accrued vacation pay payable	656,640	591,425
Payables to employees	1,812,906	1,831,995
Other accrued items	2,158,512	1,110,012
Total other financial liabilities	***6,107,148***	***5,709,330***
Personal income tax payable	247,192	382,993
Corporate income tax payable	0	55149
Value added tax payable	134,999	32,446
Social security tax payable	566,864	518,707
Income tax payable on fringe benefits	1,628	2,104
Social security tax payable on fringe benefits	0	3,011
Payables to 2nd pillar pension funds	17,124	15,646
Total non-financial liabilities	***967,807***	***1,010,055***
Total	**7,074,955**	**6,719,386**

Note 25. Fair value of financial instruments

In euros		**As at 31 December 2016**				
	Note	**Carrying amount**	**Fair value**	**Level I**	**Level III**	**Total**
Financial assets measured at fair value						
Units in listed equity funds	14.1	3,828,737	3,828,737	3,828,737	0	3,828,737
Units in listed debt funds	14.1	8,854,433	8,854,433	8,854,433	0	8,854,433
Unlisted equities[1]	14.1	43,443	N/A[1]	N/A[1]	0	0
Government bonds	14.2	36,951,495	36,951,495	36,951,495	0	36,951,495
Financial institutions' bonds	14.2	70,374,047	70,374,047	70,374,047	0	70,374,047
Financial assets measured at amortised cost						
Loans	14.3	1,384,634	1,405,624	0	1,405,624	0

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In euros		As at 31 December 2015				
	Note	Carrying amount	Fair value	Level I	Level III	Total
Financial assets measured at fair value						
Units in listed equity funds	14.1	7,642,171	7,642,171	7,642,171	0	7,642,171
Units in listed debt funds	14.1	12,386,381	12,386,381	12,386,381	0	12,386,381
Unlisted equities[1]	14.1	43,443	N/A[1]	N/A[1]	0	0
Government bonds	14.2	38,320,953	38,320,953	38,320,953	0	38,320,953
Financial institutions' bonds	14.2	47,361,694	47,361,694	47,361,694	0	47,361,694
Financial assets measured at amortised cost						
Loans	14.3	2,106,288	2,102,009	0	2,102,009	0

[1] Fair value cannot be measured reliably.

The table does not include the fair values of short-term receivables and payables because these approximate their carrying amounts.

Note 26. Operating and finance leases

The company as a lessee – operating leases

The company uses office premises, office equipment and cars under operating leases. In 2016, operating lease expenses on premises totalled 1,642,033 euros (2015: 1,636,005 euros). Operating lease expenses on other assets totalled 108,028 euros (2015: 109,918 euros).

All lease contracts can be cancelled by giving a reasonable period of notice.

Note 27. Income tax

At 31 December 2016, the company's retained earnings totalled 33,100,599 euros (31 December 2015: 32,493,445 euros) and the carrying amount of intangible assets was 7,170,836 euros (31 December 2015: 6,479,352 euros). Thus, distributable profit amounted to 25,929,763 euros (31 December 2015: 26,014,093 euros). The maximum income tax liability that could arise if all of the distributable profit as at the reporting date were distributed as dividends amounts to 5,185,953 euros (31 December 2015: 5,202,819 euros) and the maximum amount that could be distributed as the net dividend is 20,743,810 euros (31 December 2015: 20,811,274 euros).

To determine the amount of income tax liability, retained earnings are adjusted for the carrying amount of intangible assets.

The income tax liability has been calculated without taking into account that the profit of the Latvian and Lithuanian entities is taxed in their domiciles when earned.

The maximum possible income tax liability has been calculated on the assumption that the net dividend and the dividend tax recognised in the income statement for 2017 cannot exceed the company's distributable profit as at 31 December 2016.

In euros

Income tax expense/income	2016	2015
Income tax expense	59,269	256,129
Change in deferred income tax	-304,417	–211,184
Income tax expense/income	**-245,148**	**44,945**

In euros

Recognised deferred income tax assets	2016	2015
Deductible temporary differences on non-current assets	-119,311	-103,903
Tax loss carry-forward	995,758	714,950
Deductible temporary differences on other liabilities	299,819	260,801
Total	**1,176,266**	**871,848**

In euros

Reconciliation of accounting profit and income tax expense/income	2016	2015
Profit before tax	362,006	1,600,767
Tax rate 0%	0	0
Effect of tax rates in foreign jurisdictions	-935,039	-180,033
Effect of tax exempt income and taxable expenses	-36,346	55,515
Effect of non-deductible expenses	742,464	221,769
Change in unrecognised deferred tax assets	0	0
Change in recognised deferred tax assets	-16,227	-52,306
Income tax expense/income for the year	**-245,148**	**44,945**

Note 28. Transactions with related parties

The company considers parties to be related if one controls the other or exerts significant influence on the other's operating decisions. Related parties include:

- the parent company ERGO International AG and the ultimate controlling party Münchener Rückversicherungs-Gesellschaft AG;
- associates;
- other companies belonging to the same group;
- members of the company's management and supervisory boards and individuals with a significant shareholding, unless the above persons cannot exert significant influence on the company's operating decisions.

In addition, related parties include close family members of and companies related to the above persons.

The remuneration, performance bonuses and benefits provided to the members of the management board for the year totalled 554,386 euros (2015: 500,045 euros). The members of the supervisory were not remunerated.

The remuneration of a member of the management board consists of fixed remuneration and performance benefits. Performance benefits depend on the achievement of targets which are agreed between the chairman of the supervisory board and the member of the management board before the beginning of the financial year.

Payment of performance benefits is decided by the chairman of the supervisory board after the general meeting has approved the company's results for the financial year. When the agreed targets are partly not achieved, the company may decide not to pay any performance benefits. The share of maximum performance benefits in the annual income of members of the management board is considerably smaller than that of their basic remuneration. The targets that underlie provision of performance benefits include financial metrics applicable to the whole group as well as personal metrics applicable at the local level. Depending on the terms of their contracts and the circumstances of termination, members of the management board may be eligible to termination benefits for a period that may extend to the end of their term of office. Generally the term of office of members of the management board is three years.

On 29 June 2016 the company sold its interest in ERGO Invest SIA to ERGO Life Insurance SE for 3,750,000 euros. Gain on the transaction amounted to 1,673,693 euros.

In euros

As at 31 December Related party	Receivables 2016[1]	Receivables 2015[1]	Payables 2016[3]	Payables 2015
Parent of the group – Münchener Rück	10,219	0	354,916	543,696
Other group companies	1,699,669	2,359,451	6,537,700	544,623

In euros

Related party	Services purchased 2016	Services purchased 2015	Services sold 2016[2]	Services sold 2015[2]
Other group companies	755,456	595,648	885,168	1,544,322

[1] Including a loan of 1,380,000 euros (2015: 1,500,000 euros) provided to CJSC ERGO Ins. Co and a loan of nil euros (2015: 600,000 euros) provided to ERGO Invest SIA.

[2] Including interest of 125,246 euros (2015: 131,870 euros) on the loan given to CJSC ERGO Ins. Co and interest of 9,450 euros (2015: 38,325 euros) on the loan given to ERGO Invest SIA.

[3] Including a subordinated loan of 6,000,000 euros (2015: nil euros) received from ERGO Life Insurance SE.

Recognised in profit or loss on the basis of reinsurance contracts

Reinsurance contracts	**2016**	**2015**
Münchener Rückversicherungs-Gesellschaft AG		
Ceded reinsurance premiums	473,172	446,357
Reinsurers' share of claims paid	91,636	106,603
Reinsurance commissions and profit participation	40,830	-37,038
Other group companies		
Ceded reinsurance premiums	11,560	15,644
Reinsurers' share of claims paid	1,500	2,443
Reinsurance commissions and profit participation	2,272	2,295
Gross premiums from incoming reinsurance	3,412	4,787
Commissions to holders of reinsurance policies	682	957

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Signatures to annual report 2016

The management board of ERGO Insurance SE has prepared the company's review of operations and financial statements for 2016.

Kęstutis Bagdonavičius
Chairman of the management board ....20 March 2017

Tarmo Koll
Member of the management board ....20 March 2017

Saulius Jokubaitis
Member of the management board ....20 March 2017

Deniss Sazonovs
Member of the management board ....20 March 2017

Ingrīda Ķirse
Member of the management board ....20 March 2017

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Independent Auditors' Report

(Translation of the Estonian original)

To the Shareholder of ERGO Insurance SE

Opinion

We have audited the financial statements of ERGO Insurance SE (the Company), which comprise the statement of financial position as at 31 December 2016, the statement of income, statement of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the financial statements presented on pages from 19 to 80 present fairly, in all material respects, the financial position of the Company as at 31 December 2016, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (Estonia). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in Estonia, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information

Management is responsible for the other information. The other information comprises the Report by the management board, but does not include the financial statements and our auditors' report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

KPMG

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with International Standards on Auditing (Estonia) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with International Standards on Auditing (Estonia), we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Tallinn, 27 March 2017

Eero Kaup
Certified Public Accountant, Licence No 459

KPMG Baltics OÜ
Licence No 17

Profit allocation proposal

In accordance with subsections 2 and 3 of section 332 of the Estonian Commercial Code, the management board of ERGO Insurance SE makes the sole shareholder ERGO International AG a proposal that:

1) no transfers be made to the capital reserve because the capital reserve exceeds the level required by the articles of association;

2) no transfers be made to other reserves;

3) the net profit for 2016 of 607,154 (six hundred and seven thousand one hundred and fifty-four) euros be transferred to retained earnings;

4) no distribution be made to the sole shareholder.

5) As at 1 January 2017, retained earnings amount to 33,100,599 (thirty-three million one hundred thousand five hundred and ninety-nine) euros.

On behalf of the management board of ERGO Insurance SE

Kęstutis Bagdonavičius
Chairman of the management board

Information on the sole shareholder

This information is presented as at 20 March 2017.

The information is disclosed in accordance with section 334(2) of the Estonian Commercial Code.

Name of sole shareholder:	**ERGO International Aktiengesellschaft**
Legal address:	Victoriaplatz 2, 40198 Düsseldorf, Germany
Registry number:	HRB 40871, entered in the Commercial Register of Dusseldorf District Court, Germany

Dates of acquisition and subscription of the shares

1. Ordinary shares with no par value:

- 287,439 shares, 30 May 2000
- 61,550 shares, 29 May 2001
- 32,088 shares, 3 December 2001
- 65 shares, 3 June 2002
- 17 shares, 24 July 2002
- 77 shares, 10 September 2002
- 2 shares, 10 September 2002
- 62 shares, 17 September 2002
- 17 shares, 18 September 2002
- 5 shares, 2 December 2002
- 5 shares, 2 December 2002
- 865 shares, 18 November 2003
- 2 shares, 26 October 2004
- 3 shares, 2 December 2004
- 2,366 shares, 17 May 2006
- 23 shares, 24 May 2006
- 43 shares, 7 December 2007

List of business activities

Activities during the period 1 January 2016 – 31 December 2016	Amount
Non-life insurance (65121)	136,834,657
Reinsurance (65201)	-57,628

Activities planned for the period 1 January 2017 – 31 December 2017

Non-life insurance (65121)

Reinsurance (65201)